



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SIERRA NEVADA INVESTMENT COMPANY)

Appearances:

For Appellant: Thomas H. Craig, Accountant

For Respondent: James J. Arditto, Franchise Tax Counsel.

O P I N I O N

This is an appeal taken pursuant to the provisions of Section 19 of the Corporation Income Tax Act (Chapter 765, Statutes of 1937, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Sierra Nevada Investment Company to the Commissioner's proposed assessment of additional taxes in the amounts of \$20.36 and \$22.55 for the taxable years ended December 31, 1937, and December 31, 1938, respectively.

Appellant is a corporation organized under the laws of the State of Nevada and has its principal place of business in and confines its activities to California. It was organized primarily to acquire and hold the stock of the Four Fifty Sutter Corporation, a California corporation formed in 1928 to own and operate a medicodental building in San Francisco. The latter company never paid any dividends, and from 1928 to 1936, inclusive, the Appellant filed returns under the Bank and Corporation Franchise Tax Act disclosing no income and paid the \$25.00 minimum tax required by that Act. By 1936 the Four Fifty Sutter Corporation became involved in financial difficulties, and was unable to pay interest on certain obligations.

Steps to reorganize the company's indebtedness were under way. In May, 1937, to assist in relieving financial embarrassment of the Four Fifty Sutter Corporation, the Appellant acquired at a discount from the creditors of the Four Fifty Sutter Corporation forty-four notes of that corporation. It appears that all of the notes were delinquent in principal and interest when acquired, and that in order to acquire the notes the Appellant borrowed money and placed the notes in escrow with a bank. The notes with a face value of \$319,851.5 were purchased at an aggregate cost of \$106,617.20.

In 1937 and 1938 (the years involved in this appeal) the Appellant received interest from the notes in question in the amounts of \$3,800.00 and \$4,800.00 for the respective years. It filed returns under the Bank and Corporation Franchise Tax Act for the taxable years 1938 and 1939, showing for the income years 1937 and 1938 net income of \$432.19 and \$475.89, respectively. It paid the minimum tax

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of \$25.00 for each of the taxable years.

Pursuant to a demand of the Respondent, the Appellant also filed returns under the Corporation Income Tax Act for the years 1937 and 1938, reporting net income of \$407.10 and \$450.89 for the respective years. It claimed an offset against such income on the ground that the income had been subject to the Bank and Corporation Franchise Tax Act. The Respondent disallowed the offset claimed and proposed the additional assessments, which are the subject of this appeal.

Section 3 of the Corporation Income Tax Act of 1937 in force for the years 1937 and 1938 provides as follows:

"There shall be levied, collected and paid for each taxable year, a tax at the rate of four per cent upon the net income of every corporation derived from sources within this State on or after January 1, 1937; provided, however, that the income of any corporation which is included in the measure of the tax imposed by the Bank and Corporation Franchise Tax Act, Statutes 1929, Chapter 13, as amended, shall not be subject to the tax imposed by this act. Income from sources within this state includes income from tangible or intangible property located or having a situs in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce."
(Emphasis added)

Appellant does not deny that the actual seat of its corporate management is in California or that notes are integrated in its activities in California and have a situs in California (cf. the principles laid down in the cases of Wheeling Steel Corporation v. Fox, 298 U. S. 193, 56 S. Ct. 773, and New Orleans v. Stemple, 175 U. S. 309, 20 S. Ct. 110); hence, the income is taxable under the above section of the Corporation Income Tax Act, unless, as the Appellant claims, the "income... (was) included in the measure of the tax imposed by the Bank and Corporation Franchise Tax Act"

The answer to the question here involved depends upon whether the Appellant was "doing business" within the meaning of the applicable provisions of the Bank and Corporation Franchise Tax Act, which are quoted as follows:

"Sec. 5.....

"The term 'doing business,' as herein used, means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."

"Sec. 4.....

"(3) Tax on Other Corporations. With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions

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of the Constitution of this State or by this act, shall annually pay to the State, for the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event each corporation shall pay annually to the State, for said privilege, a minimum tax of twenty-five dollars (\$25).

"(4) Status of Holding Companies. Any corporation organized to hold the stock or bonds of any other corporation or corporations, and not trading in such stock or bonds or other securities held, and engaging in no other activities than the receipt and disbursement of dividends from such stock or interest from such bonds, shall not be considered a corporation doing business in this State for the purpose of this act.

"(5) Minimum Tax. Every corporation not otherwise taxed in pursuance of this section and not expressly exempted by the provisions of this act or the Constitution of this State shall pay annually to the State a tax of twenty-five dollars (\$25)."

From a consideration of Section 3 of the Corporation Income Tax Act together with Sections 4 and 5 of the Bank and Corporation Franchise Tax Act, it will be noted that it is apparently possible for a corporation to be taxed under both acts. Such is the case with a corporation deriving net income from California sources, but not doing business in this State. A holding company as defined in Section 4(4) quoted above and any business corporation not doing business could fall within that category and would pay the \$25 minimum tax provided for in Section 4(5) and would not be entitled to offset that payment against the tax due under the Corporation Income Tax Act on net income derived from California sources. This is so because Section 4(3) of the Bank and Corporation Franchise Tax Act provides for a tax measured by income only in the cases of corporations "doing business." The offset provision in Section 3 of the Corporation Income Tax Act applies only to the tax measured by income and not to the minimum tax of \$25 imposed by Section 4(5) of the Bank and Corporation Franchise Tax Act.

Respondent contends that the Appellant was not "doing business" within the meaning of Section 5 of the Bank and Corporation Franchise Tax Act during the years 1937 and 1938. Respondent's position is that the act of borrowing money and purchasing notes in 1937 (after a completely passive existence for nine years) is an isolated action, amounting only to an accommodation for Appellant's wholly owned subsidiary, and cannot be considered as an active engagement in profit transactions. He contends also that, even though a limited activity took place in 1937, there was no activity at all in 1938.

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Respondent further claims that his determination that the Appellant was not "doing business" can be upheld under Section 4 (4) of the Bank and Corporation Franchise Tax Act because the notes acquired in 1937 are "other securities" within the meaning of the words "stocks, or bonds or other securities held" used in that section, and that the Appellant was, therefore, a holding company within the meaning of that act.

After the briefs were filed in this case, the State Supreme Court rendered its decision in Golden--State Theater and Realty Corporation v. Johnson, 21 A. C. 527, and Carson Estate Company v. McColgan, 21 A. C. 549. The opinion of Justice Travnor in those cases, unanimously concurred in by the other members of the court, we believe compel a decision on this appeal favorable to the Appellant and contrary to the contentions of the Respondent. In the former case the Supreme Court was concerned with exactly the same statutory provisions with which we are here concerned.

The Golden State Theater case involved a corporation which owned all of the stock of its two subsidiary corporations. The board of directors authorized the endorsement of 'a note of one of the subsidiaries; it purchased theater property to rent to its other subsidiary at a specified monthly rental, and borrowed money to purchase the property; it collected rent, gave notices to quit and arranged for improvements, as landlord for its principal tenant, its subsidiary, and for other tenants who rented the store space in the theater property. The court held that those transactions prevented the company from being a holding company within the meaning of Section 4 (4), and that they also amounted to "doing business", within the meaning of Section 5. The court stated: "Section 4 of the Act specifically limits holding companies to corporations that engage in 'no other activities' than the receipt and disbursement of dividends from stock or interest from bonds."

In view of the language of the court, we do not believe that it is necessary to decide whether unsecured notes, such as the Appellant purchased from the creditors of the Four Fifty Sutter Corporation, are "securities" as that term is used in Section 4 (4). It is clear that in both 1937 and 1938 the Appellant did something more than receive and disburse dividends from stocks or interest from bonds. In both years it received and disbursed interest from notes. Certainly, a note is neither a stock nor a bond. In 1937 it borrowed money and purchased notes. The Appellant, therefore, was not a holding company in either year involved.

Respondent argues for the proposition that Appellant's activities did not amount to "doing business" because it did not actively engage "in any transaction for the purpose of financial or pecuniary gain or profit." It is contended that the circumstances surrounding the acquisition of the notes belie a profit motive, because the Appellant bought up the notes to relieve the pressure being put on its embarrassed subsidiary by the creditors of the subsidiary. This contention is also answered by the decision in the Golden State Theater case, Endorsing the notes of a subsidiary, and borrowing money for the purpose of purchasing property to be leased to another subsidiary, along with other transactions, were referred to by the

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court in the following language:

"It is also clear that these transactions were entered into for pecuniary gain or profit, for they were designed to aid the subsidiaries of East Bay Theaters, Inc., and thus to increase the dividends that it would receive."

There are also other factors which indicate a profit motive in this case. During the years 1937 and 1938 the Appellant received interest on its investment in the notes in question, and it purchased those notes at a discount of two-thirds from the face value thereof.

We have stated that the Appellant was not a holding company within the meaning of Section 4 (4) in either 1937 or 1938. It is also clear that the Appellant was "doing business" in the year 1937 when it borrowed money and purchased the notes. In the year 1938 it engaged in no activity, except the holding of the notes and the receiving and disbursing of interest therefrom. Under the language of the court in the Golden State Theater decision we believe that the limited activity also amounts to "doing business".

We quote from the opinion as follows:

"The doing of business, however, does not necessarily mean a regular course of business under the 1933 amendment," (referring to the 1933 amendment to Section 5) "for by its plain terms a corporation is doing business if it actively engages in any transaction for pecuniary gain or profit. Defendants would identify 'doing business' with 'carrying on a trade or business.' A series of transactions regularly engaged in may be necessary to establish the 'Carrying on of a trade or business' but the legislature made it clear that it had no such concept in mind when it referred to transaction in the singular as 'any transaction.'"

There can be no doubt that receiving and disbursing interest is a "transaction." That word has a very broad meaning and is defined in Webster's New International Dictionary as "The doing or performing of any affair; the management of any matter." It has also been shown that a profit motive was involved in Appellant's transactions,

That the Legislature considered the receipt and disbursement of income to be an activity is implied from Section 4 (4) and 4 (6) (b) of the Bank and Corporation Franchise Tax Act. The former section contains the following language: ". . . . and engaging in no other activities than the receipt and disbursement of dividends" Section 4 (6) (b) provides that "Corporations organized for the exclusive purpose of holding title to property, collecting revenue therefrom, and turning over the entire amount thereof, less expense, to an organization which itself is exempt from the tax imposed by this act, shall not be taxed under this act." The implication is clear that unless special exemption were granted, corpo-

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rations engaging only in collecting **income** from property held would be engaging in an activity subject to **the** tax.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Charles J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of Sierra Nevada Investment Company to the proposed assessments of additional tax in the amounts of **\$20.36** and \$22.55 for the taxable years ended December 31, 1937, and December 31, 1938, respectively, **pursuant to** Chapter **765**, Statutes of 1937, as amended, is hereby reversed.

Done at Sacramento, California, this 23rd day of September, 1943, by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Wm. G. Bonelli, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary