



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CALIFORNIA STATE EMPLOYEES CREDIT UNION NO. 1)

Appearances:

For Appellant: Charles J. Miller, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
Israel Rogers, Assistant Counsel

Q P I N I Q N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of California State Employees Credit Union No. 1 to a proposed assessment of additional franchise tax in the amount of \$405.16 for the income year 1957.

Appellant, a credit union operating under the California Credit Union Law, is a cooperative corporation organized to promote thrift among its members and create a source of credit for such members at legal rates of interest for provident purposes. (Fin. Code §§14000-16004.)

While Section 14201 of the Financial Code permits an unlimited number of members, Appellant's bylaws limit participation to members of the California State Employees Association Chapters at **Redding**, Chico, Stockton, Folsom, Sacramento, Preston and Fresno; their wives, husbands, widows, and minor children, organizations of said Chapters, Appellant's employees; and other credit unions.

Eligible persons become members by paying a small entrance fee ~~and~~ opening share accounts. The funds received may be loaned only to Appellant's members. (Fin. Code §14600.) Appellant is authorized to loan up to \$500 without security and up to \$10,000 with security. (Fin. Code §§~~14903~~, 14904, and 14905.) These loans are made at interest rates generally lower than those of banks or finance companies. The profits realized from credit union activities less the statutory guaranty fund reserved for bad debt losses (Fin. Code §~~15150~~) are paid to members as dividends on their shares.

Appellant has approximately 18,700 members and at the end of 1957 had over \$4 million in loans outstanding. During that year it received \$360,408 in interest income and paid out \$169,613 in dividends.

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Appellant's interest income included \$1,019.85 received from deposit of its guaranty fund in- savings accounts (pursuant to Fin. Code §15101). It also received \$6,960 in rent from property which had been purchased as a construction site for Appellant's new offices. The latter amount included \$1,382 received as rent from Appellant's own members. Appellant paid the Commissioner of Corporations \$1,424.75 as an assessment required by Section 16000 of the Financial Code to help defray the cost of administering the Credit Union Law. On its franchise tax return for the income year 1957, Appellant deducted this fee along with its entire interest and rental income and paid only the minimum tax of \$25.

The Franchise Tax Board disallowed the deductions for interest from savings deposits, rental income and the amount paid to the Commissioner of Corporations. It computed the tax on the remaining income at the rate prescribed for financial corporations (§§23183-23186 of the Rev. & Tax. Code).

This appeal presents the following issues:

1. Whether interest from savings accounts and rents from nonmembers may be deducted;
2. Whether rents received from Appellant's members may be deducted;
3. Whether Appellant is taxable as a financial corporation; and
4. If so, whether it may offset the assessment paid to the Commissioner of Corporations against the franchise tax due.

ISSUE 1. Revenue and Taxation Code Section 24405 permits cooperative associations to deduct "all income resulting from ... business activities for or with their members" or "when done on a nonprofit basis for or with nonmembers." Appellant urges that this provision entitles it to deduct the interest it received from savings deposits and the rents it received from nonmembers on the theory that such income arose out of business activity "for" members,

All income received by a credit union ultimately benefits its members and in that sense all of the business is "for" members. The clause of the statute which permits the deduction of income from business done with nonmembers on a nonprofit basis only, however, clearly indicates that the Legislature did not intend a blanket deduction. Necessarily, a limitation must be placed on the meaning of the phrase "for members." The Franchise Tax Board adopted, and the Attorney General, in an opinion dated April 29,

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1955, approved, the interpretation that this phrase referred to business carried on "for" members in directly carrying out the basic purpose of the cooperative. As an example of business "for" members, the Attorney General specified the marketing of a member's products by a cooperative organized for that particular purpose. The Attorney General concluded that a credit union could not deduct interest from deposits and from United States bonds because this was income from business with nonmembers on a profit basis and was not from business for the members in directly carrying out the purpose for which credit unions are organized. We recently reached the same result in the Appeals of Telephone Employees' Credit Union of So. Calif., Ltd., and Credit Union, Calif. Teachers Assn., Southern Section, both decided July 19, 1961, 3 CCH Cal. Tax Cas. Par. 201-776 and 201-775, 2 P-H State & Local Tax Serv. Cal. Par. 13257. For the purposes of the statute under consideration, we find no relevant distinction between interest earned on bonds or deposits and rent earned on investments made in real property. We therefore conclude that the interest received from savings deposits and the rents received from nonmembers are not deductible.

ISSUE 2. Appellant contends that the income received from property rented to its members is deductible under Section 24405 as income from business done "with their members." We must concur. There is not here, as there was in connection with the preceding issue, any necessity or room for interpretation. The rent from members was plainly from business "with" members and is thus deductible.

Appellant has agreed with Respondent that in the event the rents from members are held to be deductible and the rents from nonmembers are not, the total rental expenses should be allocated between the two types of rental income and that the expenses attributable to rent from members should be disallowed as deductions pursuant to Section 24425. That section disallows deductions allocable to income not included in the measure of the tax. In accordance with Respondent's computation, the correctness of which is conceded by Appellant, the resulting net rental that is includible in the measure of the tax is \$3,492.06.

ISSUE 3 The term "financial corporation") has no statutory definition. The courts have held, however, that two tests must be met before a corporation can be taxed as a financial corporation. It must deal in money as distinguished from other commodities (Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 (1940)), and it must be in substantial competition with national banks (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 (1943)).

Since there is no dispute as to the commodity in which Appellant deals, this issue turns on whether Appellant is in substantial competition with national banks. Appellant argues

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that it is not competing with national banks: citing **Traynor** and **Keesling**, Recent Changes in the Bank and Corporation Franchise Tax Act, II, 22 **Calif. L. Rev.** 499, 524 (1934).

Those well-qualified authors expressed the opinion that credit unions fell outside the classification of financial corporations. They indicated that credit unions met serious emergency needs of small borrowers not served by commercial banks. Further support was drawn from a 1930 ruling by the Attorney General of California that credit unions may not engage in the banking business*

However valid this conclusion may have been at the time of writing, its support has since been weakened. On December 15, 1933, even before publication of the article, the Attorney General issued an opinion specifically holding that credit unions were financial corporations. (**Ops. Cal. Atty. Gen. No. 9079.**) Ten years later the highest court of this State held that a company making loans of amounts up to \$500 was in substantial competition with national banks operating in the same locality (**H.A.S. Loan Service, Inc. v. McColgan**, 21 Cal. 2d 518 (1943)), thus **recognizing** that the small loan field is served by commercial banks. Credit unions, moreover, do not presently restrict themselves to making loans for serious emergency needs, Appellant, for example, makes loans for such purposes as buying automobiles.

In the course of the article cited by Appellant, the authors stated that because of their tremendous growth, small loan corporations should be regarded as substantial competitors of national banks. (**p.522.**) Similarly, the great growth of credit unions during the last three decades makes any opinion based on conditions existing in the early 1930's subject to revision. We take official notice of the fact that in 1931 the United States had only 1500 state-chartered credit unions, holding \$33.6 million in assets for the benefit of less than 300,000 **members**. By 1959 the number of active credit unions passed the 10,000 mark, assets totaled \$2.7 billion and membership had risen to 5.7 million people, California was second in the nation with \$261.1 million in assets. It had 619 active state-chartered unions serving over 535,000 members during 1959. (Bureau of Federal Credit Unions, Social Security Administration, U. S. **Dep't. of Health, Education and Welfare**, State-Chartered Credit Unions in (1960).)

Appellant devotes much of its argument to the fact that it does not serve the general public, only a limited membership. Any significance this distinction may have loses its force in light of the fact that as a class California credit unions boasted a combined membership of over 535,000 persons in 1959. Appellant itself has almost 19,000 members. These figures are only an **indication** of the total number of persons eligible for membership,

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Furthermore, it is unnecessary to a finding of substantial Competition that a corporation be in competition with national banks as to all possible borrowers. (Appeal of Motion Picture Financial Corp., Cal. St. Bd. of Equal., July 22, 1958, 2 CCH State Tax Cas. Cal. Par. 200-898, 2 P-H State & Local Tax Serv. Cal. Par. 13181.)

Our conclusion that Appellant is in substantial competition with national banks and is properly classified as a financial corporation for purposes of taxation is supported by recent amendments to the Revenue and Taxation Code. The 1960 amendments to Sections 23184 and 25552 refer to "financial corporations, other than credit unions" and indicate that credit unions are to be treated differently from other financial corporations only as to the minimum tax which they must pay. (Stats. 1960, Ch. 1.) Considering the nature of these sections and the form of the amending language used, it is clear that the Legislature classifies credit unions as financial corporations and that no change in prior law, in this respect, was intended.

ISSUE 4. Appellant argues in the alternative that if it is a financial corporation, it may offset the assessment paid to the commissioner of Corporations against its franchise tax liability. The assessment was imposed under Section 16000 of the Financial Code "To defray the cost of administration of [the Credit Union Law], including examinations and supervision." Revenue and Taxation Code Section 23184(c) permits financial corporations an offset for amounts paid to the State as license fees for the privilege of engaging in the business of loaning money.

This question was answered by us in the Appeals of Citrus Belt Sav. and Loan Ass'n and Riverside Sav. and Loan Ass'n, St. Bd. of Equal., December 16, 1959, 2 CCH State Tax Cas. Cal. Par. 201-439, 2 P-H State & Local Tax Serv. Cal. Par. 13217, which dealt with a similar assessment required of savings and loan associations, In disallowing any offset, we said:

It is significant that state banks are required to pay an annual assessment to the Superintendent of Banks, . . . to meet the expenses of the State Banking Department. And if they fail to pay the assessment their certificate of authority to conduct a banking business may be cancelled.... This assessment cannot be regarded as a license fee for the privilege of engaging in the business of loaning money, as specified in Section 23184, since banks pay the franchise tax "in lieu of" all other licenses. Yet this assessment is in substance the same in all respects as "the license fee computed as an annual assessment" which Appellant must pay to the Savings and Loan Commissioner to meet the salaries and

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expenses provided for in the Savings and Loan Association Law. It would be inconsistent with the intent of the Legislature to allow an offset of the latter, while banks must pay the former. The Legislature did not intend to impose a lighter tax burden on savings and loan associations.

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, AJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of California State Employees Credit Union No. 1 to a proposed assessment of additional franchise tax in the amount of \$405.16 for the income year 1957, be and the same is hereby reversed as to the deduction of rent received from Appellant's members. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 13th day of December, 1961, by the State Board of Equalization.

John W. Lynch, Chairman
Geo. R. Reilly, Member
Paul R. Leake, Member
_____, Member
_____, Member

ATTEST: Dixwell L. Pierce, Secretary