64-SBE-049

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of

THE HARTFORD FINANCE CORP. OF SAN BERNARDINO, W. R. KIRKLEN, TRANSFEREE, et al.

Appearances:

For Appellant: Paul Egly, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel'

OPINION

These appeals are made pursuant to sections 25761a and 25667 of the Revenue and Taxation Code, from the action of the Franchise Tax Board denying the petitions of The Hartford Finance Corp. of San Bernardino, W. R. Kirklen, Transferee, et al., for reassessment of jeopardy assessments of additional franchise tax in the amounts and for the taxable years indicated. below:

Appellant	Year Ending February 28	Amount.
The Hartford Finance Corp. of San Bernardino, W. R. Kirklen, Transferee	1957 1958 1959	$506.45 '531.82 92.02
The Hartford Finance Corp. of Riverside, W. R. Kirklen, Transferee	1957 1958 1959	$473.15 496.86 46.24
The Hartford Finance Corp. of Ontario, W. R. Kirklen, Transferee	1957 1958 1959	$514.07 539.83 132.35
The Hartford Finance Corp. of Covina, W. R. Kirklen, Transferee	1957 1958 1959	$716.92 752.83 139.56

The above named corporations (hereafter "the Hartfords" were formed under the laws of this state in March of 1956 by Mr. W. R. Kirklen, owner of all the Hartfords' stock. Each Hartford corporation had a capitalization of $6,000 and engaged primarily in buying and selling conditional sales contracts.

W. R. Kirklen was also the sole owner of several corporations (hereafter "the Kirklens") which operated retail outlets selling furniture and appliances to the general public on cash or credit terms, Credit sales were made under conditional sales contracts which were then sold to various financial institutions. for an amount equal to the face value of the contract plus discounted interest, Approximately 40 percent of the Kirklens' profits was derived from the discountec interest received on the sale of these contracts. In order to avoid the federal surtax imposed on taxable corporate income in excess of $25,000, the Hartfords were formed for the purpose of diverting such profits to separate corporate entities.

The Seaboard Finance Company (hereafter "Seaboard"), an unrelated corporation, had handled the bulk of the Kirklens' paper. Upon the formation of the Hartfords, Seaboard agreed to accept the paper from them rather than the Kirklens, only after the latter had jointly and severally guaranteed the Hartfords' obligations.

In a typical credit sale, credit information would be transmitted to Seaboard by one of the Kirklens' employees. Seaboard would check the customer's credit and give its approval. The customer would execute a conditional sales contract with the Kirklen store and receive his merchandise. The contract would then be assigned, without recourse, to one of the Hartfords which in turn would assign the instrument, without recourse, to Seaboard. In return Seaboard would mail back a single check. The Hartford company would be credited with the amount of discounted interest contained therein and the balance would be credited to the Kirklen store,

The Hartfords assigned contracts only to 'Seaboard and handled only Kirklens' paper. Ninety-eight percent of the contracts were handled in this manner. The remainder were discounted by the stores directly with the Bank of America or a similar lending institution, In all cases, the terms of the sales contracts were basically the same as those purchased by national banks,

The assets of the Hartfords consisted of cash and accounts receivable, Their business was conducted by utilizing offices and supplies belonging to the Kirklens, together with the services of officers and employees on the Kirklens' payroll, In return they paid the Kirklens an occupancy fee and were

charged with the cost of services and supplies, Each of the Hartfords mafntained separate books and filed separate franchise taxreturns,

The record does not state the number of contracts handled nor the dollar volume of such business. It appears, however, that the total interest income accrued by the Hartfords amounted to $62,557.59 and $17,628.08 for the income years ended February 28, 1957 and 1958, respectively. These funds . were loaned to the Kirklens on undisclosed terms.

At the hearing of this matter it was stipulated that the Hartfords were separate, distinct entities and we shall treat them as such for the purposes of these appeals.

The sole question presented is whether the Hartfords were properly classified as financial corporations under section 23183 of the Revenue and Taxation Code so as to be taxable at the rate applicable to banks and financial corporations,

Two tests must be met before a corporation may be classified as a financial corporation under section 23183: (1) It must deal in money as distinguished from other commodities (Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 493]), and (2) it must be in substantial competition with national banks (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 [144 P.2d 3311.)

While conceding that they were dealing in money as distinguished from other commodities, it has been argued, on behalf of the Hartfords, that they were not in substantial competition with national banks.

There can be no question as to the fact that the Hartfords were operating in a field also occupied by national banks. The record before us establishes that some of the Kirklens' contracts were discounted with banks and that all of the contracts involved were substantially the same as those purchased by national banks. (See also Crown Finance Corp. McColgan, supra, holding that a firm engaged in purchasing conditional sales contracts and accounts receivable in personal property, consisting primarily of household furnishi was competing with national banks.)

The circumstance that the Hartfords only purchased contracts from the related Kirklen corporations and did not serve the public in general does not insulate them from the financial classification, As we have previously held on very similar facts, substantial competition may exist regardless of this circumstance, (Appeal of Humphreys Finance Co,, Cal, St, Bd. of Equal,, June 20, 1960; Appeal of Motion Picture Financial Corp., Cal, St, Bd. of Equal., July 22, 1958.)

It is argued that the Hartfords cannot be considered to be competing with national banks because they were, in effect, merely conduits or pipelines between the Kirklens and Seaboard, performing no services or functions other than transmitting the paper that had been approved by Seaboard, Unless the term "separate entity" is to be deprived of any practical significance, the argument is inconsfstent with the stipulation that the Hartfords were separate entities,

In order to gain a tax advantage, the Hartford corporations were formed to carry out the function of acquiring and disposing of conditional sales contracts with 'the intent that they should be consfdered separate taxable entities, sufficiently viable to attribute the interest income to them rather than to the Kirklens. Now, to escape a tax detriment* it is contended that they were mere shells, performing no real function. The parties involved in creating a corporation do not have the option of treating it as a sham. (Higgins v. Smith, 308 U.S. 473 [84 L. Ed, 4061; Moline Properties, Inc. v. Commissioner, 319 U.S. 436 [87 L. Ed, 1499].)

It is unquestioned that the Hartfords were engaged in trading in substantial quantities of the same commodity that national banks deal in, This, we believe, is the focal point of competition and the fact that the Hartfords' operations were not parallel in all respects to 'the business of national banks is not controlling. (See Appeal of Stockholders Liquidating Corp., Cal. St., Bd, of Equal., Feb. 5, 1963; Appeal of Winter Mortgage Co., Cal. St, Bd. of Equal., Feb. 5, 1963; Appeal of The Marble Co., Cal, St, Bd. of Equal., Feb. 5, 1963, wherein we held certain loan correspondents to be: financial corporations even though the loans were made for the purpose of transferring them to third parties,) The courts of this state have made it abundantly clear that once it has been determined that a corporation is dealing in the same commodity. handled by national banks, differences in the terms and conditions under which that class of business is transacted are inconsequential, (Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 493]; Crown Finance Co, v. McColgan, 23 Cal. 2d 280 [144 P.2d 331].)

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,

Appeals of The Hartford Finance Corp. of San Bernardino, etc.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the petitions of The Hartford Finance Corp. of San Bernardino, W. R. Kirklen, Transferee, et al., for reassessment of jeopardy assessments of additional franchise tax for the amounts and for the taxable years set forth in the opinion of the board on file In this proceeding, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of May, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman

John W. Lynch, Member

Member

Member

Member

Attest: _____, Secretary