

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )

CRODDY CORPORATION )

For Appellant: Mize, Larsh, Mize, Hubbard & Baxter,  
Attorneys at Law

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

O P I N I O N

These appeals are made pursuant to section 25557 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Croddy Corporation against proposed assessments of additional franchise tax in the amounts of \$6,589.37, \$3,244.80, and \$2,863.17 for the income years ended September 30, 1960, 1961, and 1962, respectively.

During the years on appeal, appellant acted as a real estate agent, earning commissions on real estate sales. It also sold real estate on its own account. It engaged in these activities since its incorporation in 1953.

In addition, appellant made loans to builders and purchasers of homes. It began this activity during the year ended September 30, 1960. The loans were secured by mortgages and first deeds of trust. Some of the loans were government insured F.H.A. or V.A. loans and others were conventional or uninsured loans. Appellant sold the loans to institutional investors, usually within six months after the loans were made. Appellant thereafter serviced the loans by collecting payments and performing other, related functions, including maintaining all loan records and seeing that all liabilities

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against the underlying security were paid. Appellant received interest on the loans until they were sold and then received fees for its services in connection with the loans..

In its franchise tax returns for the income years ended September 30, 1960, and 1961, appellant described its principal business activity as "real estate." In its return for the income year ended September 30, 1952, appellant described its principal business activity as "loans."

Appellant's gross income for the years on appeal was from the following sources:

	<u>Income years ended June 30</u>		
	<u>1960</u>	<u>1961</u>	<u>1962</u>
Interest	\$ 3,290	\$13,868	\$100,651
Loan service fees		3,019	9,022
Loan fees			70,170
Discounts on notes		31,754	
Commissions on real estate sales	126,017	84,803	21,781
Gross profit on real estate sale;	47,551		23,384
Intercompany charges			13,379
Dividends			94
Miscellaneous	5,047	815	

The item designated in the above tables as "Loan fees" includes charges for making loans and for late payments. "Discounts on notes" resulted from the purchase and sale of loans. "Intercompany charges" represent bookkeeping services for a subsidiary corporation. The items titled "Miscellaneous" are composed of fees for various services other than loan services.

At the end of each of the years in question, appellant's records reflected the following amounts of loans which had not yet been sold:

<u>Income years ended June 30</u>		
<u>1960</u>	<u>1961</u>	<u>1962</u>
\$122,628	\$768,576	\$1,649,066

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Appellant paid its franchise taxes at the rate imposed upon corporations other than financial corporations. Respondent, however, determined appellant to be a financial corporation and thus subject to tax at the same rate as banks, with offsets for personal property taxes and certain other taxes and fees which banks do not pay,

Section 23183 of the Revenue and Taxation Code provides, *so far* as material here, that:

An annual tax is hereby imposed upon every financial corporation ..., for the privilege of exercising its corporate franchises within this State, according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under Section 23186[ Section 23186 provides a formula for computing the rate of tax on banks and financial corporations].

The special classification of "financial corporation" in our code was made to comply with a federal statute (Rev. Stat. § 5219, 12 U.S.C.A. § 548) prohibiting discrimination in taxing national banks. (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 [144 P.2d 331].) In line with the purpose of the classification a financial corporation is considered to be a corporation dealing in moneyed capital and engaged in substantial competition with national banks. (Crown Finance Corp. v. McColgan, supra.)

Appellant argues that it did not deal in moneyed capital and was not in substantial competition with national banks in the sense intended by the Crown Finance case. As support for its argument, appellant points out that the gross income from its financial activities constituted only 1.81 percent of its total income for the year ended in 1960 and 33.98 percent of its total income for the year ended in 1961. Appellant also states that if its income from financial activities were offset by interest expense, its gross profit from financial activities for the year ended in 1962 would have been \$87,800 or less than its average income from non-financial activities for the three-year period ended September 30, 1962.

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We believe it is clear that appellant would properly be classed as a financial corporation were it not **for** the fact that it engaged in activities in addition to those related to lending money. It was recently held in Marble Mortgage Co. v. Franchise Tax Board, \*241 Cal. App. 2d \_\_\_\_, that a corporation engaged in making, selling and servicing loans, much as appellant did, was a financial corporation. The record shows that appellant began actively seeking a share of the loan market in the year ended September 30, 1960, and continued to do so with increasing success. The amount of appellant's loans each year ranged from at least \$122,628 to at least \$1,649,066. These figures do not reflect loans which had been sold before the end of each year. Appellant was, in our opinion, **dealing** in moneyed capital in substantial competition with national banks. Appellant must therefore be classed as a financial corporation unless the fact that it also engaged in non-financial activities requires a different conclusion.

We have previously considered questions similar to the one thus presented. In Appeal of Bankamerica Agricultural Credit Corp., Cal. St. Bd. of Equal., July 7, 1942, the taxpayer made **loans on the** security of livestock and also engaged extensively in raising and selling livestock. In Appeal of Continental Securities Co., Cal. St. Bd. of Equal., Feb. 3, 1944, the taxpayer, in addition to making real estate loans, operated the **Angels Flight Railway Company** and received rents from real estate, dividends on large stock investments and commissions on insurance underwriting and other services. According to that taxpayer, four-fifths of its manpower was used in conducting non-banking business.

In holding that **the** above taxpayers were financial corporations we relied in part upon First National Bank v. Hartford, 273 U. S. 548 [71 L. Ed. 767]; Minnesota v. First National Bank, 273 U. S. 561 [71 L. Ed. 774]; and Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 493]. Language from the latter decision, applying the views of the United States Supreme **Court** in the interpretation of our statute, demonstrates why appellant must also be treated as a financial corporation:

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\*Advance report citation: 241 A.C.A. 26.

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Competition within the meaning of section 5219, Revised Statutes of the United States, does not mean that there should be a competition as to "all phases of the business of national banks ... section 5219 is violated whenever capital, substantial in amount when compared with the capitalization of national banks, is employed either in a business or by private investors in the same sort of transactions as those in which national banks engaged and in the same locality in which they do business . . . . It is enough as stated if both engage in seeking and securing in the same locality capital investments of the class now under consideration which are substantial in amount, . . . even though the competition be with some, but not all, phases of the business of national banks, or it may arise from the employment of capital invested by institutions or individuals in particular operations or investments like those of national banks. [citation ]"

We have considered an alternative possibility that only the portion of appellant's income which was derived from its financial activities should be taxed at the rate imposed upon financial corporations. Although this alternative is appealing, there is no provision for a segregation of this kind under the controlling statute, section 23183. As stated by two very well qualified authors in the most authoritative article written upon the subject of California's bank tax, a solution such as that under consideration "finds no support in the Act, presents serious accounting and administrative problems and is probably not permitted by section 5219." (Keesling anti Traynor, Recent Changes in the Bank and Corporation Franchise Tax Act (1934) 22 Cal. L. Rev. 499, 512.)

We are compelled to the conclusion that during the years on appeal appellant was a financial corporation within the meaning of section 23183 of the Revenue and Taxation Code and that, therefore, its entire net income was taxable as provided by section 23186.

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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, pursuant to section 25667 of the Revenue and Taxation Code that the action of the Franchise Tax Board on the protests of Croddy Corporation against proposed assessments of additional franchise tax in the amounts of \$6,589.37, \$3,244.80, and \$2,863.17 for the income years ended September 30, 1960, 1961, and 1962, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 1st day of September, 1966, by the State Board of Equalization.

George H. Baker, Chairman  
John W. Lynch, Member  
David R. Leland, Member  
Frank A. Stone, Member  
                                , Member

ATTEST:                                 , Secretary