BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
THE DINERS? CLUB, INC.)

Appearances:

For Appellant: Jacques Leslie
Attorney at Law

Barry S. Rubin
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

James W. Hamilton
Tax Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of The Diners' Club, Inc., against proposed assessments of additional franchise tax in the amounts of $49,112.11, $44,332.86, $33,510.44, $8,952.90, $44,564.17, $54,185.32, and $24,668.35 for the income years ended March 31, 1959, 1960, 1961, 1962, 1963, 1964, and 1965, respectively.

The question for decision is whether respondent properly classified The Diners* Club, Inc., as a financial corporation, within the meaning of section 23183 of the Revenue and Taxation Code, thereby making it taxable in the appeal years at the rate applicable to banks and financial corporations rather than at the rate applicable to general corporations.

Appeals of The Diners' Club, Inc.

The Diners* Club, Inc., (hereafter referred to as "appellant") was incorporated under New York law in 1949. It is primarily engaged in the operation of an all-purpose credit card plan for its membership. In 1951 it qualified to do business in California and it has operated in this state continuously since that time. Its principal offices are in New York City and in Los Angeles.

A prospective member in appellant's credit card plan completes an application blank and submits it to one of appellant's offices; he may either pay the annual membership fee at that time or he may elect to be billed for the fee. (Prior to 1961 the membership fee was $5.00 per year, from 1961 to 1963 it was $8.00, and in 1963 it was raised to $10.00.) Upon approval of a credit application appellant issues a Diners* Club card to the applicant. The cardholder is automatically entitled to purchase goods and services on credit from any retail outlet which has agreed to honor appellant 's cards .

'Merchant-participants in appellant* s credit card plan enter into a written contract with appellant, whereby they agree to extend to the holder in good standing of a Diners' Club card the privilege of signing the sales check rather than paying cash for the goods or services which he receives . Appellant agrees to purchase from the participating merchant all valid charges made by holders of appellant's cards, without recourse to the merchant, at a discount rate which varies from 4 percent to 7 percent. Each week the merchant sends the signed receipts which he has accumulated during the week to appellant, and appellant makes the discounted payment for those charges to the merchant in the following week. From then on all responsibility for collecting the charged amounts rests with appellant. Holders of Diners* Club cards receive a monthly itemized billing from appellant, and the total shown is then due and payable.

As a service to its members appellant issues regional directories listing the merchants and establishments which have agreed to extend credit upon presentation of a Diners' Club card. It also publishes and distributes a monthly magazine containing articles of general interest to members and merchant-participants at a cost of $1.00 per year. Other services rendered by appellant to its members include a screening of each prospective merchant-participant to be sure the business establishment warrants appellant's endorsement and recommendation to its members, analysis and investigation of any complaints or suggestions received from members concerning any participating business establishments, and the maintenance of a travel information service and a worldwide shopping service.

Appeals of The Diners' Club, Inc.

When these appeals were filed appellant's card-holding membership totalled 1,250,000, and it had participation agreements with some 90,000 merchants and commercial establishments throughout the world. Although the majority of those affiliated business establishments were restaurants, taverns, hotels, motels, transportation companies and automobile and boat leasing companies, the number of retail merchants participating in the plan was steadily increasing.

During four of the appeal years appellant's total income was derived from the following sources:

Source of Income	Income Year Ended 3-31-59	3-31-60	3-31-61	3-31-62
Members* charge purchases	$ 8,407,800	$ 9,334,780	$ 8,534,920	$ 7,893,900
Membership fees	3,673,053	4,449,824	4,830,800	5,240,176
Other income*	691,350	1,200,830	1,492,570	1,596,755
Total income	$12,772,203	$14,985,434	$14,858,290	$14,730,831

*Includes income from the miscellaneous services offered by appellant to its members, i.e., advertising, travel plan and shopping service, magazine subscriptions, etc.

Of the total income figures appellant allocated the following amounts to California, as having been derived from sources within this state:

Income Year Ended	Amount	Percent of Total Income
March 31, 1959	$2,927,029	23.27
March 31, 1960	4,550,084	30.36
March 31, 1961	4,228,351	28.45
March 31, 1962	4,061,354	27.54

In computing its California franchise tax liability for each of the years on appeal, appellant used the rate applicable to general corporations. Respondent determined that appellant was a financial corporation, and recomputed its tax liability accordingly. Appellant protested the resulting proposed additional assessments and respondent's denial of those protests gave rise to these appeals.

Appellant first contends that the burden is on respondent to prove that appellant was a financial corporation. We cannot agree, Under both federal and state law the taxing authority's determination as to the proper tax is presumptively correct, and the burden is on the taxpayer to prove it incorrect. (See 9 Mertens, Law of Federal Income Taxation, § 50.61; Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 4143; Appeal of Charles R. Penington, Cal. St. Bd. of Equal., Jan. 20, 1954; Appeal of Pearl R. Blattenberger, Cal. St. Bd. of Equal., March 27, 1952.) Thus in the instant case the burden is on appellant to prove that respondent has improperly classified it as a financial corporation.

The "financial corporation" classification (Rev. & Tax. Code, § 23183 et seq.) was created by the Legislature to comply with the federal statute (12 U.S.C.A. § 548) prohibiting discrimination between national banks and other financial corporations. (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 [144 P.2d 331]; Marble Mortgage Co. v. Franchise Tax Board, 241 Cal. App. 2d 26 [50 Cal. Rptr. 3453.) Although the term is not defined in the statute, the courts have held that a financial corporation is one which deals in moneyed capital, as opposed to other commodities (The Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 493]), and which is in substantial competition with national banks (Crown Finance Corn. v. McColgan, supra).

It is respondent's position that appellant clearly deals in money, that it is engaged on a large scale in a form of financing which brings it into substantial competition with national banks, and it is therefore a financial corporation, as that term has been construed. Respondent also points to the similarities between appellant's credit card plan and the Bankamericard plan sponsored by the Bank of America,

Appellant contends that the "substantial competition with national banks" which is required to classify a corporation as financial is a competition with the operations and investments common to banks. Appellant argues that the requisite competition is lacking in the instant case because the operation by the Bank of America of a credit card plan is not a traditional banking function but is a unique departure from normal banking activities which had been made only by Bank of America during the years in question. Appellant also contends that the necessary competition with banks is not present in this case because appellant is not a lending institution but is engaged in rendering services to its members.

Furthermore appellant maintains that its plan and the Bankamericard plan are quite different in the manner in which they operate, the services which they offer, and the public which they serve. In regard to this last alleged distinction appellant contends that the two credit card plans are not competitive because the Bankamericard plan is used mainly by people desiring to obtain consumer goods and household items, while appellant's plan is primarily utilized by businessmen and travelers.

In our opinion appellant is dealing in money or moneyed capital, as opposed to other commodities or services, thereby fulfilling the first requirement for a finding that it is a "financial corporation." Although it is true that appellant does perform some incidental services for its members, its primary business activity. is purchasing valid charges made by those members from participating merchants. Appellant itself sells none of the goods or services procured by its cardholders,, It merely finances those purchases by purchasing accounts receivable from retailers, Appellant can thus be considered to be primarily engaged in buying and selling money or its equivalent.

We also believe that appellant's activities bring it into substantial competition with national banks.

With regard to appellant's contention that competition with only one national bank which has branched out into a new field is insufficient, it does not appear that Bank of America was the only national bank in California which operated a credit card plan. There is evidence that as early as 1953 First National Bank of San Jose was offering a charge account service which utilized a credit card. It also appears that a number of national banks doing business in other parts of the United States during the period in question did have credit card plans which operated on the. order of the Bankamericard, (Comment, The Tripartite Credit Card Transaction: A Legal-Infant, 48 Calif. L. Rev. 459, 463.)

Even if appellant were correct in its contention that only one national bank was operating a credit card plan, or that because of distinctions in the two plans its credit card plan was not in competition with the Bankamericard plan, this would not alter our opinion that appellant's credit operations nevertheless were substantially competitive with the business of national banks during the years in question.

Although this precise question has not been litigated, the courts have considered whether related activities qualify a business as a financial corporation. In one case, Crown Finance Corp. v. McColgan, supra, 23 Cal. 2d 280 [144 P.2d 331], the California Supreme Court held that finance companies engaged in purchasing, at a discount, conditional sales contracts of household furnishings and other low priced articles of personal property from small local retailers were to be regarded as "financial corporations." Although the finance companies made no loans the court found there was competition with national banks because national banks made personal loans for the purchase of household equipment on the borrower's credit, and national banks purchased conditional sales contracts of the same type the finance companies purchased.

As indicated in the Crown Finance Corp. case, supra, national banks are in the business of making personal loans and discounting commercial paper. We understand that these banking activities comprise an ever-increasing part of the business of banks. The all-purpose credit card is a device designed to facilitate the purchase of goods and services and to stimulate "buying now and paying later." In substance credit card programs involve the extension of credit to the individual, which is a traditional banking function. As such, credit card programs must be viewed as but one method of arranging credit rather than as a unique departure from normal banking activities. But for the credit extended by appellant, both its club members and the participating merchants would have been obliged to obtain financing from other financial institutions such as national banks. We cannot escape the conclusion that appellant competes with national banks doing business in California for the consumer's business in the area of personal financing. In view of the large amounts of income which appellant derives from its business in California, we conclude that that competition is substantial.

In the appeal which it initially filed, appellant further contended that to uphold the proposed additional assessments would violate its constitutional rights, in view of the fact that appellant was not given written notice of the public hearing held to determine the rate of tax to be applied to banks and financial corporations during the years in question. This argument is untenable, for it is settled that there is no constitutional requirement for a hearing in a quasi-legislative proceeding such as the one held to set the tax rate applicable to banks and financial corporations, (Security-First National Bank v. Franchise Tax Board, 55 Cal. 2d 407 [11 Cal. Rptr. 289, 359 P.2d 625], appeal dismissed, 368 U.S. 3 [7 L. Ed. 2d 163; Franchise Tax Board v. Superior Court, 36 Cal. 2d 538 [225 P.2d 905].)

For the above reasons we must sustain respondent's action in this matter.

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 The Diners' Club, Inc., against proposed assessments of additional franchise tax in the amounts of $49,112.11, $44,332.86, $33,510.44, $8,952.90, $44,564.17, $54,185.32, and $24,668.35 for the income years ended March 31, 1959, 1960, 1961, 1962, 1963, 1964, and 1965, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of September, 1967, by the State Board of Equalization.

Paul R. Leake, Chairman

, Member

, Member

, Member

, Member

ATTEST: , Secretary