BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)

CAPITAL SOUTHWEST CORPORATION)

Appearances:

For Appellant: Sheldon Richman
Certified Public Accountant

For Respondent: John D. Schell
Counsel

O P I N I O 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 Capital Southwest Corporation against a proposed assessment of additional franchise tax in the amount of $940.09 for the income year ended March 31, 1966.

The question presented is whether certain dividends and capital gains constitute apportionable unitary income rather than nonunitary income specifically allocable to the situs of the taxpayer's commercial domicile.

Appeal of Capital Southwest Corporation

Appellant Capital Southwest Corporation is a small business investment company. It was incorporated under the laws of Texas on April 19, 1961, and has maintained its principal office in Dallas, Texas. During the income year in question, appellant also had a branch office on each coast: one in Pasadena, California, and another in Arlington, Virginia. Appellant's principal business activity consists of furnishing small businesses with equity capital and long-term loans, but it also provides such businesses with financial, advisory, and management services.

Appellant's Pasadena office is staffed by a vice president and his secretary. The vice president maintains liaison with California banks and screens for submission to the Dallas office the investment possibilities that are referred to him by the banks. All of appellant's investment decisions are made in Dallas and must be approved by the board of directors. As of March 31, 1966, appellant had investments in 33 corporations, 10 of which were headquartered in California. In 29 of the 33 corporations appellant's investment took the form of either (1) a note combined with an equity interest or (2) convertible notes or convertible debentures. In each of the remaining 4 corporations appellant held either a note or a stock interest but not both.

On its California franchise tax return for the income year ended March 31, 1966, appellant reported income from dividends, interest on U.S. government bonds, loan interest, capital gains, and "other income" consisting of fees for management and advisory services. Appellant treated itself as a unitary business and, in determining the unitary income to be apportioned among the states in which it did business, appellant included only its interest income and "other income". After an audit of the return, the Franchise Tax Board determined that appellant's dividend and capital gain income was derived from assets connected with appellant's unitary business and hence should have been included in the unitary income subject to apportionment.

Part of the capital gain income in dispute arose from the sale of office furniture which had been used in appellant's Dallas office. Since depreciation on this equipment had previously been taken as a deduction from admittedly unitary income, appellant now concedes that the gain from the sale must be included in unitary income.

(See Appeal of W. J. Voit Rubber Corp., Cal. St. Bd. of Equal., May 12, 1964.) Appellant also agrees now that respondent has properly computed the percentage of unitary income apportionable to California.

The income items remaining in dispute are the dividends which appellant received from Capital Wire and Cable Corporation (Capital Wire) and the capital gains which it realized from (1) the sale of its stock in Sun-Mart, Inc., (2) the retirement of a Capital Wire note originally issued to a third party and purchased by appellant at a discount, and (3) a cash distribution by Bowie Gasoline Corporation of Texas following the sale of a 75% interest in that company's natural gasoline plant. Appellant contends that these dividends and capital gains are not unitary income but rather are investment income specifically allocable according to situs. Since its commercal domicile is in Texas, appellant argues that the dividends and capital gains are attributable entirely to Texas. Respondent, on the other hand, contends that appellant's equity investments, loan practices, and management and advisory services together constitute a singie unitary business. Its position, therefore, is that all of appellant's income is unitary income subject to apportionment.

It first must be noted that appellant admits to being engaged in a unitary business. Second, it is obvious that appellant's unitary business is basically a long-term investment business. Thus, we are asked to decide the proper tax treatment for income from intangibles held as long-term investments by a taxpayer engaged in the business of making such investments, Numerous prior cases and appeals have dealt with income from intangibles held in connection with a unitary business, (see, e.g., Pacific Telephone and Telegraph Co. v. Franchise Tax Board, 7 Cal. 3d 544 [Cal. Rptr.]; Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48 [156 P.2d 81]; Fibreboard Paper Products Corp. v. Franchise Tax Board, 268 Cal. App. 2d 363 [74 Cal. Rptr. 46]; Appeal of Houghton Mifflin Co., Cal. St. Bd. of Equal., March 28 1946; Appeal of International Business Machines Corp., St. Bd. of Equal., Oct. 7, 1954; Appeal of National Cylinder Gas Co., Cal. St, Bd. of Equal., Feb. 5, 1957; Appeal of Velsicol Chemical Corp., Cal. St. Bd. of Equal., Oct. 5, 1965), but in all of them the unitary business was something other than a long-term investment business. Consequently, these prior decisions are not particularly useful in disposing of this appeal.

In other contexts interest, dividends, and gain from the sale of stock have generally been treated alike for purposes of taxation. (See Miller v. McColgan, 17 Cal. 2d 432 [110 P.2d 419].) As we view the present appeal, there is no apparent reason to give different treatment to these items of income in the context of appellant's unitary business. The salient fact about that business is that the dividends and capital gains in question are of the same general character, and arise from basically the same business operations and transactions, as the loan interest which is admittedly unitary income. Consequently, under the particular circumstances of this case, we cannot say that respondent was wrong to include the dividends and capital gains in unitary income.

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 protest of Capital Southwest Corporation against a proposed assessment of additional franchise tax in the amount of $940.09 for the income year ended March 31, 1966, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of January, 1973, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary