BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
DELTA INVESTMENT CO., INC., AND)
DELTA INVESTMENT RESEARCH CORP.)

For Appellants: Brice A. Sullivan
Counsel

For Respondent: Bruce W. Walker
Chief Counsel

David M. Hinman
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 Delta Investment Co., Inc., and Delta Investment Research Corp., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Appeals of Delta Investment Co., Inc. and Delta Investment Research Corp.

Delta Investment Co., Inc, (DIC)

Taxable Year Ended	Proposed Assessment
March 31, 1971	$1,046.97
March 31, 1972	1,046.97
March 31, 1973	1,936.67
March 31, 1974	5,268.02
March 31, 1975	1,759.70

Delta Investment Research Corp. (DIR)

Taxable Year Ended	Proposed Assessment
March 31, 1971	$ 847.98
March 31, 1972	847.98
March 31, 1973	917.31
March 31, 1974	4,721.25

The issue presented is whether respondent properly classified the appellants, DIC and DIR, as financial corporations under section 23183 of the Revenue and Taxation Code. Prior to addressing the particular facts and circumstances which gave rise to the appeal, however, we shall briefly set forth the purpose for the financial corporation classification and the established test for identifying financial corporations.

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) prohibitina imposition of state taxes which discriminate against national banks. (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 [144 P.2d 331] (1943).) Compliance with the federal statute is achieved under California law by the imposition of a tax on financial corporations which is essentially identical in structure and rate as the tax imposed on national banks. (Crown Finance Corp. v. McColgan, supra, 23 Cal. 2d at 284.) Thus, the manifest purpose for the classification is to avoid preferential tax treatment for those corporations which engage in banking activities in competition with the national banks. (H.A.S. Loan Service, Inc. v. McColgan, 21 Cal. 2d 518, 520 [133 P.2d 391] (1943).)

The term "financial corporation" is not defined in the Revenue and Taxation Code. However, in accordance

with the purpose for the classification, the California courts have held that a financial corporation is one which deals in moneyed capital, as opposed to other commodities, in substantial competition with national banks. (Marble Mortgage Co. v. Franchise Tax Board, 241 Cal. App. 2d 26 [50 Cal. Rptr. 345] (1966); The Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 493] (1940).) Thus, our task with respect to the instant appeal is to determine whether the appellants were dealing in moneyed capital, as opposed to other commodities, in substantial competition with national banks.

For purposes of ascertaining whether a corporation is dealing in moneyed capital in substantial competition with national banks, the courts and this board have focused on the following factors: (1) whether the corporation employs its moneyed capital in financial activities generally engaged in by national banks (The Morris Plan Co. v. Johnson, supra, 37 Cal. App. 2d at 624; Appeals of Croddy Corp., Cal. St. Bd. of Equal., Sept. 1, 1966); (2) whether the combined capital and surplus of the corporation is of an amount comparable to that of national banks (The Morris Plan Co. v. Johnson, supra; Appeal of First Investment Service Co., Cal. St. Bd. of Equal., July 31, 1973); (3) whether the moneyed capital employed in financial activities by the corporation represents a significant portion of its combined capital and surplus (Marble Mortgage Co. v. Franchise Tax Board, supra; Appeal of Winter Mortgage Co., Cal. St. Bd. of Equal., Feb. 5, 1963); (4) whether, if the corporation is engaged in lending activity, the loans are significant in number and amount (The Morris Plan Co. v. Johnson, supra; Appeals of Sterling Finance Corp. of California, Cal. St. Bd. of Equal., March 25, 1968); and (5) whether the corporation is earning substantial income from its financial activities (Marble Mortgage Co. v. Franchise Tax Board, supra; Appeals of Croddy Corp., supra).

With this background in mind, we turn to the facts presented by the instant appeal. At the outset, however, we observe that the record on appeal contains no information concerning the capitalization of appellants during the years in question, and very little information regarding the nature and extent of their business activities. In this connection, we note that the burden rests with appellants to prove respondent improperly classified them as financial corporations. (Appeals of The Diners' Club, Inc., Cal. St. Bd. of Equal., Sept. 1, 1967.)

The record on appeal indicates that both of the appellants were incorporated in 1969 to "lend money as personal property brokers." Since 1969, however, the primary business activities of the corporations have been real estate investment and making secured business loans. The following tables summarize information contained in the record regarding the lending activities of the appellants through the taxable year ended March 31, 1974: 1/

DIC

Taxable Year Ended	Notes Receivable	Interest Income	Loan Fee Income	Total Income
March 31, 1970	$ 59,111	$ 4,203	$ 1,145	$ 9,560
March 31, 1971	1,167,553	119,485	54,412	
March 31, 1972	1,873,423	201,214	29,630	213,674 324,379
March 31, 1973	2,715,944	273,576	11,447	409,528
March 31, 1974	2,544,264	318,580	3,395	503,539

DIR

Taxable Year Ended	Notes Receivable	Interest Income	Loan Fee Income	Total Income
March 31, 1971	$ 883,864	$ 84,812	$32,275	$141,353
March 31, 1972	1,185,857	136,688	19,542	220,853.
March 31, 1973	3,033,241	239,864	13,320	349,679
March 31, 1974	3,563,841	342,164	24,750	960,594

On the basis of the information presented in the above tables, and for the reasons that follow, it is our opinion that respondent properly classified the appellants as financial corporations for the taxable years ended March 31, 1971 through March 31, 1974. During that period the appellants were actively involved in lending money, an activity commonly engaged in by national banks. Moreover, with the exception of DIR's taxable year ended March 31, 1974, the annual income which each of the appellants derived from its lending activity accounted for at

1/ It should be noted that the tables provide no information concerning the financial activity of DIC during the taxable year ended March 31, 1975. The cause and consequence of the parties' failure to provide such information will be discussed later in the opinion.

least 64 percent of its total annual income. Finally, the tables indicate that the notes receivable accounts of DIC and DIR increased an average of over $800,000 per year during the period from March 31, 1970 through March 31, 1973, and that the notes receivable account of DIR increased by over $500,000 during its taxable year ended March 31, 1974. While the record does not set forth the precise number and amounts of the loans made by appellants, it is clear that the appellants employed substantial amounts of moneyed capital in connection with their lending activities. Thus, we are convinced that the appellants were dealing in moneyed capital in substantial competition with national banks during each of the taxable years ended March 31, 1971 through March 31, 1974. (See Marble Mortgage Co. v. Franchise Tax Board, supra, 241 Cal. App. 2d at 41; Appeals of Sterling Finance Corp. of California, supra; Appeals of Ponticopoulos, Inc., Cal. St. Bd. of Equal., Sept. 1, 1966.)

The appellants contend that they were not financial corporations during any of the taxable years in question because their financial activities did not constitute the major aspect of their business operations. However, we have previously held that a corporation may be properly classified as a financial corporation even though its financial activities do not constitute all, or even a major part, of its business operations. (Appeals of Croddy Corp., supra; Appeal of Continental Securities Co., Cal. St. Bd. of Equal., Feb. 3, 1944.) The critical question in such cases is not whether the corporation is primarily engaged in financial activities but whether its financial activities bring it into substantial competition with national banks. It would be discriminatory to allow corporations engaged in financial activities in substantial competition with national banks to pay taxes at a lower rate than the national banks on profits obtained from such activities. (See Marble Mortgage Co. v. Franchise Tax Board, supra, 241 Cal. App. 2d at 42.)

The appellants also assert that their lending activities did not bring them into substantial competition with national banks because: (1) they did not offer or advertise their lending services to the public; (2) the loans were made primarily to affiliated companies; and (3) the loans were necessary due to the unavailability of national bank financing.

The facts that the appellants did not offer their lending services to the public and that the loans

were made primarily to affiliated companies do not establish that the appellants were improperly classified as financial corporations. A corporation may be dealing in moneyed capital in substantial competition with national banks even though its lending activity involves only a small,, defined group of debtors. (Appeals of Sterling Finance Corp. of California, supra; Appeal of Motion Picture Financial Corp., Cal. St. Bd. of Equal., July 22,158.).

Moreover, while appellants correctly suggest that substantial competition with national banks cannot exist where national bank financing is unavailable (see Appeal of Arc Investment Co., Cal.-St. Bd. of Equal., Feb. 18, 1964), the record on appeal contains no evidence to indicate whether such financing was clearly unavailable or merely unavailable at the rates offered by appellants. In the absence of such evidence we have no alternative but to conclude that appellants have failed to sustain their burden of proving respondent improperly classified them as financial corporations for the taxable years ended March 31, 1971 through March 31, 1974. (Cf. Appeal of Motion Picture Financial Corp., supra.)

The final year in issue is DIC's taxable year ended March 31, 1975. Apparently acting on the belief that DIC's status for that year is governed by its financial activities during the prior "income year", 2/ the parties have failed to present any information concerning the activities of DIC during its taxable year ended March 31, 1975. However, the classification of a corporation as a financial corporation for a particular taxable year must be based on the financial activities of the corporation during that taxable year. (Appeal of First Investment Service Co., supra.) Thus, respondent's classification of DIC as a financial corporation for the

2/ Section '23041 of the Revenue and Taxation Code defines "taxable year" as the fiscal year for which the tax on banks or corporations is payable, while section 23042 defines "income year" as the fiscal year upon the basis of which the tax is computed. Thus, while the measure of the tax looks to the preceding income year, the tax is paid for the privilege of exercising the corporate franchise during the taxable year. (See Appeal of First Investment Service Co., Cal. St. Bd. of Equal., July 31, 1973.)

taxable year ended March 31, 1975 is erroneously based on the financial activities of DIC during the prior income year.

Generally, a determination by respondent is presumed to be correct and the taxpayer has the burden of proving the determination erroneous. (Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 414] (1949); Appeal of Robert L. Webber, Cal. St. Bd. of Equal., Oct. 6, 1976.) However, where it is evident that respondent's determination is arbitrary or capricious the presumption no longer avails. (Helvering v. Taylor, 293 U.S. 507, 514 [79 L. Ed. 623] (1935); Appeal of Morris M. and Joyce E. Cohen, Cal. St. Bd. of Equal., Feb. 19, 1974.)

As we have indicated, respondent's determination that DIC was a financial corporation for the taxable year in question is based solely on the financial activities of DIC during the prior income year. Thus, the assessment for DIC's taxable year ended March 31, 1975 is attributable to respondent's erroneous view of the law and has no factual support in the record. Under the circumstances, we can only conclude that respondent's action in this regard was arbitrary and must be reversed. (See United States v. Hover, 268 F.2d 657, 665 (9th Cir. 1959)

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 Delta Investment Co., Inc.
and Delta Investment Research Corp.

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 Delta Investment Co., Inc., and Delta Investment Research Corp., against proposed assessments of additional franchise tax in the amounts and for the years as follows:

Delta Investment Co., Inc. (DIC)

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March 31, 1974	4,721.25

be and the same is hereby reversed with respect to the assessment against Delta Investment Co., Inc., in the amount of $1,759.70 for the taxable year ended March 31, 1975. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 6th day of April, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member