1723.

BUILDING AND LOAN—CANNOT ESTABLISH OFFICE BUILDING FUND FROM NET EARNINGS—RETURN OF ASSESSMENT AGAINST STOCKHOLDERS—RESERVE AND UNDIVIDED PROFIT FUND.

SYLLABUS:

1. *A building and loan association is not authorized to establish from net earnings an office building fund.*

2. *Where a building and loan association has heretofore levied an assessment against its stockholders for the purpose of restoring impaired capital, and the proceeds of such assessment have not in fact been used for said purpose, and the capital of the association has been fully restored, the assessment should be returned to those making the original contributions.*

3. *After proper provision has been made from current earnings for the reserve fund of a building and loan association, the remainder of said earnings must be distributed by the board of directors to the stockholders of such association, provided, however, that the directors may, if they see fit, establish an undivided profit fund, which shall not in any event exceed three per cent of the total assets of the association.*

COLUMBUS, OHIO, February 17, 1928.

HON. J. W. TANNEHILL, *Suprintendent of Building and Loan Associations, Columbus, Ohio.*

DEAR SIR:—This will acknowledge your recent letter, as follows:

"Under Section 686 of the General Code of Ohio it is provided that if upon examination by this Department it is found that any domestic association is 'conducting its business in whole or in part contrary to law, or failing to comply therewith, he (Superintendent of Building and Loan Associations) shall notify the board of directors of such association of such fact in writing. If, after thirty days, such illegal practice or failure continues, he shall communicate the facts to the Attorney General, who shall cause proceedings to be instituted in the proper court to revoke the charter of such association.'

An examination of the affairs of the ---------- Building and Loan Company of ----------, according to law, was made as of the close of business, October 10, 1927, and the copy of report of such examination was transmitted to this company with notice in writing dated November 22, 1927, calling their attention to certain improper practices and irregularities, among them being the following, designated as Direction No 9:

'Referring to Examiner's remark 5 as to the item of 'Office building fund—$8,450.00,' you are again advised that an office building investment could not be made out of a liability account of the company. Any office building acquired would become an asset of the company arising from an investment of some of its cash assets.

There is no authority under the law for setting up any such liability. We are aware of the fact that this account was originally an assessment fund and because of the fact that this fund was created to take care of losses at the time impending and as the company has increased this fund out of its earnings without any authority whatever under the law, it is the opinion of this Department that on account of the handling of the fund its original identity has

been destroyed and the only proper course now to take to place this item on the books in proper form will be to transfer the amount now in the fund to the reserve fund of the company, which fund, under the law, is created to take care of losses.

It is therefore directed that this course be taken without delay.'

This direction was based upon information contained in the examiner's report under remark 5, page 12, with reference to a fund designated on page 2 of the examination report as—

'Office building fund----------$8,450.00'

This fund was originally an 'Assessment fund' created by an assessment of '10% of the amount of dues to the credit of shareholders'.

We quote the following from letter of the secretary of this company under date of June 23, 1900:

'In regard to the items "Assessment to Dues" and "Dues to Assessment", I desire to say that the Board of Directors of the ---------- B & L Co., passed a resolution June 22, 1899, levying an assessment of ten per cent on the amount of dues to the credit of all shareholders. This action was made necessary by the report of the committee appointed to reappraise the assets of the company. The amount of the assessment has not been distributed, consequently we have to carry it as a liability of the company. Our affairs are in much better shape and we confidently expect to be able to return the amount to our shareholders.'

This fund has appeared in the annual report to this department in the amount of $7674.00 from 1900 to 1916, inclusive.

In 1916, $1284.65 was deducted from this fund. The fund remained at $6389.35 until 1923, the company's annual report in that year showing an increase to $7412.00 and then in 1924 the fund increased to $7607.00, in 1925 to $7857.00, in 1926 to $8200.00 and up to the date of the examination herein referred to the amount of the fund had increased to $8450.00.

Our objection to these transactions is based upon the fact that these increases have been made through the application of the earnings of the company to such fund instead of accruing through assessment of the stockholders in the manner in which the fund was originally created.

This application of the earnings of the company is, in the opinion of this department, clearly illegal. For a long time as indicated by previous reports of examination we have endeavored to reach an amicable adjustment of this account as indicated in our Direction No. 9, herein referred to, but the directors and officers of this company, through their failure to accept our position, refused to handle this fund according to law.

Their contention is that they are building up this fund for use in acquiring an office building, but it is manifestly improper to reason that an investment can be made by the company out of one of its liability accounts. We have pointed out to them that this could not be done, but they are either unable or unwilling to see this viewpoint.

To adjust this matter in the only way provided by law and to prevent any further diversion of the earnings of this company in a manner not authorized by law, we ask that proceedings be instituted against this company in accordance with the requirements contained in Section 686 of the General Code of Ohio.

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A copy of our report of examination and letter of directions thereon is submitted with this application."

In your letter you ask that I institute proceedings against this company under authority of Section 686 of the General Code of Ohio on the theory that the company is conducting its business in part contrary to law, since you have notified the Board of Directors in writing and it has failed within thirty days to correct the illegal practice.

In order to determine whether or not an action in quo warranto will lie in the present instance, it is necessary to analyze carefully the practice of the company to which you have referred and the order of your department seeking correction of the same.

As I understand the facts, the particular fund to which you refer is designated as "Office building fund." The fund was originally called an "Assessment fund," having been created by an assessment of ten per cent of the amount of dues to the credit of shareholders in 1899. According to my understanding, this assessment was rendered necessary because through a reappraisement it was found at that time that the capital of the association was impaired. It appears, however, that this fund continued to be carried as a liability and that the association subsequently made up from earnings the impairment of capital and, at the present time, its statutory reserve is above the minimum requirement of Section 9671 of the Code. That section is in the following language:

> "The amount to be set aside to the reserve fund, for the payment of contingent losses shall be determined by the board of directors, but in all permanent or perpetual associations, at least five per cent of the net earnings shall be set aside each year to such fund until it reaches at least five per cent of the total assets. All losses shall be paid out of such fund until it is exhausted. When the amount in such fund falls below five per cent of the assets as aforesaid, it shall be replenished by annual appropriations of at least five per cent of the net earnings as hereinbefore provided until it again reaches such amount."

It is further disclosed from the report which accompanies your letter that the fund in question has been added to from time to time out of current earnings.

It is first necessary to determine whether or not there is any authority for a building and loan company to establish and maintain a fund of this character, irrespective of the source of the sums credited thereto. Among the powers of building and loan associations is found the following in Section 9659 of the General Code:

> "To accumulate from the earnings a 'reserve fund' for the payment of contingent losses and an 'undivided profit fund', both of which may be loaned and invested as other funds of the association."

This section only authorizes the creation of two funds from earnings and I have heretofore quoted the provisions of Section 9671, giving the detailed method by which the reserve fund is created. With respect to the payment of dividends and the creating of the undivided profit fund, Section 9673 of the Code provides as follows:

> "After payment of expenses and interest, a portion of the earnings to be determined by the board of directors, annually or semi-annually, shall also be placed in the reserve fund for the payment of contingent losses, as hereinbefore provided, and a further portion of such earnings to be determined by the board of directors, shall be transferred as a dividend annually or semi-annually, in such proportion to the credit of all members

as the corporation by its constitution and by-laws provides, to be paid to them at such time and in such manner in conformity with this chapter as the corporation by its constitution and by-laws provides. Any residue of such earnings may be held as undivided profits to be used as other earnings, except that such undivided profit fund at no time shall exceed three per cent of the total assets of the association."

I believe it clear from the quoted provisions that building and loan associations cannot lawfully create any other fund from earnings than the ones specifically mentioned. These associations are limited in their functions to the authority conferred by statute and, since there is only recognition of the two funds mentioned, I believe that your position is entirely right and that there is no authority to create from earnings an office building fund such as the building and loan in question has sought to establish.

It may be suggested that such a practice cannot in any way prejudice creditors of the association, since it merely preserves in the assets monies which would otherwise be subject to distribution to the stockholders. In other words, this fund constitutes an additional security to creditors and depositors of the association over and above the reserve fund directed to be established by statute. If a building and loan association had the status of an ordinary corporation, there would be much force in this argument. These associations are, however, of a peculiar character. Stockholders therein are not permanent but, by statutory authority, stockholders may retire from time to time and their stock may be canceled and subsequently reissued. In fact it may be said to be one of the fundamental theories of these associations that their character is mutual in that borrowers therefrom are in many instances also stockholders. Originally this was the sole method of borrowing from an association of this character. One must have subscribed for stock in order to borrow money and payments upon the stock subscription were made from time to time and when the stock subscribed for was entirely paid, the amount thereof aggregated the amount due upon the loan and thereupon both the loan and the stock were canceled. While there has been a considerable widening of the powers of building and loan associations with respect to loans, this distinctive feature is still retained. The result of this dual role of stockholder and borrower was that the borrower, by reason of dividends upon the stock, participated during the period of his loan in the net profits of the association. This is made clear by the provisions of Section 9651, as follows:

"To permit members to withdraw all or part of their stock deposits, at such times, and upon such terms, as the constitution and bylaws provide. Any member, however, who withdraws his entire stock deposit, or whose stock has matured, shall be entitled to receive all dues paid in and dividends declared thereon, less all fines or other assessments, and less the pro rata share of all losses, if any have occurred."

Therefore, it is of great importance to a borrower-stockholder that he be credited with the earnings of the stock for which he has subscribed, for thereby he is enabled to secure his loan at a lower rate of interest. Since his character as a stockholder is transitory and merely incident to his status as a borrower, he has no interest in building up the assets of the association such as may be said to be incident to the ordinary ownership of stock in an ordinary corporation.

It was doubtless with this peculiar situation in mind that the Legislature has specifically limited the amount which may lawfully be placed in the undivided

profit fund and has only authorized the creation of this fund together with the reserve fund. In my opinion, therefore, it is the duty of the board of directors of a building and loan association, after making proper provision from net earnings for the reserve fund, to distribute net earnings to the stockholders with the single exception that an undivided profit fund may be established up to the maximum named in the statute.

You will observe, however, that the reserve fund is to be accumulated from earnings. In the particular case in question a substantial part of the fund in question was created by assessment upon the stockholders. It has since been carried as a liability of the company and, since it was not created from earnings but from assessment, it necessarily follows that the liability for this fund exists to the stockholders who were the original contributors by reason of the assessment. This liability cannot, in my opinion, be regarded as being extinguished by mere lapse of time. The assessment having been made and the objects for which it was made having failed and the fund not being further necessary for that purpose, I feel that the liability to the original stockholders still persists. Consequently, I do not believe it to be within your authority to direct the transfer of this fund to the reserve fund, in so far as the amounts therein represent the original assessment. These sums should be distributed, if it is possible at this time from the books of the company to ascertain to whom distribution should be made. Such sums as represent assessments which cannot now be identified should be held in a special fund as a liability against the possible future claim of those originally subject to the assessment or their legal representatives. This liability of reimbursement being continuing, I know of no authority by which it may be converted into an asset or by which it may be transferred to the reserve which, as I have before stated, is to be accumulated from earnings for the purpose of protection against loss.

So much of the fund as has been created from earnings, however, is in a different status. As I have before pointed out, there is no authority for the creation of a fund of this character out of earnings or otherwise. The provisions of Section 9673 of the Code make specific direction as to the distribution of net earnings. You will observe that so much thereof as the board of directors or the by-laws and regulations provide shall be placed in reserve and the remainder thereof distributed subject to the right of the directors to create an undivided profit fund up to three per cent of the assets of the association. In the present instance the reserve is above the statutory minimum and I therefore feel that you cannot properly require the association to transfer the whole amount of this fund derived from earnings to the reserve. If the directors choose, they may place it in the reserve, but they have the alternative to build up the undivided profit fund to the three per cent maximum or to distribute by way of dividends to the stockholders. Where action upon the part of the association is discretionary, as it is in this instance, I do not believe it within the power of your department to substitute its judgment for the discretion of the board of directors. This will not prevent, however, your department from making a lawful requirement of the association to distribute this portion of the fund in one of the three alternative methods. It has often been held that mandamus or injunction will lie to compel the exercise of discretion on the part of corporate bodies.

In view of the foregoing, I feel that the institution of an action by me under authority of Section 686 of the General Code would not be proper at this time. This is due to the fact that the requirement which you made under date of November 22, 1927, was beyond your authority. If, however, your department should

make a further requirement of the association along the lines suggested above, and it should still fail to comply with said order, I will be glad to have you refer the matter to me again.

Respectfully,
EDWARD C. TURNER,
Attorney General.

1724.

GASOLINE TAX—WHEN REFUNDER MAY BE MADE.

SYLLABUS:

Refunders of the tax paid upon gasoline may not be made unless applications therefor be filed with the Tax Commission of Ohio within ninety days of the date of purchase or invoice.

COLUMBUS, OHIO, February 17, 1928.

HON. JOSEPH T. TRACY, *Auditor of State, Columbus, Ohio.*

DEAR SIR:—This will acknowledge receipt of your recent communication, as follows:

> "I am herewith making departmental request for an opinion relative to the refunder of gasoline tax such as is provided for in Section 5534 of the General Code. A number of requests are on file seeking payment where the date of invoice is more than ninety days old.
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> We desire to be advised as to whether the ninety day limit—as stated in above Section—is directory, or positively mandatory. It would greatly facilitate the administration of this feature of the law, both in the Tax Commission and especially in the Department of Auditor of State, if these claims be honored even once a year rather than at such short intervals, and it would seem that even if the man has delayed asking for his money longer than ninety days it ought not entirely invalidate his claim, provided there is no question as to the validity of the amount asked for."

Section 5534 of the General Code is in the following language:

> "Any person, firm, association, partnership or corporation who shall use any motor vehicle fuel, as defined in this act, on which the tax herein imposed has been paid, for the purpose of operating or propelling stationary gas engines, tractors not used on highways, motor boats or aircraft, or who shall use any such fuel upon which the tax herein provided for has been paid, for cleaning or dyeing, or any other purpose than the propulsion of motor vehicles operated or intended to be operated in whole or in part upon the highways of this state, shall be reimbursed to the extent of the amount of the tax so paid on such motor vehicle fuel in the following manner; provided however that such applications for refunds must be filed with the tax commission of Ohio within ninety days from the date of purchase or invoice.
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> Such person, firm, association, partnership or corporation shall file with the Tax Commission of Ohio a statement of the quantity of fuel used for purposes other than propulsion of motor vehicles, as set out in