

2254.

CORPORATION—FOREIGN—LISTING OF CREDITS—DEDUCTIONS.

SYLLABUS:

A foreign corporation, in listing its "credits" liable to taxation in Ohio, may under the provisions of Section 5327, General Code, deduct from its claims and demands that arise out of the business it transacts in this state, only such bona fide debts as arise from the same source.

COLUMBUS, OHIO, June 19, 1928.

The Tax Commission of Ohio, Columbus, Ohio.

GENTLEMEN:—This will acknowledge receipt of your recent communication which reads:

"The Tax Commission would respectfully request an opinion on the following question:

A Delaware corporation has branch offices in a number of Ohio cities. The company is engaged in operating Industrial Loan Banks. Funds are supplied the various branch offices by the home office, from the proceeds of the sale of collateral trust bonds, issued by the company. In setting up its properly taxable assets, may the branch office list as a 'debt' owing the main office, the amount of money assigned to it as a result of the sale of 'credits' arising out of the year's business, done by the branch office.

We are enclosing a letter from the Auditor's office, Cleveland, Ohio, setting forth, at some length, the facts concerning the various transactions involved.

We shall be pleased if your office can give this case immediate attention."

The letter from the auditor of Cuyahoga County to which you refer reads as follows:

"SUBJECT

The balance sheet of the Community Finance Service, Inc., a Delaware corporation, shows a bonded and mortgage indebtedness of \$4,105,000. It sells its bonds as money is needed by the Cleveland branch. Chattels or credits arising from said business in Cleveland, amounting to \$291,579.46, are pledged for payment of said bonds by the home office in Delaware. The company sets up as a legal bona fide debt (amount \$296,661.82), which is money received from the sale of said bonds (at Delaware) said money is forwarded to the Cleveland branches of the Community Finance Company. The company claims the liability from the sale of these bonds should follow the assets of 'credits' that arise from the creation of such debt. If this were permissible it would eliminate the taxable credits.

This department would like to have an Attorney General's ruling on the following question:

The Community Finance Service, Inc., is organized under the laws of Delaware, with an authorized capital stock of 50,000 shares, par value \$10.00, and an authorized bond issue of \$5,000,000. On December 31st, 1927, the

company issued and had outstanding capital stock to the par value of \$500,000; and its bond issue was \$4,105,000 held by nearly twelve hundred persons in eighteen states and five foreign countries.

The stock was given as a bonus with bonds.

On January 1st, 1928, the company operated through 35 branches in seven states, seven of such branch offices being located in Ohio, in cities of Akron, Cincinnati, Columbus, Dayton, Toledo and two in the city of Cleveland.

The company is engaged in the business of operating industrial loan banks, making industrial loans to wage earners not to exceed \$300.00 on chattel mortgage (operating under what is known as the Petty Small Loan Law or Lloyd Act).

The business of the several branches is conducted through branch managers, and the company maintains a control over the entire business and the management of the several branches by a system of daily and monthly reports, and frequent examinations and audits by its field supervisory staff.

In addition to the supervision, each branch is subject to the examination and audit of the State Banking Department, excepting in Ohio where the examiners of the Department of Commerce function.

Community Finance Service, Inc., obtains funds to loan on chattel mortgages by the issuance of its collateral trust bonds, secured by the chattel mortgages thus created. The bonds are issued by the home office (9th and Market street, Wilmington, Delaware), and proceeds thereof are transferred to the various branches when and as the need for funds in the several branches so indicate.

The capital supplied the two Cleveland branches in question represents their portion of the proceeds of the company's collateral bond issue, including \$330,000 borrowed from the banks as of December 31st, 1927.

From the business transacted in Cuyahoga County, as explained above, there was created at the close of the company's fiscal year (chattel mortgages) credits amounting to \$291,579.46. The company claims the very chattel mortgages in question are hypothecated under the outstanding bond issue of the company, \$296,661.82 of the proceeds of which constitute a debt, for which the \$291,579.46 of chattel mortgages are pledged as security.

It is through the sale of the bonds (at Delaware) that the receivables had their origin.

The Community Finance Service, Inc., claims the liability for the sale of these bonds should follow the assets or 'credits' that arise from the creation of such debt. The company claims these receivables would not have been created unless a portion of the proceeds from the sale of bonds had been allotted to the several Cleveland branches; hence so much of the debt of the company as is represented by \$296,661.82 of this bond issue (this being the proceeds sent to the Cleveland branches) is the proportion of the debt incurred for the benefit of the several Cleveland branches. The company claims the receivables \$291,579.36, which emanate from business transacted within the state and localized in Cuyahoga County, are pledged for the payment of the bonds, and that the apportioned indebtedness, amounting to \$296,661.82, created by the home office through the issuing of said bonds should be allowed as an offset against the credits of \$291,579.46."

The word "credits" is a constitutional term, found in Section 2 of Article XIII of the Constitution of Ohio, where it is declared that:

"Laws shall be passed taxing by uniform rule all moneys, 'credits,'
* * * etc."

The framers of the Constitution did not define the word "credits" which it thus employes to denote a specific subject of taxation.

In 1856, the General Assembly by statute defined the word "credit" and declared it to mean "the excess of the sum of all legal claims and demands * * * over and above the sum of the legal bona fide debts owing by such person;" and ever since, that legislative definition has been acquiesced in.

Section 5327, General Code, defines "credits" and reads as follows:

"The term 'credits' as so used, means the excess of the sum of all legal claims and demands, whether for money or other valuable thing, or for labor or service due or to become due to the person liable to pay taxes thereon, including deposits in banks or with persons in or out of the state, other than such as are held to be money, as hereinbefore defined, when added together, estimating every such claim or demand at its true value in money, over and above the sum of legal bona fide debts owing by such person. In making up the sum of such debts owing, there shall not be taken into account an obligation to a mutual insurance company, nor an unpaid subscription to the capital stock of a joint stock company, nor a subscription for a religious, scientific, literary, or charitable purpose; nor an acknowledgment of indebtedness, unless founded on some consideration actually received, and believed at the time of making such acknowledgment to be a full consideration therefor; nor an acknowledgment made for the purpose of diminishing the amount of credits to be listed for taxation; nor a greater amount or portion of a liability as surety, than the person required to make the statement of such credits believes that such surety is in equity bound, and will be compelled to pay, or to contribute, in case there are no securities, nor any tax, fee or assessment due or to become due to the government of the United States or to the State of Ohio, or to any political subdivision thereof. Pensions receivable from the United States shall not be held to be credits; and no person shall be required to take into account in making up the amount of credits, a greater portion of any credits than he believes will be received or can be collected, or a greater portion of an obligation given to secure the payment of rent than the amount that has accrued on any lease and remains unpaid."

There is no constitutional or statutory definition of the term "debts." However, in the case of *Motor Company vs. Boyle*, 23 O. N. P. (N. S.) 353, it was held that legal bona fide debts as used in Section 5327, General Code, includes all obligations to pay money, due and existing on any ground.

In opinion No. 1487, rendered by this office to the Tax Commission of Ohio under date of December 30, 1927, the syllabus reads as follows:

"Credits of a non-resident corporation may be taxed in Ohio, only when they are localized by being committed to the charge and management of an agent or other representative who is more than a mere custodian or collector, and who has power to deal in a managerial capacity with the fund represented by the credits."

In the letter from the auditor of Cuyahoga County which you inclose, it is stated that the credits of the Delaware corporation here concerned, emanate from busi-

ness transacted within this state and are localized in Cuyahoga County. And therefore there is no question as to the taxability of such credits in that county.

The difficulty lies in determining what are the credits of the corporation in question, as defined by General Code, Section 5327, which provides that the term "credits" means the excess of all legal claims and demands over and above the sum of legal bona fide debts owing by such persons; and the question arises as to whether in the instant case, the term is limited to the debts growing out of the Ohio business upon which the credits herein named are realized.

The local branches of the corporation obtain their funds, which are loaned on chattel mortgages, from the home office of the corporation, which is at Wilmington, Delaware. The amount so received by the local branches represents their portion of the proceeds of the company's collateral bond issue including the amount borrowed from the banks as of December 31, 1927. The chattel mortgages secured by the Cleveland branches are sent to the Delaware office and the home office obtains funds to loan on chattel mortgages by the issuance of its collateral trust bonds secured by the chattel mortgages.

There was created at the close of the company's fiscal year from the business transacted in Cuyahoga County credits amounting to \$291,579.46. The Delaware company now claims that the chattel mortgages in question are hypothecated under the outstanding bond issue of the company, \$296,661.82 of the proceeds of which constitute a debt for which the said \$291,579.46 of chattel mortgages are pledged as security. The receivables had their origin through the sale of the bonds in Delaware, and the corporation claims that the liability for the sale of these bonds should follow the assets or "credits" that arise from the creation of such debt; or in other words, that the receivables would not have been created unless a portion of the proceeds from the sale of bonds had been allotted to the several Cleveland branches.

It is therefore claimed that so much of the debt of the company as is represented by \$296,661.82 of this bond issue, the amount of the proceeds sent to the Cleveland branches is the proportion of the debt incurred for the benefit of the several Cleveland branches, and that the apportioned indebtedness amounting to \$296,661.82 created by the home office through the issue of the bonds should be allowed as an off-set against the credits of \$291,579.46. If this be permissible, it will eliminate the taxable credits. Is this such a "bona fide debt" as is contemplated under the provisions of Section 5327, General Code?

In the case of *Hubbard vs. Brush*, 61 O. S. 252, it was held in the third paragraph of the syllabus that:

"Such corporation, in listing for taxation its 'credits' liable to taxation in this state, may, under the provisions of Section 2730, Revised Statutes (now 5327, General Code), deduct from its claims and demands that arise out of the business it transacts in this state, such of its bona fide debts as arise from the same source."

In the case of *Hess, Auditor, vs. Insurance Company*, 116 O. S. 416, in the course of the opinion it was stated that:

"It is urged by counsel for the auditor that the amount which the Insurance Company seeks to deduct as a 'legal bona fide debt' from its credits in making its return for taxation is only a contingent liability to the company for its policy holders and therefore the deduction as a 'legal bona fide debt' is not authorized by the provisions of Section 5327, General Code, known as a 'debt' by the provisions of Section 9357, General Code.

It may be stated at the outset that it is difficult to make a distinction between the terms above quoted; that is, 'legal bona fide debt' and 'debt,' for if the fund in question is in fact and in law, a 'debt,' then it is a 'legal bona fide debt.' "

In the case of *Tax Commission of Ohio, et al., vs. The National Malleable Casting Company*, 111 O. S. 117, it was held in the second paragraph of the syllabus that:

"The Legislature in its definition of 'credits' in Section 5327, General Code, (95 O. L. 353) used the word 'debts' in the significance of an obligation based upon contract express or implied. * * * "

Bouvier's Law Dictionary defines the word "debt":

"(1) A sum of money due by certain and express agreement.
* * * * * "

In the case of *Lane County vs. Oregon*, 7 Wall. 71, 19 L. Ed. 101, the Supreme Court of the United States construed the word debts as used in the Constitution and the statutes in the following language:

"What then is its true sense? The most obvious, and, as it seems to us, the most rational answer to this question is, that Congress must have had in contemplation debts originating in contract or demands carried into judgment, and only debts of this character. This is the commonest and most natural use of the word."

In Cooley on Taxation, Vol. 3, 4th Ed., Section 1159, it is stated that:

"The right to have debts deducted from the value of taxable property is not absolute, but is in the nature of a favor, and no constitutional right is violated by a law that permits the deduction of some debts and not of others. It has been held that even though the Constitution gives the right to deduct indebtedness from credits, yet that right can be secured only in the manner provided by law; * * * statutes authorizing such deductions are to be strictly construed. * * * "

In order to be deductible as a debt, the obligation must be a valid and subsisting one, and within the legal meaning of the word 'debt' or 'indebtedness.' For instance, an indebtedness existing merely as a convenience in bookkeeping, and not a bona fide indebtedness, cannot be deducted. So an agent or trustee cannot deduct as a debt money in his hands as such, belonging to the principal or beneficiary. * * * So contingent obligations are not deductible as debts."

In the case of *Heinz Company vs. Benham, Treasurer*, Court of Appeals of Franklin County, No. 359, rendered February 15, 1916, in construing Section 5327 and applying the ruling of the case of *Hubbard vs. Brush*, supra, to the facts in that case, it was said by Allread, J., that:

"The more difficult question arises out of the right of the plaintiff to deduct therefrom a proportion of the underlying indebtedness of the general plant from which the goods sold in Ohio were consigned."

The three branches of the syllabus of *Hubbard vs. Brush*, supra, were then quoted and the opinion continued as follows :

"We cannot, however, escape the conclusion that the Supreme Court in adopting the syllabus above referred to intended to announce a general rule for the taxation of local credits in cases where a foreign corporation had adopted a local situs in this state for the transaction of a part or all of its business. There has been no material change in the statutory law of this state since the announcement of this decision and we feel bound to follow and apply it."

The opinion then concluded as follows :

"Upon the whole, we are of the opinion that we are justified in following the syllabus above quoted from the case of *Hubbard vs. Brush*."

In substance the court held in the Heins case that the taxable credits were those emanating from the business of the Columbus, Ohio, branch and that the deductible debts were those growing out of the business of the local branch and that there could not be deducted an amount as apportioned of the total indebtedness of said foreign corporation.

A similar question was before this department in 1914. See Annual Report of the Attorney General, 1914, Vol. II, page 1578. The question related to the same corporation as was involved in the case of *Hubbard vs. Brush*, supra, and was as to whether or not such foreign corporation, for the purpose of arriving at its taxable credits, could deduct from the gross amount of all accounts payable to it at the Columbus office, a proportional share of the debts of the company incurred in the purchase of raw material and for other purposes in connection with the process of manufacturing, such debts being those of the corporation in general and not directly, at least, attributable to the Columbus branch. In other words, was the right of the company to deduct debts limited to such debts as were incurred by the Columbus office directly?

It was stated in the opinion of 1914, above cited, that :

"The laws of Ohio do not tax claims and demands as credits but merely the excess or difference between the sum of all claims and demands due or to become due in favor of the tax payer, and the sum of all legal bona fide debts by him owing."

After citing the case of *Barnes vs. Flummerfelt*, 21 Wash. 498, the opinion continued as follows :

"Of course, the firm claimed the right to deduct all its debts from its credits which were localized in Washington for the purpose of arriving at its taxable credits. The Supreme Court of Washington denied the right to make the deduction on the ground that the two businesses were separate and distinct and that the only debts which should be deducted from the business credits taxable in Washington were those debts arising out of the business there conducted.

* * * As I have pointed out in dealing with the subject of situs, credits can be localized in a state, if belonging to a foreign corporation, only upon the theory that the business conducted by the company, or on its behalf,

in the state, can be separated from the main business of the company and considered as a distinct undertaking. Once the separation is made it runs through the entire subject, so to speak, and serves as well to put out of the equation the debts assignable to the main office or manufactory as the credits pertaining to the main office as such. In other words, going back to the case of *Hubbard vs. Brush*, 'the business it transacts in this state' must be considered as a separate and distinct undertaking as well for the purpose of ascertaining the amount of the legal bona fide debts owing on account of the business as for the purpose of ascertaining the sum of the claims and demands due to or to become due to the company on account of that business.
* * *

The opinion then concluded as follows:

"Admitting, then, the seeming injustice of the application of the rule to the case at hand, but being unable to find statutory or other ground for assigning to the business of the Columbus branch of the H. J. Heinz Company any part of the indebtedness of the home office of the company for the purpose of deducting such part from the total sum of the claims and demands due to the Columbus office and arising out of the business conducted by it, I am of the opinion that the only debts of the company which may be deducted from such claims and demands, for the purpose of arriving at its credits taxable in Franklin County, Ohio, are the debts which have been incurred in the course of the business conducted at Columbus, considered as a separate undertaking; that is, such debts as have been incurred by the Columbus office in or by the corporation itself for and on behalf of the Columbus office in such a way as that the relation between a particular indebtedness and the business of the Columbus office can be definitely shown and ascertained. Inasmuch as the company does not claim the existence of any indebtedness of this class, but asserts merely the right to deduct either all debts of the company owing to persons residents in Ohio or a proportionate part of the debts of the company assigned to the Columbus office on the basis suggested by the sales of the Columbus office, as compared with the sales of all the other branch offices of the company, I am of the opinion that both of these claims of right, should be denied, and that the company should be limited to the deduction of such indebtedness as has been created by or in behalf of the Columbus agency and that only."

Specifically answering your question it is my opinion that the only debts deductible in the instant case are those growing out of the conduct of the business by the Cleveland branch of said corporation.

Respectfully,
EDWARD C. TURNER,
Attorney General.

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APPROVAL, FINAL RESOLUTION ON ROAD IMPROVEMENT IN
HARDIN COUNTY.

COLUMBUS, OHIO, June 19, 1928.

HON. HARRY J. KIRK, *Director of Highways, Columbus, Ohio.*