FRANCHISE TAX: Capital stock notes not exempted.

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State Tax Commission
Jefferson City, Missouri

Attention of Mr. A. J. Murphy;

Gentlemen:

This department acknowledges receipt of your request for an opinion of this office on the following matter:

> "The Corporation Franchise Tax law in Section 4641 levies a tax on corporations of 1/20 of one per cent of the par value of its outstanding capital stock and surplus, and the courts have construed 'surplus' to mean the difference between the amount of outstanding capital stock and amount of assets, excluding liabilities.
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> There is a proviso in Section 4641 which says 'bank deposits shall be considered as funds of the individual depositor left for safe keeping, and shall not be considered in computing the amount of tax collectible under the provisions of this article.'
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> We have interpreted the law to mean that all of a banks assets above deposit liabilities are capital and surplus.
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> It is our opinion that no deduction can be made from such determined capital and surplus because of the preferred stock or capital notes issued by such banks and owned by the RFC.

> We would like very much to have an opinion from your Department as to whether or not preferred stocks and capital notes owned by the RFC corporation are deductible liabilities under the Corporation Franchise tax law."

Section 4641 Revised Statutes of Missouri 1929, provides in part as follows:

> "For the taxable year of 1929 and thereafter every corporation organized under the laws of this state shall, in addition to all other fees and taxes now required or paid, pay an annual franchise tax to the state of Missouri equal to one-twentieth of one per cent of the par value of its outstanding capital stock and surplus, * * * * * *"

A franchise is a right and a franchise tax is a tax on the right to do business. It is not a tax against the physical property but it is a tax or license exacted by the State because the State permits the party taxed to do business within the state. In the case of State vs. Pierce Petroleum Corporation, reported in 318 Missouri, 1020, the Supreme Court of Missouri says, l. c. 1027:

> "The tax is not a property tax, but an excise levied upon the privilege of transacting business in this state as a corporation. State vs. Tax Commission, 282 Mo. 213."

In the case of State ex rel. Marquette Hotel Investment Company vs. State Tax Commission et al., reported in 221 S. W. at page 721, the Supreme Court of this State in Banc discussed the question you inquire about. At page 722 the opinion therein states as follows:

"It clearly appears, by reference to sections 1 and 2, that the fundamental idea in the mind of the Legislature was that a corporation doing business wholly in this state should be taxed under the provisions of this act upon two things: First, upon the amount of its outstanding capital stock, regardless of the value of its assets, whether more or less than the amount of the outstanding capitol stock; and, second, upon any surplus property employed in its business in this state. The tax is levied not upon the property itself, but upon the right of the corporation to transact business in this state. The references to the amount of the authorized capital stock and to the amount of the surplus are made solely for the purpose of pointing out a method of determining the amount of the tax. It is, of course, obvious that a corporation may be authorized to issue a very limited amount of capital stock, and may, in fact, in the case of a domestic corporation, have outstanding only one-half of the capital stock which it is authorized to issue. But the amount of capital stock outstanding is by no means the measure of the amount of capital which the corporation may use in its business. It commonly happens that, upon the organization of a corporation, all or so much of its capital stock as is required by law to be paid up is paid up, and in addition thereto a sum is contributed by the stock holders as a means of establishing and reinforcing the credit of the corporation. There is no limit to the amount which may be so contributed. A corporation organized and authorized to issue capital stock in an amount not exceeding $2,000 may borrow and employ in its business any sum whatever. The result is that a corporation with a minimum stock subscription may actually employ huge sums of capital in its business. It might well happen that no part of this

> total employed in business, in excess of the amount of the outstanding capital stock, would be surplus in the ordinary acceptation of that term. If this excess were borrowed money, the amount so borrowed would constitute a liability; but the corporation would nevertheless be employing the amount of that liability in business. The money so borrowed, or the property purchased with that money, would be assets of the corporation. The corporation would have the right to use and actually would be using, under its franchise, not only the amount of its outstanding capital stock, but all of the money so borrowed. This it has a right to do, and it is that right which the General Assembly intended to tax by the enactment of the statute here in question."

Continuing, l. c. 723, the opinion says:

> "The Constitution thus declares that taxes shall be uniform and in proportion to the value of the property taxed. (note that it is the value of the property, not the value of the owner's interest therein, that is to be taxed.) These provisions are intended to secure uniformity and equality in taxation, so far as possible, and they apply to all taxpayers, both natural and corporate, and to franchise as well as to property taxes.
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> Relator contends that its indebtedness should be deducted from its surplus assets for assessment purposes. But is any natural person allowed to deduct his indebtedness from his assets, before giving his property in for assessment for taxation? Not at all. It is well known that this has never been the policy of this state. Now a franchise may be granted to natural persons

> as well as to corporations, and may be taxed when owned by the one as well as when owned by the other. Why should the Legislature be supposed to have intended to depart from the constitutional rule of equality and uniformity merely because this is a franchise tax? It cannot be presumed that the law intends in matters of taxation, to extend to corporations a favor which it denies to natural persons."

At page 726 thereof, on Motion for Rehearing, the Court speaks as follows:

> "A franchise tax is not one levied upon property, but one placed on the right to do business. It may be graduated according to the extent of the business done. The act before us contemplates a tax upon the right to do business in accordance with the property actually used in the business.
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> Franchise taxes, to be fair, should be measured by the volume of business. The volume can best be measured by the property used in the business. To illustrate, one corporation has $1,000 of its own, and starts a business with it as its capital stock. It keeps within its capital stock. The volume of its business necessity is small. On the other hand, another corporation has $1,000 of its own (in capital stock) and borrows $49,000, and with the $50,000 starts the same kind of business. It should do many times the business of the other, and its tax upon the right to do business should be proportionately greater."

We think the Supreme Court of this State in Banc, in the above case has answered your inquiry to the effect that the Mississippi Valley Trust Company is not entitled to have deduction in the payment of its franchise tax by reason of or on account of the fact that it has as a part of its capital structure $500,000 of capital stock notes held by the Reconstruction Finance Corporation.

The franchise tax is not a tax on the capital stock notes but is a tax on the right of the Mississippi Valley Trust Company to do business, and as is stated in the above opinion, the corporation which only has $1,000 of capital stock and keeps within its capital stock, does a smaller business than the other corporation therein mentioned which has a capital stock of $1,000 and borrows $49,000 and uses the $50,000 with which to operate its business. Likewise, the Mississippi Valley Trust Company in the eyes of reason, and we think the law, by reason of expanding its capital with this $500,000 of capital stock notes does a greater business just as the above corporation who borrows $49,000 would do a greater business. The Supreme Court in the above case says that the corporation which has the larger assets should do many times the business of the other and its tax upon the right to do business should be proportionately greater. As stated in the case of Title Guarantee Loan and Trust Company vs. State, 155 So. 305, by the Supreme Court of Alabama, l. c. 307:

> "In fixing the measure of the excise tax the legislature may and should have regard to the value of the privilege to the taxpayer."

We think that it is immaterial as to who owns the $500,000 capital stock notes, as it is not the capital stock notes which are taxed or upon which a franchise tax is collected, but it is the right of the corporation to do business that is taxed: The value of that right to be measured by the corporation's capital and surplus. The $500,000 of capital notes are a part of the capital structure and should be considered as such in the assessment of the tax. While we do not pass upon the problem as to whether or not the notes themselves are taxable, for the purpose of your inquiry we deem that issue immaterial, for even though a tax might not be levied directly against them it is proper to use and consider them as a part of the capital structure in measuring the amount of tax to be paid by the Trust Company.

The State of Massachusetts exacts a franchise tax somewhat similar to the tax required by the State of Missouri. The question was presented to the Court as to whether it was proper to consider shares of stock of a national bank in measuring the amount of franchise tax. In the case of A. J. Trower Company vs. Commonwealth, 111 N. E. 966, the Supreme Judicial Court of Massachusetts, passing upon this question stated, l. c. 968:

> "The tax levied upon the plaintiff in determining the amount of which these shares were considered is strictly an excise and not a property tax. It is an excise upon the privilege or commodity or franchise of existing and doing business as a corporation* * * *It is no objection to the validity of such an excise tax that in measuring its amount consideration is given to property which could not be taxed, such as government bonds. Com. vs. Hamilton County, 12 Ala. 298. Affirmed in 6 Wahl, 611, 18 L. Ed. 907."

And at l. c. 969 it is held:

> "The franchise tax upon the plaintiff not being a tax upon property is not taxation upon its shares of national bank stock."

In order to avoid misunderstanding that might arise we call attention to the fact that this opinion is written concerning the Franchise Tax and the opinion written by this Department on February 19, 1935 to your Commission, concerned the Ad Valorem Tax.

Our conclusion is that preferred stocks and capital notes owned by the Reconstruction Finance Corporation are not deductible liabilities under the corporation franchise tax law and that in the instant case no deduction should be made on account of the $500,000 capital stock notes held by the Reconstruction Finance Corporation in assessing and collecting the corporation franchise tax.

Yours very truly,

DRAKE WATSON,
Assistant Attorney General

APPROVED:

ROY McKITTRICK,
Attorney General.

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