OPINION NO. 1115

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

FILED

JAN 6 1974

Superior Court of the District of Columbia Tax Division

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| CAPITAL HOLDING CORPORATION, Petitioner | : | |
| v. | : | No. 2215- |
| DISTRICT OF COLUMBIA, Respondent. | : | |
| and | : | |
| CAPITAL HOLDING CORPORATION, Petitioner | : | |
| v. | : | No. 2248- |
| DISTRICT OF COLUMBIA, Respondent | : | |

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

These consolidated cases are before the court on petitions filed by Capital Holding Corporation against the District of Columbia. Capital is a Kentucky corporation seeking a refund of corporate franchise taxes and interest thereupon paid to the District for the calendar years 1970, 1971 and 1972 in the following amounts:

| | Tax | Interest | Total |
|---|---|---|---|
| 1970 | $69,071.22 | $7,597.83 | $76,669.05 |
| 1971 | $84,308.88 | $4,215.44 | $88,524.32 |
| 1972 | $102,294.71 | $5,626.21 | $107,920.92 |

The court has had the benefit of briefs from counsel, argument on two occasions and the testimony of one witness. Briefly stated, the factual picture that presents itself (as set forth in the stipulation of the parties) is that Capital Holding Corporation is a holding company which owns 99% of the stock of Peoples Life Insurance Company, a District of Columbia corporation, with home offices in the District of Columbia. Peoples does business in 14 states and the District of Columbia and pays the 2% net premiums tax imposed by 47 D.C. Code §1806 on "policy and membership fees and net premium receipts or consideration received on all insurance and annuity contracts on risks in the District of Columbia."

Peoples pays a net premiums tax in each of the states in which it does business, with respect to the contracts written in those states.

During the three years at issue before the court, Peoples paid dividends to Capital Holding Corporation and the District of Columbia imposed a tax on Capital Holding Corporation under 47 D.C. Code §1571(a) with respect to its receipt of those dividends from Peoples.

Capital Holding Corporation opposes the imposition of the tax on the dividends on three grounds:

1) That it is not subject to District of Columbia Franchise tax, 47 D.C. Code §1571(a), because it is not engaged in any trade or business within the District of Columbia;

2) That 47 D.C. Code §1580 precludes imposition of the tax on a dividend paid to one corporation by another corporation which is subject to D. C. income tax;

3) That upholding the tax as assessed by the District would be unconstitutional.

Petitioner's first contention is dependent upon construction of Title 47, D.C. Code §1571(a). Section 1571(a) authorizes imposition of tax "for the privilege of carrying on or engaging in any trade or business within the District and of receiving income from sources within the District . . ."

It is the position of Capital Holding Corporation that the statute is to be read in the conjunctive; that they are not engaged in business in the District; and that they therefore are not subject to taxation under §1571(a). It is the opinion of the court that the statute was intended to be read in the disjunctive. The authorities in this jurisdiction, which are binding on the court, have consistently construed the statute in the disjunctive. The well reasoned opinion of Judge Jo V. Morgan, in Consolidated Title of D. C., Docket Nos. 1642-1660, Opinion No. 962 (Mar. 17, 1959), aff'rmd. 107 U.S.App.D.C. 211 (1960), points out, among other things, that if a conjunctive reading is applied to the statute, one result that would necessarily follow is that if a corporation is engaged in business in the District but is not receiving other income from a source within the District, it would not be liable for

the franchise tax. Now, as then, the court does not believe that such was the intent of the statute. The case of D. C. v. Virginia Hotel, 92 U.S.App.D.C. 186, has also construed the statute consistent with this position. The statute is to be read in the disjunctive.

Capital Holding Corporation is taxable under §1571(a) because it has received income from sources within the District and this is so without regard to whether or not it was engaged in business in the District. Therefore, Capital Holding Corporation's first contention is rejected and the court need not, and therefore will not, decide whether or not Capital Holding Corporation was "doing business" in the District.

Capital Holding Corporation next contends that the language of §47-1580 precludes the dividend paid from Peoples to Capital from being treated as income to Capital. It is true that §1580 provides that a dividend paid by a corporation taxable under subchapter II, of Chapter 15, Title 47 of the D.C. Code, to another corporation is not to be considered as income from sources within the District of Columbia for purposes of subchapter II. However, Peoples is not subject to taxation under subchapter II. As an insurance company, it pays only a net premiums tax under Title 47, Chapter 18. Capital Holding Corporation argues persuasively that since 47 D.C. Code §1806 specifically states that the net premiums tax shall be in lieu of all other taxes (with certain exceptions not material to this issue), that the privilege afforded other corporations by virtue of payment of income and franchise taxes should be afforded insurance corporations by virtue of their payment of the net premiums tax, which is in lieu of such income and franchise tax.

Once again, however, the Consolidated Title case has dealt with this question in this jurisdiction. Judge Morgan, quoting Mertens, Federal Income Taxation, §3.08, wrote that "deductions, like exemptions, are privileges, and must be narrowly construed." The petitioner, a title company, was subject to a gross receipts tax under Title 47, Chapter 17,

which, like the net premium tax that Peoples was subject to, was the only tax that the petitioner paid. Since the petitioner was not subject to Income and Franchise tax, the deductions for intercompany dividends allowable thereunder were therefore not available to the petitioner. Peoples was not subject to income taxation and therefore Capital Holding Corporation cannot, by liberal construction, be afforded the deduction allowed to those corporations which receive dividends from corporations which are subject to such tax.

Further support for this position can be found in the legislative history of the 1974 Amendment of 47 D.C. Code §1580. The statute was amended so as to extend the intercorporate dividend exclusion to corporate recipients of dividends from insurance corporations taxed on net premiums, under Title 47, Chapter 18. The statutory change, which does exactly what petitioner is asking the court to do in this case, is to be effective for all taxable years ending after December 31, 1973. The bill changing the statute originally made the change effective for all taxable years ending after December 31, 1969, but the effective date was changed by amendment to the bill prior to its passage.

The soundness of petitioner's logic is supported by the enactment of the bill, but the effective date was clearly intended to be taxable years beginning after December 31, 1973. This court cannot do what the legislature not only failed to do but specifically declined to do. Accordingly, there can be no intercorporate dividend exclusion applied to the income Capital Holding Corporation received from Peoples for the years 1970, 1971 and 1972.

The last question raised by Capital is that of the constitutionality of taxing dividends received by a foreign corporation not doing business in the District to the extent that the source of the earnings from which those dividends are paid is other than the District of Columbia. The contention is that such a construction would constitute a due process violation. The cases relied upon by Capital have been considered by the

court but do not seem sufficiently analagous factually to be controlling. Those cases each involved a single corporation and the relationship of a particular tax imposed by a state upon that corporation to income earned outside the taxing state. The analogy would be if the District of Columbia was attempting to impose the net premiums tax on all of Peoples' income. To the contrary, Peoples pays net premiums tax to the District of Columbia only on premiums received from contracts written on District of Columbia risks. The tax in question here is imposed on Capital Holding Corporation and not on Peoples. All of the dividends Capital receives from Peoples come from the home office in the District of Columbia. Capital contends, however, that the income upon which the dividends are based is earned outside the District and that the District therefore has no rational basis by which it can tax such income to Capital. The closest case factually is, interestingly, a Kentucky case, Atlantic Coast Line Co. v. Commonwealth, 302 Ky. 36, 193 S.W.2d 749 (1946).

The decision of the Kentucky Court of Appeals is of course not binding on this court and moreover, as petitioner points out in its brief, the court was concerned with placing a burden on commerce and not with constitutionality. The law of the District of Columbia on this issue is also expressed in Consolidated Title, where the subsidiary corporations were in fact earning income outside the District of Columbia. The court held that the concern was not with the sources of their income, but only with the sources of petitioner's income. Here petitioner is Capital Holding Corporation and the source of its income is Peoples. Under Consolidated Title the subsidiaries were a source within the District since, as in the instant case, they had their principal offices and businesses in the District; they were domiciled therein, corporately and commercially.

Other Supreme Court authorities have been found by the court that cast light upon the contentions of the petitioner. The court commented, in Shaffer v. Carter, 252 U.S. 37 (1920),

> ". . . since it is settled that nothing in [the Constitution] or 14th Amendment prevents the states from imposing double taxation, or any other form of unequal taxation, so long as the inequality is not based upon arbitrary distinctions."

In the case of State of Wisconsin v. J. C. Penney Co., 311 U.S. 435 (1940), the court said:

> "A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it is given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society."

Based on the teachings of these and other cases on the subject, the court finds that although the tax at issue here may have been burdensome while it existed, it was not so unrelated to the District nor so arbitrary as to be constitutionally defective.

In view of the above-stated findings of fact and conclusions of the law, it is therefore adjudged that petitioner's appeal be and hereby is denied.

January 6, 1975

William E. Stewart, Jr.
Judge

cc:
SERVED AS FOLLOWS: Jan. 7, 1975

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