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The Status of Foreign Holding Company
Edward M. Bullard, of the Chicago Bar.

If the laws regarding the organization and regulation of corporations were uniform throughout the states, there would be no apparent necessity for the incorporation of companies in states where it was not intended that they carry on business. This condition, however, is almost wholly imaginative. Local policy has prompted states to offer inducements to business enterprises to become incorporated under their laws which other states have not seen fit to grant. At present there may be sound business reasons for the organization of corporations in states other than those in which they propose to conduct their entire operations. Especially is this true of holding companies. In many instances the general corporation acts of the states drafted before holding companies in the modern sense were known are in no manner adapted to the formation thereunder of corporations of this type. In other states legislatures have provided laws making possible the setting up of the holding company structure on a very workable basis and authorizing the issuance to such companies of charters notably free from undue burdens and restrictions. These are facts of common knowledge. But the problems of these corporations do not end there. What is their legal position when they establish themselves in other jurisdictions purposing there to do whatever acts their charters authorize and intending to maintain in the state of their creation nothing but the bare corporate personality?

The statutes of the states universally require foreign corporations to procure from the Secretary of State or other state officer, a license or certificate of authority before transacting business in the state. Failure to procure such a certificate is generally held to disentitle a foreign corporation doing business in the state to bring any action in any court of the state. Conversely, the want of a license will not constitute a defense to the corporation when sued, for example, on a contract made by it in the state. Statutes frequently provide that persons acting as officers, agents or directors of the corporation who shall assume to exercise corporate powers in the name of such corporation before it has been authorized to do business in the state, shall be individually liable for all debts contracted by them in the corporate name. To what extent are these penalties and restrictions applicable to holding companies?

Suppose in a suit wherein a foreign holding corporation is made defendant the company endeavors to have set aside service of process on an officer or agent on the ground that it was not doing business in the state and hence not “in” the state for the purpose of service of process. Would such a contention be likely to prevail, notwithstanding the fact that the defendant was performing in the state the usual functions of a holding company?

Most of the states, if not all, impose upon corporations an annual license fee or franchise tax. This tax is commonly assessed at a certain rate upon that proportion of the authorized capital stock represented by “business done and property located in the state” or upon “the capital employed in the state” by corporations doing business in the state or the assessment is made on some other quite similar basis. These taxes, it is true, are applicable alike to domestic and foreign corporations, but the essential factor or one of the essential
factors in every case is the doing of business within the state by the corpo-
ration. The question, therefore, readily suggests itself whether a holding
corporation and particularly a foreign holding corporation, exercising within
the state its ordinary offices is doing business within the state so as to be
subject to these franchise tax statutes.

A holding company in the accepted sense is chartered to acquire, own,
hold, vote and administer the stock of subsidiary companies of a designated
class. For these purposes it may maintain an office where its books will be
kept, its directors' and stockholders' meetings held, the dividends on the stock
of its subsidiaries received from which the interest on its obligations and divi-
dends on its stock will be paid, and for the administration of all the other
affairs of the corporation. It may maintain a bank account, deposit the stock
of is subsidiaries and its other securities with safe deposit companies or pledge
such stock and securities with a Trustee as collateral for its own obligations.
All this may be done within a particular jurisdiction. Does all or any of this
constitute the doing of business in the state? The answer cannot safely be
given "Yes" or "No." The nature of the case which gives rise to the inquiry
should first be noticed. In an ordinary civil suit may the defendant plead
in bar of the action that the plaintiff holding company is an unlicensed foreign
corporation and hence that the contract or claim is unenforceable at the suit of
such a plaintiff brought within the state? This was answered in the affirmative
by the United States District Court for the Eastern District of Pennsylvania
in an interesting case\(^1\) in which the corporation on whose behalf the claim
was being asserted was a Delaware holding corporation owning a controlling
interest in the stock of several Pennsylvania and New York subsidiaries.
Nothing was done by the Delaware company except to exercise control over
the subsidiary companies through its stock ownership, but all of the customary
acts incident to such control were performed in Pennsylvania. The meetings
of its directors were held in Philadelphia. Its books were in the custody of
its executive officers and clerks in Reading and all of the clerical work of the
company was done there. Its banking was done in Pennsylvania and its secu-
rities were deposited with a Pennsylvania trust company under the company's
mortgage. The company was not licensed to do business in Pennsylvania.
The court held that it was doing business in the state in violation of the
foreign corporation statutes and that the claim could not be prosecuted. The
decision was affirmed by the Circuit Court of Appeals\(^2\) where it was said:

"It will thus appear this company was called into being to do local
Pennsylvania work. It had no purpose to exercise its charter power
elsewhere than in that state, and it made no effort or pretense so to do.
Everything it did was a local act and in fulfillment of the local purpose
for which it was created."

It is regrettable that the court did not content itself with this statement.
The fact was cited in support of the above conclusion that certain of the sub-
sidiaries of the Delaware company were actually engaged in business in Penn-
sylvania. Conceding that it is easier to regard as the transaction of business
the acts of an operating company than those of a holding company, it is sub-
mitted that the situs of operations of a subsidiary should have no bearing

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\(^{1}\)In re Montillo Brick Works, 163 Fed. 621.
\(^{2}\)172 Fed. 310.
whateversoever on the legal question of whether or not the holding company is doing business within the meaning of the statutes of a particular state. The subsidiary companies may be doing business in the state of the parent company's incorporation, or in the state where its office is maintained, or in some third state, or in all or any two of such states. It is gratifying to see that the courts for the most part have dismissed these considerations as irrelevant to the issue. All of this harks back to the age-old controversy as to how far and under what circumstances the so-called corporate fiction may be disregarded, or better stated, when may the distinction between the corporation and its stockholders be overridden? No one would seriously contend that an individual residing in state M owning and holding stock in a corporation doing business in state N was simply by virtue of his stock ownership engaged in business in State N. The fact that the owner of the stock is a corporation instead of an individual, should make no difference. The nature of the acts done by the holding company itself should determine whether such company is doing business, and not the acts of a separate legal entity.

While an individual who invests his money in the stock of corporations, receives dividends and votes the stock, is not regarded as a business man by reason of these acts alone, a holding company stands somewhat differently. Although its business is of a peculiar nature in that it does not manufacture, buy or sell tangible things, but simply invests its capital, collects and distributes the proceeds from the investment and thus, as put by one Judge, is really nothing more than "an incorporated gentleman of leisure," still it is incorporated to do business for a profit and practically speaking is a business corporation. It appeals to one as reasonable and fair that the statutes of the several states requiring foreign corporations to procure a license to do business in the state should be held applicable to holding companies and that such companies upon failing to procure a license should be subjected to all of the penalties which may be invoked under the laws of the state against ordinary corporations.

No special considerations enter in, it is believed, to alter the rule in those cases where the foreign holding company is made defendant in the action and seeks to set aside service of process on an officer or agent for the reason that it is not doing business in the state at the time service is had. The validity of service of process was sustained by the New Jersey Court of Chancery in Groel v United Electric Company of New Jersey,1 where it was made upon the New Jersey agent of the United Gas Improvement Company, a Pennsylvania corporation. This company had caused to be formed in New Jersey a subsidiary corporation whose bonds and stock were issued and delivered to the Pennsylvania company. These securities were then used to acquire by way of exchange the stock of several other New Jersey corporations. The Pennsylvania company thus became so far as its New Jersey activities were concerned a true holding company. The decision that these acts constituted doing business so as to render effectual the service of process, clearly is right.

In Conley v. Mathieson Alkali Works,2 the defendant contended that it had not been properly served with process, service having been had on a director of the company in New York state. The defendant was a Virginia corporation

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2 Conley v. Mathieson Alkali Works, 69 N. J. Eq. 397; 60 Atl. 822.
owning the entire stock of a corporation whose plant was located in New York and all of whose business was done there. It did not appear that any of the business of the defendant incidental to the ownership of this stock was performed in New York. The United States Supreme Court held that the mere ownership by the defendant company of the entire stock of the company engaged in manufacturing its product in New York did not amount to a transaction of business in New York by the defendant,—the two corporations being separate legal entities.

The bare fact of ownership of stock by a foreign corporation in a domestic corporation even though it be a controlling interest should never be regarded as the transaction of business.

The more difficult question,—yet at the same time a more interesting one,—is that of the applicability of the franchise tax statutes of the several states to holding companies, and especially to foreign holding companies. For some years prior to 1917 the New York franchise tax law imposed a tax on corporations doing business in the state providing that "the amount of capital stock which shall be the basis for tax * * * shall be the amount of capital employed within this state." The first case of importance decided by the New York Court of Appeals construing this statute with reference to holding companies is People ex rel Chicago Junction Railways and Union Stock Yards Co. v. Roberts. There the relator was a New Jersey corporation having invested its entire capital in the stock of the Union Stock Yard & Transit Co., an Illinois corporation. This stock was held in New York and substantially all of the usual functions of the relator as a holding company were performed in that state. The court agreed that the relator was doing business in New York, but the majority of the justices felt that no capital was employed in New York within the meaning of the statute and that no franchise tax was assessable.

"There can be no claim in this case that the income of the relator received from the Illinois corporation, and disbursed in New York City, was converted into capital. It is doubtless true that the income from its investment in the Illinois corporation, when received, was the property of the relator within this state. But it was not capital, but the profits from capital. * * * The fact is that the whole capital of the relator had already been employed in the purchase of the shares of the Illinois corporation, and remained so invested. All that was done by the relator at its New York office was to receive and distribute the dividends or income from the Illinois investment. * * *"

There was a dissenting opinion, the purport of which is contained in the following quotation:

"The statement that its capital stock was invested in business in Chicago is misleading, for it had no capital stock invested in business there. Its capital stock was invested in certain shares of stock of a company that invested its capital stock in business in Chicago."

The doctrine of this case was reaffirmed by the Court of Appeals in a comparatively late case, People ex rel Manilla Electric Railroad & Light Corporation v. Knapp. The relator holding company was there a Connecticut corpora-
The capital of the company was principally invested in utilities operating in the Philippine Islands. The court said:

"The relator in 1903 sent or invested the entire of its issued capital stock for employment in the Philippine Islands. The assets it thus acquired were in effect deposited in a safety deposit vault. They were removed from business as effectively as though in the safety vault in Manilla or the state of New Jersey. They were passive. They maintained or aided no enterprise or activity in this state. The acts of the relator within this state did not require the use here of any part of its capital. It employed or used no moneys other than those derived as dividends or interest on the stocks or obligations of the foreign corporations operating wholly without this state. * * * The assets of the relator consisted of the shares of stock and the obligations of other corporations foreign in their origin, property and operations, from which, in interest and dividends, its entire income was derived. * * * A foreign corporation may be within this state for corporate purposes and not be doing business here within the meaning of taxing statutes. * * * The activities of the relator related to the management of its internal affairs, the owning and holding of property and the distribution of its avails. * * *

It is not correct reasoning to assert that the relator must be doing business in New York because it was not doing business in New Jersey. A corporation is not more bound to pursue the activities of business than is the private citizen. It may, as may be, enter into and then retire from business, or refrain from business. Nor is every exercise of its chartered powers and purposes the doing of business within the purview of the tax law. We hold that under the facts presented the relator was not, within the year ending October 31, 1916, doing business in this state within the intendment of sections 181 and 182 of the Tax Law."

The New York tax laws were generally revised in 1917, and one section of the new law expressly exempts from the franchise tax "holding corporations whose principal income is derived from holding the stocks and bonds of other corporations."

The State of Pennsylvania for some years has had what it terms a Capital Stock Tax which is in reality nothing other than a franchise tax in that it is payable by domestic corporations and by foreign corporations doing business in the state,—the tax being based upon the capital stock employed or used in the commonwealth. The Pennsylvania Supreme Court has taken the same view as to the operation of this tax in the case of holding companies as was taken by the New York Court of Appeals with respect to the similar tax of that state. The leading case is The Appeal of Callery.¹ The holding company concerned was the Gulf Oil Corporation, organized under the laws of New Jersey, with authority to acquire the stocks of subsidiary companies engaged in the business of producing and marketing petroleum products. The New Jersey Company acquired all of the stock of the Gulf Refining Company, a Texas corporation. The New Jersey Company did not own any tangible property in Pennsylvania, but all of its affairs as a holding company were

¹116 Atl. 222.
carried on there. In deciding that no capital of the New Jersey Company was employed in Pennsylvania so as to render the company liable to the tax in question, the court said in part:

"As the business relating to charter purposes of the company 'holding the stock of subsidiaries' was conducted in Pittsburgh, where its board of directors met, this, it is urged is doing business liable to taxation, though the holding company owned no property in the state.

Acts in conformity to, and in furtherance of, the sole business purpose of a going concern undoubtedly represent 'doing business'; but such acts alone do not constitute 'doing business in and liable to taxation,' the situation which our taxing statute requires, and through which appellee bases his contentions as to the nontaxability of his shares here in question. The act recognizes a distinction between doing business that requires registration to bring a company within reach of legal process, and doing business in and liable to taxation. * * * The Gulf Oil Company is doing business within the meaning of the registration act, while its capital stock is not liable to a state tax through lack of taxable value."

The present Illinois Corporation Act requires the payment of a franchise tax at a fixed rate on the proportion of the capital stock of the corporation "represented by business transacted and property located in this state." The following section of the act states that in ascertaining the amount of the authorized capital stock represented by business transacted and property located in the state the sum of the business transacted in the state and the total tangible property of the corporation located within the state shall be divided by the sum of the total business of the corporation and the total tangible property wherever situated. It is to be noted that the basis for the tax is made the business transacted in the state and the tangible property located in the state. Section 137 of the Corporation Act in defining tangible property expressly excludes shares of stock, bonds, notes, etc. Since the great bulk of the property of holding companies usually consists of intangibles, it might be concluded that the Illinois statute is not designed to cover holding companies at all. The Supreme Court of the state has not as yet had the question before it.

The above mentioned tax cases are by no means exhaustive of the authorities, but are fairly representative of a marked tendency to exempt holding companies from liability for franchise taxes. Technically the dissenting opinion in People ex rel Chicago Junction Railways & Union Stock Yards Co, v. Roberts, supra, seems sound. The contrary view which, nevertheless, prevails may perhaps be ascribed to some theory similar to that which is responsible for the exemption of corporate stock from personal property taxes when the corporation is itself required to pay a tax on its capital stock. Still, this exemption so far as is known has never been extended to stockholders of a corporation whose capital stock tax is paid in another state. The analogy is therefore unsatisfactory. In any event, this gesture of liberality toward holding companies in franchise tax matters is as welcome as it may be surprising. From the business standpoint it is certainly defensible. Whether it be so from the legal standpoint is a question that cannot advisedly be answered in the absence in most states of any expressed legislative policy with special regard to holding companies.