

SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
TAX DIVISION

GAL-TEX HOTEL CORPORATION :
Petitioner, :
v. : Tax Docket
: No. 3698-85
DISTRICT OF COLUMBIA :
Respondent. :

O R D E R

This matter came before the Court for hearing on Cross-Motions for Summary Judgment filed by Petitioner, Gal-Tex Hotel Corporation, hereinafter "Gal-Tex", and Respondent, District of Columbia, hereinafter "the District". Gal-Tex challenges the District's determination that certain rental income and interest was apportionable business income subject to corporate franchise taxes, Gal-Tex further maintains that the District's taxation of this income would result in Gal-Tex being exposed to double taxation. The District maintains that its determination was accurate and the Notice of Tax Deficiency for Gal-Tex's 1981 Franchise Tax Return was properly issued.

MATERIAL FACTS NOT IN DISPUTE

1. Gal-Tex is a corporation with its principal office at 2302 Post Office Street, Moody National Bank Tower, Room 504, Galveston, Texas 77550. Gal-Tex's mailing address is P.O. Box 59, Galveston, Texas 77553.
2. Gal-Tex owned and operated hotels in the District of Columbia, Alabama, Texas and Tennessee during Tax Year 1981.

3. Throughout 1981, the relevant tax year in dispute, Gal-Tex owned and operated The Hotel Washington located at 1434 F Street, N. W., Washington, D. C., with a legal description of Lot 803 Square 225.

4. In November 1979, Gal-Tex collected \$973,509 for two of its hurricane-damaged Alabama hotels under a blanket property damage insurance policy. Gal-Tex used a portion of the insurance proceeds to pay the blanket mortgage secured by the damaged hotel (which it did not repair but ultimately sold) and to make repairs to the damaged motor hotel. Gal-Tex invested the remaining \$600,000 in short-term interest-bearing certificates of deposit (CDs). Of the total invested in CDs, \$300,000 remained invested in short-term CDs throughout 1981; Gal-Tex has no record of the investment of the remaining \$300,000 after June 1980.

5. In 1974, Gal-Tex received a \$427,191.31 refund of overpaid pension premiums for non-District employees for the period January 1, 1964 through January 31, 1970.

6. Gal-Tex used the refunded monies to repay outstanding loans to affiliated companies. \$15,000 was placed in the Operating Account of Gal-Tex and the remaining \$412,191.31 was invested in certificates of deposit with Moody National Bank in Galveston, Texas. On December 29, 1980, Gal-Tex redeemed a \$215,000 CD and deposited it in Gal-Tex's Operating Account at Moody. On February 22, 1982, Gal-Tex used certificates of deposit totalling \$412,191.31 to secure a \$600,000 line of credit as a security for industrial revenue bonds. It was anticipated that these CDs would be released in 1988.

7. Gal-Tex invested approximately \$1,012,191 from the insurance proceeds and the pension refund principal in highly liquid CDs with staggered maturity dates ranging from 30 to 180 days.

8. On Gal-Tex's Consolidated Financial Statement for 1981, the amounts invested in its CDs was carried as current assets and cash equivalents.

9. The total interest income earned in 1981 was not specifically earmarked for any purpose and was placed in the general cash account of Gal-Tex. Gal-Tex contemplated that the interest income would be used in connection with developing hotel or motel properties.

10. Gal-Tex owned several hotels in other states. These hotels had small amounts of space set aside for small specialty shops. In 1981, Gal-Tex received \$73,854 of rental income from leasing such retail shop space from its hotels in Texas and Tennessee.

11. Gal-Tex apportioned its depreciation expenses including depreciation of the rental shop space at issue on its 1981 D. C. Tax Return while allocating the rental shop income at issue outside of the District. The rental income received from the leased shops was placed in Gal-Tex's general operating account and treated as part of its corporate revenues.

12. Gal-Tex earned income in 1981 from a variety of rental activities including rental of rooms to guests and rental of space for meetings, conventions, and social receptions at its various hotels. This income was included as apportionable business income on Gal-Tex's 1981 D. C. Tax Return.

13. In addition to filing a tax return in the District, Gal-Tex filed 1981 state tax returns in Alabama, Texas and Tennessee. In each of these jurisdictions, only a percentage of Gal-Tex's income was taxed.

14. On its 1981 D. C. Tax Return, Gal-Tex treated the interest income and the rental income sought to be

apportioned and taxed by the District as nonbusiness income. On December 19, 1984, the District issued a Notice of Tax Deficiency to Gal-Tex for fiscal year 1981 in the amount of \$24,124, representing a \$16,335 deficiency plus \$7,769 of statutory interest. The amount reflects the corporate franchise tax Gal-Tex owed to the District on the interest income from Gal-Tex's short-term interest-bearing accounts and from rental shop income which the District sought to characterize and tax as apportionable business income.

15. Petitioner paid the taxes, and filed this appeal.

CONCLUSIONS OF LAW

"Summary Judgment is an extreme remedy which is appropriate only when there are no material facts in issue and when it is clear that the moving party is entitled to judgment as a matter of law." Spellman v. American Security Bank, 504 A.2d 1119, 1122 (D.C. 1986). The opposing party may prevail only if he rebuts this showing with specific evidence. Id. at 1122.

Petitioner maintains that the interest income earned in 1981 from its insurance proceeds and refunded pension premiums was not "business income" within the meaning of D. C. Code § 47-441. Such income, it urges, is actually nonbusiness income because the interest arose from investments held to produce income for its long-term future business expansion. Petitioner further maintains it was not in the separate business of investing in securities for profit in 1981. Moreover, Petitioner argues that the income earned from the rental of space at its various hotels represents a de minimus part of its overall hotel operation and only D. C. source rental income is subject to tax by the District.

The District maintains that the Notice of Tax Deficiency was properly issued and that Gal-Tex is liable for the tax on its interest income from short-term interest-bearing accounts as well as on the rental shop income properly apportioned.

Definition of Business Income

The District of Columbia adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA"), also referred to as the Multistate Tax Compact, in 1981. D.C. Code § 47-441 (1987). One of the District's purposes in enacting UDITPA was to facilitate the proper determination of local tax liability of multistate taxpayers including the equitable apportionment of their tax bases. Id. at Art. I(1).

Under D.C. Code § 47-441 Art. IV(1)(a), (e) (1987), a multistate taxpayer's income is divided into two classes for purposes of apportionment or allocation and taxation: "business income" and "nonbusiness" income. Business income is defined as:

[I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Id. at Art. IV (1)(a).

In this jurisdiction, the leading case interpreting the statutory definition of "business income" contained in D.C. Code § 47-441 Art. IV (1)(a) is District of Columbia v. Pierce, 462 A.2d 1129 (D.C. 1983). The Pierce court reasoned that the first clause of the statute defining business income sets forth a unitary transactional test by requiring that every transaction, taxable as such, be in the regular course of the taxpayer's trade of business. It

further noted that the second clause of the statute provides an alternative functional test which allows business income to include income from tangible and intangible property if the acquisition, management and disposition of the property constitutes an integral part of the taxpayer's regular trade or business operation, regardless of how sporadically they arise out of those operations. The second clause triggers the application of the alternative tests in order to determine whether income is "business income" subject to apportionment. Id. at 1131.

Interest Income

Under the statutory definition of business income and the interpretative case law, this Court finds that the District correctly characterized the interest income received from Gal-Tex's short-term interest-bearing investments of the insurance proceeds and the pension premium refund as business income apportionable and taxable by the District.

Holiday Inns, Inc. v. Olsen, 692 S.W.2d 850 (Tenn. 1985) and Champion International Corp. v. Bureau of Revenue, 540 P.2d 1300 (N.M. 1975) are cases similar to the case before this Court and demonstrate that other state courts found that interest income from short-term investments of working capital was "business income" as defined in UDIPTA. In Holiday Inns, the court found that interest income was business income where a multistate corporate taxpayer in the hotel business invested working capital in short-term interest-bearing securities, held the funds in a readily liquid form available when needed in the business, and spent both the principal and interest from the investment in operating its hotel business. Holiday

Inns at 854. Similarly, in Champion, the court found that interest income was business income under the functional test when a corporation purchased short-term investments with its excess capital and used the invested principal and interest earned on the principal in its business activities. Champion at 1303. Both of these cases illustrate that income is business income under the functional test when a multistate taxpayer uses principal invested in short-term obligations and the interest earnings thereon for business purposes.

Petitioner's contention that Sperry and Hutchinson Company v. Department of Revenue, 527 P.2d 729 (Or. 1974) ("S&H") illustrates that short-term investment principal and interest may be characterized as nonbusiness income with the proviso that the facts must show that neither the principal nor interest were used in the business. The court in Sperry held that interest income was correctly characterized as nonbusiness income when the taxpayer held the interest from short-term investments pending acquisition of unrelated businesses and pending favorable developments in the long-term securities market and where nothing in the record indicated that the principal or interest in the investments was drawn for use in the business. Id. at 731. The Sperry court also found that interest income from short-term investments to be business income when the same taxpayer liquidated the investments and used the principal and interest to meet business obligations. Id. at 731.

This Court finds that the interest income from Gal-Tex's short-term investments of insurance proceeds and refunded pension premiums is business income under Pierce's functional test. Unlike the facts in the Sperry case, the

facts on the record here support a finding that the principal and interest income were used by Gal-Tex in its hotel business. The CDs were highly liquid with staggered maturity dates ranging from 30 to 180 days. Gal-Tex carried the principal amounts of the investments on its balance sheet as current assets and cash equivalents. As various of its short-term CDs came due, Gal-Tex sometimes chose to reinvest the principal in other short-term CDs but also chose to deposit principal into its operating account where it was available for use in the hotel business. Gal-Tex did not reinvest the interest earned on the CDs and instead placed the interest in its general cash account where it was available for use in the hotel business.

Gal-Tex also argues that the interest income is nonbusiness income because Gal-Tex's receipt of insurance proceeds from a casualty loss to a hotel and of the refund of overpaid pension premiums are not in the normal course of its business. The Pierce holding outrightly rejects Petitioner's contention. Under the functional test, the Pierce court held that insurance proceeds received for a damaged business property are business income. Pierce at 1132. Applying the functional test, this Court finds that the damaged hotels were business properties that were an integral part of Gal-Tex's unitary business as shown by the following evidence: Gal-Tex deposited the revenues from the damaged hotels in its general corporate accounts and used the insurance proceeds for hotel business purposes to invest in CDs, to release a mortgage on the damaged hotel, and to make repairs on the motor hotel.

The reasoning in Pierce also extends to the overpaid pension premiums. Although Gal-Tex is not in the business of receiving refunds for overpayments, Pierce held that the

extraordinary or sporadic nature of the transactions was irrelevant, if the intangible property, here the pension premiums, is an integral part of Gal-Tex's hotel business. Pierce at 1131. Payment of pension premiums on behalf of employees is undisputably an integral part of operating a hotel. Gal-Tex treated the pension premiums as business expenses as shown by the deduction of pension payments on Gal-Tex's 1981 D. C. Tax Return. As with the insurance proceeds, Gal-Tex treated the refund as business income by using a portion of the refund for its immediate business needs to repay business loans.

At oral argument, Petitioner emphasized that principal amounts can be invested in activities so unrelated to a taxpayer's business that the origin of the principal does not control the interest income's classification as business income. In support of its argument, Petitioner cited Gilmore Steel Corp. v. Department of Revenue, 9 Or.T.R. 210 (1982). In Gilmore, the court found that gain from the sale of an industrial center was nonbusiness income to a taxpayer in the steel business because the activities of the industrial center were "discrete" from taxpayer's unitary steel business because no funds from the steel operation were used in the industrial center which was self-supporting, the funds of the two operations were not mingled, and the books, records and bank accounts of the two businesses were kept separately.

The facts in this case do not support the conclusion that Gal-Tex's investments were a discrete activity outside Gal-Tex's unitary hotel business. This Court has found that Gal-Tex used both the investment principal and interest in its hotel business. Additionally, the

principal from the CDs and the interest income were commingled with other business income in Gal-Tex's general cash accounts. Gal-Tex also used only one set of corporate records to account for its CDs and its other business operations.

Finally, Petitioner argues that it is not in the securities business and therefore the income generated from its investments is nonbusiness income. See Champion, 540 P.2d at 1303; Cin. N.O. & T.P. Railway, 684 S.W.2d 303, 305 (Ky. 1984).

Business income is not limited to income from a taxpayer's business alone but also includes income derived from regular investment practices of a taxpayer that are "an integral function of [the taxpayer's] regular business functions." Cin. N.O. & T.P. Railway at 305. The record in this case reveals that Gal-Tex's short term investments were an integral part of its regular hotel business.

The Rental Shop Income

Gal-Tex argues that its rental shop income for Tax Year 1981 is not business income for the following reasons: (1) the rental space is de minimis; (2) Gal-Tex is not in the business of being a landlord; (3) the rental income is produced from a discrete activity, not part of Gal-Tex's unitary business; and (4) the regulations in effect in 1981 may exclude rental income from apportionment under certain circumstances.

Gal-Tex argues that it is not in the business of being a landlord. This Court, however, finds that Gal-Tex's rental shop income is business income derived from the leasing of space in the regular course of the hotel business. The facts on record support the conclusion that the rental shop income was part of Gal-Tex's unitary

business income. Gal-Tex's hotel business involves not only the rental of hotel rooms to guests but also rental of rooms for business meetings, conventions, and social receptions as well as rental of space for shops. Gal-Tex's corporate books show that the shop income was treated as part of Gal-Tex's overall business income and not segregated. The rental income was commingled with other hotel revenues available for use in the overall hotel business.

This Court finds that Petitioner's claim that the rental activity is a discrete activity apart from Gal-Tex's unitary hotel business lacks merit. The facts in this case clearly show that the rental of shops was part of Gal-Tex's unitary hotel business. Courts look for a combination of factors when determining whether a business is unitary. See Pierce, at 1132; Silent Hoist & Crane Co., Inc. v. Tax Division Director, 494 A.2d 775, 785 (N.J. 1985). In Silent Hoist, the following combination of factors lead the court to hold that rental income received by a taxpayer was business income of a unitary business: (1) the record did not establish that out-of-state real estate operations were conducted as a discrete business enterprise; (2) the property was under central management; (3) the income generated by the property was put into the general corporate funds and used as working capital; and (4) the financial records offered strong evidence that the business was integrated and run as a unitary business. Silent Hoist at 785.

Applying the factual indicia cited by Pierce and Silent Hoist to the facts of this case, this Court finds that the record clearly shows that Gal-Tex's rental of retail shop space was not conducted as a discrete business

enterprise. The rental shop income was commingled with the general revenues of the corporation for use in the hotel business. Gal-Tex took a depreciation deduction for the shop area to offset its total apportionable hotel business income in the District for 1981, and Gal-Tex has made no suggestion that the shop rentals were conducted by management independent of the hotel corporations' central management.

Since this Court finds that the rental shop income is business income, Section 309.5 (d)(1) of Chapter 16 of the District of Columbia Rules and Regulations (1981), codified in D.C. Code § 47-441 Art. IV(4) (1987 Repl. Vol.) (providing that rental income is allocated "to the extent that [it constitutes] nonbusiness income) does not apply to the rental shop income.

Double Taxation

Even if Gal-Tex was subjected to some double taxation by other state taxes, the Supreme Court has refused to eliminate all overlapping state taxation of a domestic multistate taxpayer. Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 170-71 (1983). The Court has held that there is no reason in theory why the power to tax income should be exclusive when the income is from a unitary business, part of which is conducted in other states. Mobile Oil Corp. v. Com'r. of Taxes of Vermont, 445 U.S. 425, 446 (1980). Therefore, the fact that Gal-Tex may have been subject to some minimum double taxation does not affect the validity of the corporation franchise tax imposed by the District.

CONCLUSION

For the foregoing reasons, this Court finds that both the interest income and rental shop income are apportionable and taxable business income under D.C. Code § 47-441 (1987 Repl. Vol.).

Wherefore, it is this 31st day of March, 1988,

ORDERED that Respondent's Motion for Summary Judgment is hereby GRANTED; and it is

FURTHER ORDERED that Petitioner's Motion for Summary Judgment is hereby DENIED.

SO ORDERED.



JUDGE IRALINE G. BARNES

Copies to:

Stephen Gray, Esquire
Butler & Binion
1747 Pennsylvania Avenue, N. W.
Washington, D. C. 20006

Laura E. Cohen, Esquire
Assistant Corporation Counsel
1133 North Capitol Street, N. E., Room 238
Washington, D. C. 20002