July 5, 1935.

OPINION NO. 1620

TAXATION, GROSS INCOME; RENTALS AS GROSS INCOME.

Rents derived from leasing of property must be included in the return of "gross income".

SAME; LEASING OF PROPERTY AS "BUSINESS."

Leasing of property and receiving rents therefrom constitutes "business" within the meaning of the Gross Income Tax Act.

Honorable William Borthwick,
Tax Commissioner,
Honolulu, T. H.

Sir:

Pursuant to your request of July 1st regarding the questions raised under the Gross Income Tax Act of the applicability of this tax to persons receiving rents, I have given the problem my consideration and have reached the conclusion that rents from the leasing of property must be included in the "gross income" of the taxpayer. Also that the leasing of property and receiving rents therefrom constitutes "business" within the meaning of the Gross Income Tax Act.

There are two main questions involved: (1) whether a person who is subject to the tax because he is engaged in some activity, the privilege of engaging in which is taxable under the Act, must include in his gross income amounts received as rentals? The answer to this question is found in sec. 1 (6) where "gross income" is defined as including "all receipts, actual or accrued * * *

by reason of the investment of the capital of the business engaged in, including interest, discount, rentals" * * * etc.

Whether the person is in the sole business of renting property or not is immaterial to the answer of this first question. Though most of his income may come from other surces he must include in his taxable income the amount received as rent for property leased by him.

That the rentals from leased property can validly be included in the measure of the tax imposed on some other activity was decided in *Flint* vs. *Stone Tracy,* 220 U. S. 107, 55 L. Ed. 389, 31 Sup. Ct. 342 (1912) where the court said: "The income is not limited to such as is received from property used in the business, strictly speaking, but is expressly declared to be upon the entire * * * income * * * from all sources * * *. In other words, the tax is imposed upon the doing of business of the character described, and the measure of the tax is to be the income * * * received not only from property used in business, but from every source."

The answer to this first question is fortified by the answer to the second question: (2) If a person engages in no other activity taxable under the Gross Income Tax Act but owns property which he leases and from which he received rentals, is such person engaged in "business" so as to be subject to the Gross Income Tax Act? This question must be answered in the affirmative.

Such a person is engaged in "business" within the meaning and intent of the Act. Sec. 1 (7) defines "business" as follows: "'Business' as used in this Act, shall include all activities (personal, professional or corporate) engaged in or caused to be engaged in with the object of gain or economic benefit, either direct or indirect, but shall not include casual sales."

This is a very broad definition and followed literally includes all activities entered into "with the object of gain or economic benefit." When a person leases real or personal property he is putting the property to a use for

which he receives compensation in the form of rent. That this activity is "for the object of gain or economic benefit" cannot be denied and is within the meaning of "business" as defined in the Act.

This is not a novel conception of "business," as will be shown by the cases cited below, and is well within the contemplation of the Legislature which furnished us a broad definition of "business."

In *Cedar Street Co.* vs. *Park Realty Co.* decided at the same time as *Flint* vs. *Stone Tracy,* 220 U. S. 107, 55 L. Ed. 389, 31 Sup. Ct. 342 (1912) the question arose under the Federal Corporation Tax Law whether the Park Realty Co. was "doing business" when "it was engaged in no other business except the management and leasing" of one hotel.

Said the Court:

"'Business' is a very comprehensive term and embraces everything about which a person can be employed. Black's Law Dict., 158, citing *People v. Commissioners of Taxes,* 23 N. Y. 242, 244. 'That which occupies the time, attention and labor of men for the purpose of a livelihood or profit.' Bouvier's Law Dictionary, Vol. 1, p. 273.

"We think it is clear that corporations organized for the purpose of doing business, and actually engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, or leasing ore lands and *collecting royalties,* managing wharves, dividing profits, and in some cases investing the surplus, are engaged in business within the meaning of this statute * * *.

"Of the *Motor Taximeter Cab Company Case,* No. 432, the company owns and leases taxicabs, and collects rents therefrom. We think it is also doing business within the meaning of the statute."

In these cases the statute in question did not offer any definition of "doing business" so the definition furnished by the U. S. Supreme Court is a judicial and not a statutory definition. The fact that the Legislature gives us a broad definition of "business" makes it easier to

reach the conclusion that leasing property is doing business.

The *Park Realty Co.* case and the *Motor Taximeter Cab Co.* case show that the same principles apply to the leasing of either real or personal property.

In the recent case of *Laing* vs. *Fox,* 175 S. E. 355 (1934) the Supreme Court of West Virginia in interpreting the West Virginia Gross Income Tax, after which the Hawaii Gross Income Tax Act was patterned, held that the West Virginia Act applied to investment receipts in the nature of interest, dividends, *rentals* and the like. The court said at page 360, "We reject the theory of plaintiff that income from loans and investments is not an income of a 'business, profession, trade, occupation or calling' within the meaning of the statute which provides that 'business,' as used therein, 'shall include all activities engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect' * * * The lending or investing of money requires of one so engaged active and discriminate judgment." This case has considerable bearing on any proper interpretation of the Hawaii Gross Income Tax Act as it interprets a statute which is so similar to ours both in respect to the statute as a whole and the various sections, some of which are identical in wording.

The definition of "business" found in the Hawaii Act is identical with the West Virginia definition. This case is given added prestige by the fact that it was affirmed by the United States Supreme Court in a memorandum decision in 55 Sup. Ct. 126 (1935).

In *Stiner* vs. *Yelle,* 25 P. (2d) 91 (1933) the Washington Supreme Court was divided on the question of the constitutionality of the Washington Gross Income Tax. The specific question of what constituted doing "business" was not raised in the majority opinion upholding the Act. However, Steinert, J. supported by three other Justices of the Washington Supreme Court, said in his dissenting opinion in unequivocal language

that leasing property constituted doing business. At page 99 he says, "What I have said with reference to the professional man applies equally to the *landlord,* the mortgage loan company, and even the salaried man. Taken as a whole those included in the exempted class (those enumerated in the last sentence) are numbered by the thousands. *They are all engaged in business activities.* They each have an occupation from which a gross income may be realized."

Care should be taken to distinguish other cases in this field, notably *McCoach vs. Minehill,* 228 U. S. 295, 57 L. Ed. 843; *Zonne vs. Minneapolis Syndicate,* 220 U. S. 187, 55 L. Ed. 428, 31 Sup. Ct. 361; *Jasper Ry-Co. vs. Walker,* 238 Fed. 535 (19 17) and *Attorney General* vs. *B. & A. Ry.,* 124 N. E. 257 (Mass. 1919). The facts of all these cases are similar. They involve railroad corporations originally organized to conduct railroading operations and which later have leased for long periods of time (from 99 to 999 years) their entire properties. The lessor corporations in leasing their properties have amended their charters so that they became mere holders of the title to the property. Their positions were more that of passive trustees than of active landholders. The court in the last named case strikes the keynote of the distinction from the ordinary understanding of "doing business" when it says in the last paragraph: "There is nothing at variance with the result in Copper Range Co. vs. Com., 218 Mass. 558, 103 N.E. 310. The salient facts of that case were that a business corporation was organized for the *express purpose* of holding the stocks and securities of other corporations. *That was its business.* Manifestly the doing of the precise thin for which a business corporation is chartered is doing business. The income of a corporation not doing business for profit is not within the scope of the present statute, even though such corporation may fall within the general classification of business corporations."

In this case as in the *Minehill, Zonne* and *Jasper*

cases we find that there has first been a corporation "doing business," which corporation has abandoned the purposes of its incorporation by becoming a lessor to the successor in its line of endeavor. This would seem to be sufficient grounds on which to distinguish it from the *Park Realty Co.* case which has not been expressly overruled but has been merely limited by these later decisions.

The ground of distinction between the *Park Realty Co.* case and these later cases is found in *Von Baumbach* vs. *Sargent Land Co.,* 242 U. S. 503, 516, 37 Sup. Ct. 201, 204, 61, L. Ed. 460, 468 (1916). Here the earlier decisions are reviewed and the test derived from a consideration of all of them was said to be "between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes. " See also *People* vs. *Sohmer,* 217 N.Y. 443, 112 N. E. 181; *W. E. St. Ry.* vs. *Malley,* 158 C. C. A. 581, 246 Fed. 625.

There remains but one case to be considered, *Norman* vs. *S. W. Ry.,* 157 S.E. 532 (Ga. 1931). It was here held that a railroad corporation chartered by the laws of the state, which, with the present consent of the state by amending its articles of incorporation, had leased to another corporation its entire property owned and held by it for railroad purposes, and which engaged in no other business except such as was necessary to maintain the corporate existence and to receive and distribute to its shareholders the rental from such leased property and the income from stocks and bonds into which such rentals were converted, does not engage in doing business within the meaning of the Georgia Gross Income Tax Act. The opinion is difficult to follow in view of the fact that the court was supplied by the legislature with a statutory definition yet it chose to rely on the judicial decisions of

the *Minehill, Zonne* and other cases. It failed to satisfactorily distinguish the *Park Realty Co.* case and dismissed it by saying that the facts of that case "would seem to make a difference." Although the reasoning of the *Norman* case is unconvincing the facts in the case were sufficiently analagous to the facts of the *Minehill* and *Zonne* cases to justify the result reached by the court.

Yours very truly,

DUDLEY C. LEWIS,
Special Deputy Attorney General.

APPROVED:

J. V. Hodgson,
Acting Attorney General.