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MORTGAGE INVESTMENTS BY FOREIGN CORPORATIONS

ROBERT P. WILKINS*

It has been conservatively estimated that total mortgage investments by foreign corporations in South Carolina at the present time are well in excess of \$700,000,000.00. Foreign capital has always been one of the chief "imports" of South Carolina. The scope of this article is limited to questions pertaining to investment in notes secured by mortgages on South Carolina real estate by foreign corporations whose sole activity within this state is such investment.

Before making an investment in South Carolina, the foreign lender must resolve two basic questions:

- (1) What must it do to comply with the corporate law of South Carolina?
- (2) What tax liability will it incur?

CORPORATE PROBLEM

The basic corporate question involved is whether a foreign corporation is "doing business" in South Carolina by taking, purchasing or participating in South Carolina mortgages. Foreign corporations which are doing business must obtain authority from the state to do so.¹ The obtaining of such authority is generally referred to as "domesticating" or "qualifying."

This question must now be resolved under the provisions of the South Carolina Business Corporation Act of 1962.² However, a review of the background of the problem is necessary for a complete understanding of it.

The question of what is doing business and what is not is quite complex, with any line of demarcation which may exist being vague and shadowy. The leading South Carolina case on the question of doing business is *British-American Mortgage Co. v. Jones*.³ In that case the mortgage company, a foreign corpora-

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1. See Evans, *Foreign Corporations, Symposium of South Carolina Corporation Law*, 15 S.C.L.Rev. 451 (1963) for a general application of the SOUTH CAROLINA BUSINESS CORPORATION ACT of 1962 to foreign corporations.

2. S. C. CODE §§ 12-11.1 to 12-31.2 (Supp. 1963). The Act took effect on January 1, 1964 and repealed most of the corporate statutes then in effect. Further citations will be from the 1963 Supplement and the Act will be referred to hereafter as the BUSINESS CORPORATION ACT.

3. 77 S.C. 443, 58 S.E. 417 (1907).

tion, sought to have the Comptroller General enjoined from enforcing the provisions of the qualification statute which required payment of annual license fees. The manner of transacting business was as follows: "A person in South Carolina, who desires to make a loan from this company, forwards his application to the home office in the City of New York, where the application is accepted or rejected. If accepted, the notes and mortgages are prepared in New York, and sent to the applicant in South Carolina, who executes them in South Carolina and forwards them to New York with draft attached, which draft is paid in New York, according to the terms of the contract, the debt is payable in New York, and as a matter of fact, is collected and paid in that city."⁴ Construing the statute,⁵ the court held that the company was doing business in this state.

That statute provided:

It shall be a further condition precedent to the right of any such (foreign) corporation to do business in this state, that it shall be taken and deemed to be the fact, irrebuttable, and part and parcel of all contracts entered into, between such corporation and a citizen or corporation of this state, that the taking or receiving, from any citizen or corporation of this state of any charge, fee, payment, toll, impost, premium, or other moneyed or valuable consideration, under or in performance of any such contract, or of any condition of the same, shall constitute the doing of its corporate business within this state, and that the place of the making and of the performance of such contract shall be deemed and held to be within this state, anything contained in such contract, or any rules or by-laws of such corporation, to the contrary notwithstanding.

After holding that the statute clearly showed the company to be doing business in the state, the court went still further and said:⁶

Even if this statute had not been enacted, the exercise by the petitioner of the corporate functions hereinbefore mentioned, would have constituted the doing of business in this state. *Chattanooga Nat. B. & L. Assn. v. Dennison*, 189 U.S. 408, in which it was decided that the granting of a loan by

4. *Id.* at 445.

5. S. C. CODE § 12-701 (1962) (now repealed).

6. 77 S.C. 443, 58 S.E. 417 (1907).

a Tennessee building and loan association to a citizen of Alabama, upon the latter's signed application, solicited by a traveling agent for the association, and the taking of a note and mortgage executed within the state by the borrower, as security, constitute, regardless of the form and terms of such instruments, the doing of business in the state, within the meaning of the Alabama Constitution and statutes, requiring foreign corporations doing any business within the state to designate a local agent for service of process and to have a known place of business within the state.

The attorneys for the petitioner contend, that the case mentioned is materially different from that under consideration, in that there was no agent of the petitioner in this state soliciting business. The Court, however, did not rest its decision upon that fact, but on the ground that the foreign corporation exercised within the State of Alabama some of the functions for which it was created.

It should be noted that, in the *British-American* case, the court did not recognize the distinction between "doing business" so as to subject a foreign corporation to the jurisdiction of the courts of this state and "doing business" so as to subject it to the qualification statute. In the case, *State v. Ford Motor Co.*,⁷ this distinction was clearly recognized.

The *Ford* case was an action to recover in behalf of the state the penalties prescribed⁸ for failure to comply with the qualification statute. Service was obtained pursuant to statute by process left with the Secretary of State. Ford had never incorporated or qualified to do business in South Carolina, had no office or property in the state, and sold all automobiles to its dealers in this state through its Charlotte, North Carolina branch. Relations with its dealers throughout the state were covered by the standard Ford-Dealer contract, which gave Ford almost absolute control over the activities of its dealers. Representatives of the Charlotte office came into the state from time to time to consult with and advise dealers on sales and other problems, to supervise the servicing of the warranty on Ford automobiles and generally to cultivate business.

A unanimous court held: (1) that Ford was doing business in South Carolina to such an extent as to subject it to process left

7. 208 S.C. 379, 38 S.E.2d 242 (1946).

8. For the penalties prescribed see S. C. CODE § 12-737 (1962) (now repealed).

with the Secretary of State; and (2) that Ford was not doing business within the meaning of the qualification statute, i.e. intrastate business, but was engaged in interstate commerce, and therefore, was not subject to the requirements of the statute, indeed could not be subjected to such requirements without offending the commerce clause of the Federal Constitution; and (3) that Ford's dealers were not its agents and that Ford was not doing intrastate business through them.

In *Gulletley v. Strickland*,⁹ a Virginia building and loan association, which was admittedly doing business in this state without qualifying, brought a foreclosure action against a resident mortgagor. One of the mortgagor's defenses was that the contract was void by reason of the building and loan's failure to comply with the requirements of the qualification statute. It was held that the contract was not nullified "before conviction." The court did not elaborate, but a reasonable inference seems to be that the contract might have been nullified after conviction of the corporation for failure to qualify in a proceeding brought by the state. Although the court probably would not have declared such a contract void,¹⁰ it might very well have refused to lend its aid to a non-qualifying corporation in a foreclosure action against a South Carolina citizen or corporation.

In light of these decisions, the major problem which confronted foreign lenders was the risk that they might be held to be doing business without having qualified and might therefore be unable to enforce their mortgages in South Carolina courts.

The legislature in 1951, in order to remedy the uncertainty created for foreign corporations which were desirous of making South Carolina mortgage investments, enacted what became Section 12-706 of the 1962 Code.¹¹ This section, generally referred to as the limited qualification statute, provided that a foreign corporation whose sole business within the state was the lending of money secured by mortgages of real estate located within the state could file a written appointment designating the Secretary of State as its agent for the service of process, provide other limited information, pay a fee of fifty dollars and thus be exempt

9. 74 S.C. 394, 54 S.E. 576 (1906).

10. See Annot., 80 A.L.R.2d 465 (1961), superseding 12 A.L.R. 1379 (1921), Rights of assignee or subsequent holder of negotiable paper executed to a foreign corporation doing business in state without complete compliance with local requirements. See also Annot., 7 A.L.R.2d 256 (1949), Effect of execution of foreign corporation's contract which, while executory, was unenforceable because of noncompliance with conditions of doing business in state.

11. Now repealed.

from the provisions of the chapter¹² of the code relating to foreign corporations.

Under the procedure created by Section 12-706, a foreign corporation could comply with its terms and become limitedly qualified, thus avoiding possible penalties for failure to qualify and enabling it to make loans without the necessity of qualifying generally.

The Business Corporation Act took effect on January 1, 1964, and repealed Section 12-706 of the South Carolina Code. Section 12-23.1 (b) of the Act specified several activities which of themselves will not constitute the doing of business.¹³ Sections 12-23.1 (b) (5) and (6) were designed to allow without the necessity of qualification the activities previously protected under Section 12-706 and read as follows:

* * *

- (b) Without excluding other activities which may not constitute doing business in this state, a foreign corporation shall not be deemed to be doing business in this state, for purposes of this chapter, solely by reason of carrying on in this state any one or more of the following activities:

* * *

- (5) Creating or acquiring evidences of debt, mortgages, or liens on real or personal property.
- (6) Securing or collecting debts or enforcing any rights in property covering the same.

* * *

The Attorney General of South Carolina has issued his opinion¹⁴ in which he states that the limited qualification of any corporation which had been obtained under Section 12-706 was terminated upon the effective date of the Business Corporation Act. His opinion further makes it clear that foreign corporations whose activities entitled them to limited qualification under Section 12-706 are entitled to an exemption from qualification under Sections 12-23.1 (b) (5) and (6).

In another opinion of the Attorney General,¹⁵ the question of whether a foreign mortgagee may bid in the property at a fore-

12. S. C. CODE §§ 12-701 to 12-738. The application of § 12-725 which provided for withdrawal of foreign corporations was not excluded by § 12-706. All these sections have now been repealed.

13. See also ACT 740 of 1964, ACTS AND JOINT RESOLUTIONS OF SOUTH CAROLINA, providing a similar exemption for foreign insurance companies.

14. OPS. ATT'Y GEN. of S.C., Aug. 6, 1963.

15. OPS. ATT'Y GEN. of S.C., April 22, 1964.

closure sale or take a deed in lieu of foreclosure without endangering its exempt status is discussed:

It is clear that the acquisition of the mortgage is an exempt activity under Section 12-23.1 (b)(5) of the Code. The acquisition of mortgaged property by the mortgagee at a foreclosure sale by bidding in such property, or the acceptance of a deed in lieu of foreclosure when the consideration is the satisfaction of the mortgage debt, are considered normal methods of "securing or collecting debts or enforcing any rights in the property covering the same," within the exemption provided by Section 12-23.1 (b)(6) of the Code. The subsequent holding of such property pending an orderly sale thereof is closely related in purpose to collection of the debt and enforcing rights in property securing the debt, and in our opinion would not constitute the doing of business in this state by a foreign mortgagee, particularly where these activities are not part of the functions for which the corporations involved were organized.

A closely related problem is whether the renting by a mortgagee of a property which had been acquired at a foreclosure sale by the mortgagee or by deed in lieu of foreclosure constitutes the doing of business or whether it is within the exemption provided by 12-23.1 (b)(6). In an annotation entitled *Leasing of real estate by a foreign corporation, as lessor or lessee, as doing business within state within statutes prescribing conditions of right to do business*,¹⁶ the general principle is stated:

* * * In conformity with the generally recognized doctrine that "doing business" in the state by a foreign corporation imports the transaction of its ordinary and customary business therein, many courts hold that acts and transactions of such a corporation within the state which are not a part of the business it was formed to conduct, including those which are mere incidents to a future or past engagement in such business in the state or to the present conduct of such business in other states, are insufficient to constitute "doing business" in the state, as that term is variously employed with respect to foreign corporations.

In accordance with the views stated above, it has been generally held that the granting or obtaining by a foreign corporation of a lease on real property within a state does

16. 59 A.L.R.2d 1131, 1133 (1958).

not constitute "doing business" within the state, for the purposes of a statute prescribing the right of a foreign corporation to do business. Holdings of this kind give weight to the fact that leasing is no part of the functions for which the corporations involved were organized. * * *

The Attorney General stated¹⁷ that the rental of a foreclosed property pending an orderly sale of such property does not constitute the doing of business by the foreign mortgage company when the property is acquired either by being bid in by the mortgagee at the foreclosure sale or when the mortgagor gives the mortgagee a deed in lieu of foreclosure. If a mortgagee held rental properties after it had had an opportunity to sell these properties at no loss to it, then its activities certainly might be construed to be doing business. On the other hand, if the mortgagee held such properties and had been able to secure a sale only at a loss to it, it would seem to be a harsh penalty to hold that it was doing business, when, in fact, it was still in the process of attempting to "collect a debt," which activity did not constitute doing business.

Service of process upon foreign corporations which are not authorized to do business in South Carolina, including those which need not obtain authority under Section 12-23.1, is governed by Section 12-23.14. Under this section every such corporation doing any business within the state (including those which need not obtain authority under Section 12-23.1) is deemed to have designated the Secretary of State as its agent for service of process.

Section 12-23.15, which is derived chiefly from Section 117 of the Model Act,¹⁸ specifies the effect of a foreign corporation doing business in this state without authorization. Sub-sections (b) and (c) of Section 12-23.15, according to the annotated draft of the Business Corporation Act,¹⁹ "are especially designed to guarantee the integrity of contracts made by an unauthorized foreign corporation, since any impairment of the validity of the contract on this ground would be an unduly harsh remedy. Thus sub-section (c) specifically preserves the virtue of the contract and guarantees the corporation's right to defend a suit. Sub-section (b), however, requires the unauthorized foreign corpora-

17. OPS. ATT'Y GEN., *supra* note 14.

18. MODEL ACT (prepared by American Bar Association Committee).

19. DRAFT VERSION SOUTH CAROLINA BUSINESS CORPORATION ACT OF 1962, Reporter's note p. 245.

tion to secure authority to do business in this state and to pay up all past due taxes, fees, etc., before it can go into the South Carolina courts as a plaintiff.”

It is therefore incumbent upon a foreign lender to limit its activities to those specified in Section 12-23.1 (b) so as to avoid any problem under Section 12-23.15.

INCOME AND FRANCHISE TAXES

There are three basic situations under which foreign lenders make South Carolina mortgage investments. There are variations, but the three examples below have been limited to those situations in which the South Carolina Tax Commission²⁰ has granted favorable income and franchise tax treatment.

In all three examples, the foreign corporation has no office in South Carolina and has not qualified to do business in this state. Its loans generally are serviced by an independent contractor located within the State of South Carolina; however, payments may be made directly to the foreign lender's office outside the state.

In the first situation a local lender makes a real estate loan which is secured by a mortgage on South Carolina real estate. Subsequently, a foreign lender purchases the note and mortgage by assignment from the local lender. This transaction is consummated at the foreign lender's office outside the state. The note and mortgage are held at the foreign lender's office outside the state. The local lender, prior to making the loan, generally will have solicited a commitment by the foreign corporation to purchase it.

In the second situation the procedure is almost identical to that set forth above but instead of purchasing the note and the mortgage, the foreign corporation purchases a participation in the loan, which participation is generally represented by a certificate of participation. The purchase is consummated at the foreign lender's office outside the state. The local lender remains the mortgagee of record.

The final situation is where the foreign corporation makes a mortgage loan directly to the borrower. Generally this loan is solicited in South Carolina by an independent broker (not an

20. The writer wishes to express appreciation for the cooperation extended by the Hon. Otis W. Livingston, Chairman of the Tax Commission and his staff in reviewing this portion of this article for conformity with the policies and procedures of the Commission.

agent of the foreign corporation) who presents the application to the foreign corporation. This transaction will be consummated at the foreign lender's office outside the state.

The maxim *mobilia sequuntur personam* embodies the general principle in relation to situs for the purposes of taxation of intangible personal property, and the general rule is, in the absence of controlling circumstances to the contrary, that the situs of intangible property for the purposes of taxation is the state of the owner's domicile; but there is a well-established exception to this general rule to the effect that there may be a business situs of intangibles distinct from the domicile of the creditor.²¹ If the intangibles have gained "business situs" within the taxing state, then as an exception to the general rule, they may be subject to tax.

Applying the situs theory, the Tax Commission has consistently²² taken the position that income in the form of interest on notes (or participations therein) secured by mortgages on South Carolina real estate held by foreign lenders in accordance with the circumstances described above is not taxable in South Carolina.²³

If the foreign lender is engaged in wholesale overt solicitation of loans within the state from an office maintained by it within the state and is engaged in other similar activities, thus giving the intangibles a business situs within the state, then the Tax Commission might take the position that income tax is due on the interest income. In any event, the Tax Commission has held that a foreign lender, if it acquired the mortgaged property either by foreclosure or by deed in lieu of foreclosure, will be subject to income tax on the rent from the property or upon any gain upon its subsequent sale.

The South Carolina license fee or franchise tax is imposed pursuant to Sections 65-601 to 65-616 of the 1962 Code. Section 65-607 provides that a corporation doing business partly within

21. See Annot. 76 A.L.R. 806 (1932) supplemented at 143 A.L.R. 361 (1943), Business situs for purposes of property taxation of intangibles in state other than domicil of owner. See 27 AM. JUR. *Income Taxes* § 191 at 416 (1940) that a state does not have the power to impose a tax on the income of a nonresident or a foreign corporation derived from . . . the gain on sales of intangibles, the situs of which is outside the state. . . . See 85 C.J.S. *Taxation* § 1090 at 703 n. 66 (1954), Income from bonds secured by mortgages on out-of-state lands is subject to taxation by state where recipient resides.

22. For an earlier contrary opinion see OPS. ATT'Y GEN. of S.C., 221, April 15, 1960.

23. This presupposes that the sole activity of the corporation within the state is the making of loans as described in the examples.

and partly without the state shall pay the corporate license tax only on that portion of its capital used within the state. Under the situs theory described above, the Tax Commission has determined that foreign lenders engaged in the activities described in the examples are not subject to the corporate license tax.

CONCLUSION

Basic guidelines have now been established which should encourage foreign lenders to make additional mortgage investments in the state. If the foreign lender observes these guidelines, the corporate and tax problems ordinarily encountered by such lenders can be avoided.