

1980

# Kennecott Copper v. Bingham and Garfield Railway : Reply Brief

Utah Supreme Court

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UTAH SUPREME COURT

BRIEF

8091 P1-RB

IN THE SUPREME COURT

of the

STATE OF UTAH

KENNECOTT COPPER CORPORATION,  
a corporation, and

BINGHAM AND GARFIELD RAILWAY  
COMPANY, a corporation,

*Plaintiffs,*

— vs. —

THE STATE TAX COMMISSION,

*Defendant.*

PLAINTIFFS' REPLY BRIEF

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IN THE SUPREME COURT  
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KENNECOTT COPPER CORPORATION,  
a corporation, and

BINGHAM AND GARFIELD RAILWAY  
COMPANY, a corporation,

*Plaintiffs,*

} Case No.  
8091

— vs. —

THE STATE TAX COMMISSION,

*Defendant.*

---

PLAINTIFFS' REPLY BRIEF

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STATEMENT

At page 348 of the Transcript, Mr. Gilmour, of  
counsel for the Defendant, said:

“This case should be decided on the facts as  
shown by this record, uninfluenced by any other  
considerations whatsoever.”

With this statement Kennecott is in complete agreement. The relevant and important facts, as given in the record, are clear and the justiciable issues involved are neither many nor complex. The case should be heard and determined purely on those legal issues and those facts.

In the light of this statement of Commission's counsel, it is surprising to be presented with a brief of 361 pages which contains not only a mass of discussion and citations entirely irrelevant to the issues involved, but also arguments necessarily premised upon facts which either are not in the record or, in some cases, are directly contrary to the actual testimony and even to the Commission's own findings. The brief also seeks to contest here the actual decision made by the Commission below. These points will be brought to the attention of the Court as our brief progresses.

Moreover, in reading the brief, we are constrained to feel that counsel for the Commission has sought to prejudice an impartial consideration of the legal questions involved through statements or innuendoes as to Kennecott's good faith in this proceeding, which both the Commission and its counsel should know, to be contrary to the facts.

For example, on page 6 of the Defendant's Brief, we find it stated that:

“The tax returns filed annually since 1931 by plaintiff seem, in the light of the facts now of record, to have been consistently understated with

respect to the net income attributable to plaintiff's Utah operations. On the basis of these facts they appear to have been incorrect to begin with as to the Utah Copper Company and incorrect after 1936 as to plaintiff.

“Both the individual income and corporation franchise tax laws of the state are based on the fundamental principle of self-assessment. This means that each taxpayer, familiar with the facts of his own business and with the law, is required to compute his tax correctly in the first place. Where this is not done, it would appear quite immaterial how many changes of position the taxing authority must take to secure a correct computation. With all of the forces at its command, plaintiff over the years since 1931 appears to have been quite skillful in resisting any computation of tax other than of its own interpretation of the statute. The lack of consideration of important facts, ability to prolong the controversy, lack of any penalty in the process, periodic changes in defendant's personnel, the need for revenue in the Uniform School Fund, are merely some of the factors which have operated in plaintiff's favor to make its strategy successful.”

There is, and can be, no possible justification for this charge of bad faith, if not more, against Kennecott. The facts are that, beginning with the enactment of the franchise tax law in Utah, Kennecott's representatives worked closely with the Commission in the preparation of Kennecott's tax returns. If the returns were incorrect, they were so as the result of advices from, or with the knowledge of, the Commission's representatives. That errors might have crept in in the course of the inter-

pretation of the then new law is understandable, but to charge Kennecott with wilful and consistent understatement of its tax liability is neither factually correct nor appropriate.

Again, on pages 42 and 43 of Defendant's Brief appears the following statement:

“Plaintiff in filing its Utah corporation franchise tax return ignored the separate corporate entity of the sales subsidiary and the intercompany contractual arrangements in force between plaintiff and its sales subsidiary. \* \* \* In lieu of such commissions actually paid, there were deducted instead amounts which were estimated to have been the expenses incurred by the sales subsidiary in selling the copper and molybdenite produced by the Utah Division. This ‘adjustment’ was at variance with the regular practice followed and maintained in keeping the separate books of account of the Utah Division. It was apparently done in an effort to put plaintiff in a better argumentative position to claim that the out-of-state sales of copper and molybdenite were negotiated and effected by plaintiff itself instead of by the sales subsidiary as was actually the case.”

This charge was not even suggested in the course of of the hearing below. The assertion was first made by the Commission at the time of oral argument after the hearing had been closed and taking of testimony concluded. It was immediately answered by a statement from Kennecott's counsel. The facts are as follows:



The full selling commissions paid the Sales Corporation had been deducted on the returns filed by Kennecott and its predecessor, Utah Copper Company, for the years 1931 to 1941, both inclusive. In the course of the discussions which resulted in the settlement of the 1935 to 1941 controversy, constituting the subject-matter of this Court's Case No. 6324, the Commission demanded that the Sales Corporation's profit be eliminated because it was a wholly-owned subsidiary of Kennecott and the amount should be disallowed as intercompany profit. Kennecott concurred, and its concurrence was confirmed by a letter dated January 13, 1942, by C. C. Parsons, Esq., on Kennecott's behalf, submitting to the Commission computations for the year 1940 with such elimination (actual expense substituted) as a basis for the then contemplated settlement. The Commission thereafter proposed adjustments, likewise eliminating the profit, on May 23, 1942, for the years 1935 to 1939, both inclusive, and on August 15, 1942, for each the years 1940 and 1941. These adjustments were the basis upon which final settlement was made. The sales profit each year was disallowed, with an explanation in each instance by the Commission similar to the following for the year 1935:

“The deduction for commission on copper sales in the amount of \$68,450.47 includes a selling profit of \$30,047.41 for the Kennecott Copper sales division. The selling company is a subsidiary of the taxpayer, therefore the amount has been disallowed as a intercompany profit.”

Thus, the practice of deducting only the net selling expense was adopted in accordance with the requirement of the Commission in the course of the settlement of the 1935-1941 case. It was understood by both the Commission and Kennecott that in assessing the franchise taxes for future years this settlement basis would be adhered to. Accordingly, Kennecott deducted only the net selling expense in its returns for 1942 and subsequent years.

The first advice Kennecott had of the Commission's present proposal to allow the full amount of the commissions paid was in the proposed adjustments dated March 10, 1951 applicable to the year 1948. On June 29, 1951 similar adjustments were made by the Commission for each year 1942 to 1950, both inclusive.

On page 105 of its Brief, the Commission refers to the stipulation entered into by the parties in Case No. 7298 as to the sales activities of the Sales Corporation and implies that, in entering into the stipulation, Kennecott withheld from the Commission detailed information as to the agency relationship, of which the Commission was not advised until the hearing in the present case.

The Commission has at all times been fully aware of the nature and details of the agency relationship between Kennecott and the Sales Corporation. Substantially all of the same facts as to this relationship, now relied upon by the Commission in its decision and its argument before this Court, were contained in an affidavit, dated January 27, 1938, submitted by Kenne-

cott to the Commission in the earlier hearing covering the tax years 1935-1941, a copy of which was contained in the record in Case No. 6324 before this Court.

Accordingly, there is no basis for the implication of bad faith sought to be made by the Commission, nor can the Commission rely on any lack of information regarding the Sales Corporation as a basis for departing in this case from its prior position that the sales made by the Sales Corporation in New York were Kennecott's sales for the purpose of the allocation formula.

## ARGUMENT

### I

#### Point

**The constitutional argument under the Commission's Point I is erroneous and irrelevant since it is not applicable to a franchise tax based upon net income from business conducted within and without the State. Moreover, the Utah Franchise Tax Law specifically provides for an allocation of net income. (Def's. Br., pages 60-96.)**

The substance of the Commission's argument under its Point I is that mining is intrastate commerce, that a state may tax the privilege of engaging in mining even though the entire product is subsequently sold outside the state in interstate commerce, and that such tax may be measured by the full value of the product within the state even though such value is determined by reference to actual cash receipts from sales outside the state (Def's Br. 64). From this premise, the Commission apparently

contends that the Utah franchise tax *could* constitutionally be applied to the total net income of the Utah Copper Division, without any apportionment whatsoever.

The Commission's argument goes only to the constitutionality of an hypothetical occupation tax and an ad valorem mine tax based on net proceeds, the constitutionality whereof is ruled by considerations wholly foreign to the franchise tax under review. Kennecott has not challenged the constitutionality of either the Utah occupation tax or the mine tax based on net proceeds; Kennecott has paid both. Moreover, what is immediately conclusive against the Commission's argument is that the Utah Franchise Tax Act by its express terms is laid upon only that part of the taxpayer's total net income reasonably attributable to its business done in Utah, this by a formula of allocation spelled out in the very act itself. Sections 80-13-3 and 80-13-21, Utah Code 1943.

The Utah franchise tax is an additional and a very different kind of tax. It is not, as the net proceeds tax or the mining occupation tax, one imposed upon the mine, or a particular type of local business based upon or graduated by the volume of that local business or the value of its products (e. g., the number of plant units employed or units of goods produced, within the State, or the gross receipts from the products produced within the State). Rather, the Utah franchise tax is a tax for the privilege of doing business in corporate form within the State, applicable generally to all types of business activi-

ty (manufacturing, mining, selling, transportation, etc.) and levied upon the portion, properly allocable to Utah, of the total net income of the taxpayer from sources both within and without the State. In such a case, as the Utah statute itself recognizes, where a foreign corporation does business both within and without the taxing State, the tax may constitutionally be imposed only upon that portion of the total net income of the taxpayer fairly attributable to its activities carried on or business done within the State, and a reasonable method for computing such portion of the total net income must be provided.

The following cases, primarily relied upon by the Commission, all involve taxes upon local production or manufacture, and not upon net income from business activities conducted both within and without the State, as the following brief description of the statutes there involved demonstrates: *American Manufacturing Co. v. St. Louis*, 250 U. S. 459, 63 L. ed. 1084 (1919) - city ordinance imposing a license tax on the privilege of conducting a manufacturing business in the city measured by the amount of sales of the manufactured goods; *Heisler v. Thomas Colliery Co.*, 260 U.S. 245, 67 L. ed. 237 (1922) - state tax on each ton of anthracite coal mined and prepared for market, based upon the value of the coal when ready for shipment within the state; *Oliver Iron Mining Co. v. Lord*, 262 U.S. 172, 67 L. ed. 929 (1923) — occupation tax on mining or producing ore measured by the value of the ore mined or produced within the state at the place at which it was brought to the surface;



*Lacoste v. Dept. of Conservation*, 263 U. S. 545, 68 L. ed. 437 (1924) - severance tax on skins or hides taken from wild fur-bearing animals within the state measured by value thereof; *Hope Natural Gas Co. v. Hall*, 274 U. S. 284, 71 L. ed. 1049 (1927) - license or privilege tax on the production of natural gas based upon its value at the well within the state; *Utah Power & Light Co. v. Pfof*, 286 U. S. 165, 76 L. ed. 1038 (1932) - tax upon the generation of electrical energy within the state based upon the number of kilowatt hours measured at the place of production; *Federal Compress and Warehouse Co. v. McLean*, 291 U. S. 17, 78 L. ed. 622 (1934) - license tax for the privilege of operating a cotton compress graduated according to the number of bales of cotton compressed each year and of operating a warehouse graduated according to the capacity of the warehouse; *Coverdale v. Arkansas-Louisiana Pipe Line Co.*, 306 U.S. 604, 82 L. ed. 1043 (1938) - privilege tax on the production of mechanical power within the state based on the horsepower capacity of the machinery employed.

It is well settled that a franchise tax upon a foreign corporation for the privilege of doing business in the State which is based upon net income or capital, must tax only the net income or capital properly and fairly attributable to its activities *within the taxing State*, and that, where the total net income of the taxpayer results from activities, or its capital is employed, in more than one State and so is subject to taxation in more than one State, a reasonable apportionment thereof to the taxing State is essential.

This constitutional doctrine was early established, perhaps the most famous early decision being *Western Union Telegraph Co. v. Kansas*, 216 U. S. 1, 54 L. ed. 355 (1910). In that case the Supreme Court held invalid a Kansas statute requiring a foreign corporation to pay a designated percentage of its total authorized capital as a condition of its right to continue to do domestic business in Kansas. The statute was held to contravene both the Commerce Clause and the Due Process Clause. In recognizing the failure to apportion, as the vice of the statute, the Court stated (p. 30) :

“Looking, then at the natural and reasonable effect of the statute, disregarding mere forms of **expression**, it is clear that the making of the payment by the telegraph company, as a charter fee, of a given percent *of its authorized capital*, representing, as that capital clearly does, *all* of its business and property, both within and *outside of the State*, a *condition* of its right to do local business in Kansas, is, in its essence, not simply a tax for the privilege of doing local business in the state, but a burden and tax on the company’s interstate business and on its property located or used outside of the state.”

The requirement of a fair apportionment of net income to the business done within a State was but recently reiterated by the Supreme Court in *Spector Motor Service, Inc. v. O’Conner*, 340 U. S. 602, 71 S. Ct. 508, 95 L. ed. 573 (1951). In that case the Court stated (p. 609) :

“ . . . where a taxpayer is engaged both in intrastate and interstate commerce, a state may tax the privilege of carrying on intrastate business and, *within reasonable limits*,<sup>7</sup> may compute the amount of the charge by applying the tax rate to a fair proportion of the taxpayer's business done within the state, including both interstate and intrastate.” (Italics supplied)

Three of the cases cited by the Supreme Court in footnote 7 in that decision (the Butler Bros., Hans Rees', and Underwood Typewriter cases) are cited on page 62 of Plaintiffs' Brief and clearly establish the principle that the tax must apply to the “fair proportion” of the taxpayer's total business represented by that part done within the State.

Thus, Butler Brothers v. McColgan held valid a California franchise tax based upon net income derived from business done within the State determined by an allocation to the State of a portion of total net income. Hans Rees' Sons, Inc. v. North Carolina (discussed more fully on pages 62-64 of Plfs' Br.) held invalid a tax on a foreign corporation based on net income allocated to the State, on the ground that the apportionment formula operated to tax profits not attributable to transactions within the State's jurisdiction. Underwood Typewriter Co. v. Chamberlain upheld the apportionment prescribed in a Connecticut statute, applicable to all foreign and domestic corporations carrying on business within the State, as taxing only net income earned from business carried on within the State. In both the Hans Rees' and



Underwood Typewriter cases the taxpayer's entire manufacturing business was conducted within the taxing jurisdiction. Yet, since the taxes, as in the suit at bar, were based upon net income from activities conducted both within and without the State, a fair apportionment of income to business carried on within the State was held by the Supreme Court to be constitutionally required.

The case of *International Harvester Co. v. Evatt*, 329 U.S. 416, 91 L. ed. 390 (1947), also cited by the Supreme Court in the *Spector* case, is cited by the Commission (Def's Br. 80-84) as authority for the contrary proposition - i.e., that under the Utah franchise tax statute, Utah could tax 100% of the net income of the Utah Copper Division without apportionment. The Ohio statute involved in that case was a tax upon the privilege of doing business in the State based upon a proportion of the corporation's total capital stock. An apportionment formula was prescribed by the statute based in equal parts on the proportion of the business done and the proportion of the property located in Ohio. The holding of the Court was that, on the facts involved, the tax was valid since the taxpayer was conducting an intrastate business and it had not been demonstrated that the apportionment formula achieved an unfair result. This decision substantiates the contention that a fair apportionment formula is required in a franchise tax statute imposing a tax, based upon net income, for the privilege of doing an intrastate business, when such statute is applied to a foreign corporation engaged in business both within and without the taxing State.

The Commission (Def's Br. 84-86) also relies upon *U. S. Glue Co. v. Town of Oak Creek*, 247 U. S. 321, 62 L. ed. 1135 (1918). The statute there involved levied the tax "only upon that proportion of such income as is derived from business transacted and property located within the State", the apportionment being determined in accordance with a prescribed formula. The numerator was the gross business of the corporation in the State, plus the value of its property in the State, the denominator being the total of such items both within and without the State. The Supreme Court of the United States merely held that the *allocated* net income taxed with respect to business transacted and property located in the State was validly taxed even though the total net income *before allocation* was derived in part from manufacture in the State and shipment and sale outside of the State.

Although sometimes discussed by the Supreme Court as a Commerce Clause question as well, the basic vice of the failure of a franchise tax, which is measured by total net income or capital, to include an apportionment formula, or the inclusion of one arbitrary or unfair in its application to the particular factual situation, is a violation of the Due Process Clause; namely, the taxing of activities or property outside the taxing State and beyond its jurisdiction - that is to say, extraterritorial taxation. This objection was clearly stated by the Supreme Court in *Connecticut General Life Insurance Co. v. Johnson*, 303 U. S. 77, 82 L. ed. 673 (1938), as follows (pp. 80-81):

“\* \* \* a state which controls the property and activities within its boundaries of a foreign corporation admitted to do business there, may tax them. But the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere.”

To summarize, to the extent that the Commission contends that the Utah franchise tax would be constitutional if applied (contrary to its express provisions) to tax the entire net income of the Utah Copper Division, without any reasonable allocation, its argument is completely unsound and contrary to the applicable decisions of the United States Supreme Court and of this Court itself. The Commission's constitutional argument under its Point I relates solely to an occupation tax on local business graduated according to the volume of its local activity or the value of the product produced. However, as the cases discussed above under Point I C at pages 61-67 of Plaintiffs' Brief clearly hold, a reasonable allocation is required where, under a franchise tax such as that in Utah, the corporate income is the result of activities within and outside the State. The Utah statute was written and must be applied with this constitutional restriction in mind.

## **II Point**

**The Commission's argument that none of the net income of the Utah Copper Division is allocable outside Utah is erroneous. It is contrary to the provisions of the franchise tax statute, the facts, and the Commission's own determination. (Def's. Br., pages 96-218.)**

As its Point II, the Commission contends that, under the provisions of the Utah franchise tax statute, Kennecott is not entitled to apportion any of the net income of the Utah Copper Division outside of Utah and that, accordingly, the Court should now, contrary to the Commission's own decision, allocate all such net income to Utah as being subject to tax. Although confused with numerous irrelevant arguments and a welter of inapplicable cases, the substance of the argument is based upon two contentions, both of which are unsound: First, that Kennecott, by its divisional accounting method, has computed the net income of the Utah Copper Division and that all of such net income is attributable to business done in Utah; Second, that as respects the Utah Copper Division, Kennecott is not engaged in business outside of Utah and that, consequently, the statutory allocation formula is not to be applied to the net income of that Division.

The brief answer to this contention is simply that it is contrary to the facts in evidence and to the Commission's own Findings of Fact. However, since it is a new contention not previously raised and not discussed in Plaintiffs' Brief, some discussion seems desirable in order that the real nature of the contention and its lack of basis in the record and the cases cited by the Commission will be evident to the Court.

Before doing so, the fallacy of the Commission's assertion as to the holding of this Court in Case No. 7298 will be shown.

(a)  
Point

**The Commission's assertion that this Court in its Case No. 7298 determined that Kennecott's franchise tax should be computed on the basis of its entire net income for the Utah Copper Division, as reflected in its accounts, without application of the statutory apportionment formula, is in error.**

The issue in this respect in this Court's Case No. 7298 (118 Utah 140, 221 P. 2d 857), as stated by this Court and quoted on p. 103 of Defendant's Brief, was not that here urged by the Commission. Rather, it was the very different question of whether to permit Kennecott, for the year 1942, to allocate to Utah *a proportionate part of its total net income from all its divisions*, as distinguished from allocating to Utah *a proportionate part of the net income of the Utah Copper Division*. For all years prior to 1942, Kennecott had made its franchise tax returns on the basis of an apportionment of the net income of the Utah Copper Division alone, and the taxes for all these years had been settled with the Commission on that basis. In filing its return for the year 1942, this same practice had been followed by Kennecott, and a change to an apportionment of total net income of all Divisions was not urged by Kennecott until six years after the filing of its 1942 return on the other basis. In view of these facts, this Court refused Kennecott permission to change from its prior method of allocating to Utah a proportionate part of the net income of the Utah Copper Division (118 Utah at 149, 221 P. 2d at 862). In this decision of this Court and this action of the



Commission, Kennecott has concurred and has not raised again the question of applying the apportionment formula to its total net income from all Divisions, which was denied by this Court.

Not only does the decision of this Court in Case No. 7298 not support the present argument of the Commission, but it is exactly to the contrary.

**(b)**  
**Point**

**The Commission's contention that Kennecott's manner of accounting precludes this taxpayer from making any allocation outside of Utah of any part of the net income from its Utah Copper Division is not in accord with either the law or the facts.**

The Commission contends in its Brief (p. 102) that Section 80-13-16 (1), U.C.A. 1943 (quoted on p. 51 of that Brief) requires that "where the net income attributable to business within the state is separately computed on the taxpayer's books of account, the statute commands that the tax be computed on the basis of the net income reflected on the taxpayer's books" and, accordingly, that an allocation of total net income of the taxpayer is not permitted or required. This is another example of the manner in which the Defendant's Brief seeks to confuse the issues.

In the first place, Kennecott's divisional accounting as to the Utah Copper Division does not purport to arrive at, and does not reflect, net income solely "attributable to

business done in Utah"; secondly, contrary to the Commission's contention, Section 80-13-16 (1), has no bearing whatever on apportionment of net income. This provision relates to the accounting principles and methods to be used in the computation of the total "net income" from activities without as well as within the State before any apportionment thereof is made. After such total "net income" has been computed, then and only then is determination to be made of the portion of such "net income" assignable to Utah. The structure of the act makes this abundantly clear. Section 80-13-3, of the Utah franchise tax law provides for the imposition of a tax measured by "*net income* for the preceding taxable year *computed* and *allocated* to this state in the manner hereinafter provided". Section 80-13-16 (1) specifically prescribes how such net income shall be *computed*, and Section 80-13-21 specifically provides for the *allocation* of the net income so computed to business done within and without the State.

As stated in Plaintiffs' Brief (pp. 7-8), Kennecott has followed a divisional method of accounting for its various mining operations.

The record is entirely clear as to what the net income of the Utah Copper Division, as recorded by this divisional accounting practiced by Kennecott, is and what it is not.



As has been stated in Plaintiffs' Brief (p. 7), Kennecott is engaged in a number of activities, including principally the production and sale of copper and other metals from mines located in Utah, Nevada, New Mexico and Arizona. Each of these operations is characterized as a Division, and each Division includes the local operations and activities under the local management (but under the general supervision and direction of Kennecott's main office in New York), certain other activities conducted, directed or supervised in whole or in part by the New York office, and the activities with respect to the sales of the Division's products which are wholly conducted, supervised or directed by the New York office and are in no way a responsibility of the local management.

Because each of these Divisions represents a unitary operation, the accounting for each Division seeks to show the net income earned from the extraction, processing and sale of the product of the mines of each Division as the result of, and taking into account, all activities of Kennecott, wherever conducted, with respect to that product. The Divisional accounting for each Division accordingly shows the net income of the Division resulting from the sales of its own products, together with any miscellaneous income specifically attributable to the Division, less the expenses incurred with respect to that Division (including a reasonable allocation of operating expenses, taxes and similar charges which are common to more than one Division). The Divisional accounting was in no way designed to show, nor does it show, how much of the

income of any Division was earned in any particular State, or as the result of any particular activity in the course of the unified business of producing and selling the mineral products from each of the several mines.

The following uncontradicted testimony by Mr. Fernald (Tr. 342), which is quoted and italicized in the Findings of Fact of the Commission (F. 65 p. 153), clearly establishes that the separate divisional accounting system was not intended to, and does not, reflect the net income of the Utah Copper Division properly attributable to activities within the State of Utah. After pointing out that separate accounts were maintained for Kennecott and each of its subsidiaries, Mr. Fernald stated:

“The system followed with respect to the accounts for the Utah Copper Division is the same as is followed for the other divisions of Kennecott Copper Corporation. Again, there is the separate accounting of the affairs of each of these Mines Divisions. The accounts of each division accordingly show the income arising from the sale of the products of the mines of that division (and any other income from the operations of that division) and the costs applicable thereto, *without regard to whether sales or costs are within or without the state where the mines are located and without regard to any other state boundaries*. This is the same system of books and accounts which has been followed ever since the properties of the several Mines Divisions, or any of them, became the properties of the Kennecott Copper Corporation.

“Accordingly, we have the separate accounting followed as between Kennecott Copper Corporation and its subsidiaries, each corporation by itself. We have the separate accounting followed as between the various divisions, mining divisions, of the Corporation; but there is only the unitary accounting for the operations of each of the divisions, *without any attempt ever made in any way to break that down into a separate accounting, as between that realized in one state or another, or as between the income derived from one operation or group of operations and another, in each division.*” (Italics supplied.)

The Commission itself in its Findings of Fact and Conclusions of Law recognized this fact. Thus, it states (F. 69, p. 163) :

“69. Having found on the basis of the record, including Mr. Fernald’s testimony (Tr. 340-5), that the separate accounts of the Utah Copper Division as regularly kept by Kennecott properly and clearly reflect the assets and liabilities and operations and net income of the Utah Division, it becomes necessary to determine what, if any, business activities or operations with respect to the Utah Division are carried out by Kennecott outside the State of Utah.

*“We have hitherto pointed out that Kennecott in directing and co-ordinating its world-wide enterprise, including its Utah Copper Division, from New York, is engaged in business in New York. For the purposes of this proceeding with respect to its Utah Division, Kennecott does business both within and without the State of Utah.”* (Italics supplied.)

The Commission (F. 69) then goes on to state, in its opinion in this case, that it is not its function or prerogative to attempt to evaluate, by its own judgment, the relative significance to the production of income of the Utah Copper Division of the mining and other operations in Utah as against the operations in New York. It states that the Commission's function is to determine the facts and then the statute determines the portion of net income assignable to business done within Utah. The Commission then proceeds to apply the apportionment formula prescribed by the statute, but in accordance with its misinterpretation of the facts.

In its final finding in this connection the Commission states (F. 71, p. 190) :

"71 We have heretofore found that the separate books of accounts are regularly kept and maintained for the Utah Copper Division of Kennecott accurately and truly reflect the net income of the Utah Division. We also find that the application of the statutory rules for determining the portion of the net income of the Utah Division assignable to business done within this state and to be allocated to this state for taxation under Section 80-13-21, Utah Code Annotated 1943, does allocate to this state the proportion of net income of Kennecott fairly and equitably attributable to this state. We also find that it is not necessary for this Commission to make any other basis of allocation to avoid subjecting the taxpayer to double taxation. (See: Sec. 80-13-21 (8))."

The Commission's present contention is, accordingly, directly contrary to its own findings.

The Commission cites, in support of its present contention, a number of quotations from textbooks, articles and court decisions, which it alleges demonstrate that where the books of a taxpayer are so maintained as to show the net income earned solely from activities within the taxing State, the net income so shown should be used in determining the tax, rather than resorting to an allocation of total net income.

It seems unnecessary to discuss these citations in detail. As they show on their face, they are speaking of situations where the particular accounting shows the net income earned solely from activities within the taxing State, which is not the case before this Court. They expressly recognize that, where the business is unitary, or where the accounting shows the net income from activities in more than one State, the net income as so shown cannot be used without an appropriate allocation. Thus, the quotation from 167 A.L.R. 943 appearing on page 99 of the Commission's Brief states:

“ ... A direct allocation by the separate accounting method is made where a taxpayer does business in two or more states, *but all of his activities in one state, or all of a certain type of business in one state, is conducted as a separate business not connected with activities in other states.* But in most cases a business is unitary,



so that a direct allocation is impossible, and an allocation - sometimes called 'indirect allocation' - must be made under a formula."

It is only when the separate accounting shows that income attributable solely to business done in the taxing State that use of such separate accounting can become permissible. On the contrary in the case before this Court, Kennecott's divisional accounting for the Utah Copper Division shows not income earned in Utah but rather net income earned as to products originating in the Utah mine as the result of all activities, wherever carried on, contributing thereto.

**(c)**  
**Point**

**The Commission's assertions that, as to its Utah Copper Division, Kennecott is not engaged in business in any State other than Utah and that none of the activities of the New York office contribute to the income of the Utah Copper Division are not only in direct conflict with the facts in the record and the applicable authorities but as well with the very determinations of the Commission itself in this proceeding. (Def's. Br., pp. 219-232.)**

The Commission's assertions result from a disregard of the real nature of Kennecott's business and its unitary character, the services rendered by its officers and employees in New York and their contribution to the earning of the income of the Utah Copper Division. This is true, whether or not the activities of the Sales Corporation are to be taken into account, a matter to be discussed under our Point III.

We have already outlined, commencing on page 8 of Plaintiffs' Brief, the nature of the operations of the Utah Copper Division. As there pointed out the process of extracting the ore from the ground, its progress through the concentrators, smelters and refineries (which additional processes are required to produce a marketable product) and the sale of the resulting metals, constitute one continuous, uninterrupted and unified operation, the sole purpose of which is the production and sale of metals at a profit. A part of this operation, namely, the physical acts of removal of the ore from the mine and its concentration and a large part of smelting, is conducted in Utah; the remainder, namely, the transportation, a part of smelting, the refining and sale, and Kennecott's activities with respect thereto, take place outside the State of Utah.

This continuous process is carried on through the activities of officers and employees of Kennecott located both in Utah and elsewhere, the work of all of whom is necessary to the successful operation of the venture and the realization of the profit therefrom.

As pointed out above (p.22) the Commission, with all the evidence in this case before it, has recognized the fact and value of the out-of-state activity, and determined that the statutory formula should be applied to the net income of the Utah Copper Division (although in its determination it has misconstrued the facts applicable to one of the factors of that formula, F. 69, p. 163, Def's Br. 219, 242). But now, unsupported by the evidence, it



urges that the income earned through the mining of the ore and the preparation and sale of the metals is attributable entirely to Kennecott's activities within Utah, and that its findings to the contrary were in error.

We do not believe that any extended discussion is required to demonstrate the error in this contention. As this Court well knows, a large and complicated operation, such as that here involved, requires for its successful conduct a variety of services, rendered by many people working in different fields, under the direction of a competent supervisory and executive staff, which in this instance is located at Kennecott's principal offices in New York. The metals cannot be merely scooped from the ground and handed to a willing buyer on the spot, ready and able to receive and pay for them. Large plants and other facilities must be designed, constructed, operated and maintained. Materials and supplies must be purchased, transportation provided arrangements made and continuously supervised for the smelting and refining of the ore. Proper accounting for each of the operations must be maintained. Advertising, finances, pensions, labor relations, engineering and legal problems and multitudinous other matters must be adequately handled, and require the full time service of many persons. And all these distinct, but related and equally essential activities, must be supervised, coordinated and directed and policies determined, by the directors and chief executives of the company and their staff.

As clearly shown hereinafter on page 29 et seq. of this Brief, many of these essential activities with respect to the Utah Copper Division are conducted in the New York office.

The Commission really does not deny the above. Rather it seeks without basis in fact to minimize the importance of these out-of-state activities of the Utah Copper Division by referring to the New York office as solely an "administrative office" (Def's Br., pp. 221, 229, 230) engaged in "housekeeping duties" (Def's Br., p. 22), and by pointing to the fact (true in the case of any industrial enterprise) that the labor force at the plant largely exceeds in number the executive and supervisory staff in the principal office (Def's Br., pp. 39, 229). The Commission also implies that, because the company also maintains an office in Salt Lake City, the New York office is really surplusage for which more than adequate allowance has been made by allocated cost allowed as an expense in arriving at total net income from the unified operation (Def's Br., pp. 162-3) - thus treating all net income as being attributable solely to the activities in Utah.

The truth is, of course, that the income of the Utah Copper Division results from the activities conducted both within and without the State of Utah; it cannot be attributed solely, or in any definite part, to one or the other. The case is precisely one where, because no such direct allocation of income can be made, recourse must

be had to a formula designed to do justice between the states involved and the company whose business is conducted in both. This the Utah statute prescribes.

Because of the effort of the Commission to minimize the activities of the New York office in the production of income, and in fact, to assert that no income is attributable to such activities, it seems desirable at this point to discuss more completely than in Plaintiffs' Brief the activities performed by the New York office as respects the Utah Copper Division itself.

In this connection, and to evaluate whether net income is properly attributable to the functions of that office, it is important to keep in mind the basic test of the nature of a unitary business. This is concisely stated by Altman and Keesling, *Allocation of Income in State Taxation* (2d 1950) as follows (p. 101):

“The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state.”

The Commission itself has found that Kennecott directs its industrial enterprises from its headquarters in New York (F.23, p. 23). It also found that the New York office coordinates all operational matters relating to mining, smelting refining and selling, and that its functions are many and varied as to relations with operations in the field, relations within itself and general relations with the public and the outside world (F. 24, p.

26). The New York office establishes the over-all policies for all the operating divisions and subsidiaries (F. 25, p. 29).

More specifically, as appears in the record, the General Purchasing Agent of Kennecott, located in New York, purchases approximately 44% of Kennecott's materials, equipment, machinery and supplies (Tr. 45-6, 154). Local purchasing agents, including those in Kennecott's Salt Lake City office, are under the general supervision of the New York office (Tr. 45-46, 154). It should be noted, as indicated in the cases cited subsequently in this Brief, that centralized purchasing is one of the accepted indicia of a unitary business.

The local accounting office in Salt Lake City handles the details of the local accounting for the Division and reports accounts monthly to New York where they are consolidated with the other accounts of Kennecott (Tr. 46). The New York office supervises and has detailed control over the accounts kept in Salt Lake City (Tr. 46). While the Salt Lake City office handles ordinary labor matters, important matters relating to the Utah Copper Division, such as labor contracts and increases in wages are considered and determined in New York (Tr. 46). All salaries of supervisory personnel in Utah above a certain amount are approved by the Salary Committee of the Board of Directors in New York and the New York management selects supervisory personnel. (Tr. 47).

All contracts with respect to the acquisition of property or property rights are received, approved and executed in New York, as are special contracts such as smelting and refining agreements (Tr. 46). The Traffic Department in New York routes all shipments of products out of Utah and shipments of purchases into Utah; the local office handles details in this connection under the supervision of the New York office (Tr. 46, 47).

The New York office handles any controversy respecting local taxes. All Federal taxes are handled exclusively in New York (Tr. 47). The New York office also handles all the detail of sales accounting and settlements, and transmits the results to its Salt Lake office (Tr. 175).

The highly important matter of the rate and volume of production is directed from the New York office, based on constant study and estimates of market and other economic conditions as well as metal, smelter and refinery space available (Tr. 149). Daily reports as to tonnage mined, copper content, tonnage of concentrates produced, grade of concentrates, and blister, fire refined, and electrolytic copper produced, are forwarded to New York, assembled there and evaluated (Tr. 151). The New York office negotiates all smelting contracts including those required when more concentrates are produced in Utah than the Garfield smelter can treat, and also all refining contracts (Tr. 151). It is obvious that from the sole standpoint of coordination of the production, smelting and refining processes, the New York office plays a highly important part in the realization of net income.



Kennecott maintains offices at the Baltimore and Perth Amboy refineries of A.S. & R., from which offices Kennecott's employees report to the New York refinery supervisor as to the proper accounting by the refineries for metals and operating costs and charges (Tr. 52, 152).

The New York office, and the Board of Directors must pass on all appropriations for capital expenditures by the Utah Copper Division exceeding \$5,000 (Tr. 48). Capital investment and expansion, of course, are crucial aspects in the profit picture of an industrial enterprise. These matters are determined in the New York office and purchasing of materials and equipment therefor is made by the Purchasing Department in New York (Tr. 153-154). Kennecott's New York office is its principal office which supervises and controls all operations of every kind wherever performed.

A recent example which strikingly illustrates the importance of the New York office in connection with the business of the Utah Copper Division and the benefits thereby given Utah is the new Garfield refinery of Kennecott, the whole program for which, except field construction, was under the direct supervision of an officer of the New York office — i.e., original recommendation, development of designing and engineering and technical forces, selection of equipment and letting of contracts therefor (Tr. 154).

The New York office also actively participates in matters relating to the sales of the company's products,

as well as exercising supervision and control over such sales. Such activities are outlined more fully hereinafter at page 64 et seq.

This more detailed summary of the duties and activities of the New York office, as respects the Utah Copper Division itself, its constant, intimate and important direction of and active participation in the business of the Utah Copper Division, has been presented to show once and for all the absurdity of the Commission's claim that no net income of the Division (or only about 8% as it contends in its Point III) is attributable to out-of-Utah activities.

The Utah franchise tax expressly provides (Section 80-13-21 (5) and (6) ) that the net income of a corporation doing business in Utah is to be apportioned if it "carried on *any* business outside this State", and is to be allocated wholly to Utah only if it "carries on *no* business" without this State. Under Section 80-13-1 (5), the term "doing business" is broadly defined to include "any transaction or transactions in the course of its business" by a corporation. Even if we disregard the functions of the Sales Corporation and A.S. & R., it is still perfectly clear that, as respects the Utah Copper Division, Kennecott is engaged in business, essential to the operation of that Division, outside of the State of Utah. No more is needed under the statute to require an allocation.



The Commission's contention that the entire worth of the New York office is its cost is incredible. Kennecott believes it need not further magnify the material presented to this Court by submitting economic and business information and opinions as to the importance of the contribution to net income by management (Tr. 53-57), let alone a general operating, supervisory and executive office as extensive as in Kennecott's New York office. Such testimony already appears in the record. There is no magic method of stating the exact amount of its relative contribution. This is the very reason for the adoption and application of the apportionment formula of the statute.

As an additional point to its argument that 100% of the net income is to be allocated to Utah, the Commission apparently contends that Kennecott's activities in New York with respect to the Utah Copper Division are not such as would justify New York in imposing a tax on Kennecott for business done in that State, and that therefore Utah is free to tax the entire income of the Division (Def's. Br., p. 166). We have no doubt that, were the situation reversed, and Kennecott's New York office activities carried on in Salt Lake City, the Commission would assert jurisdiction to tax in Utah, whether or not other activities were carried on in this State. The fact is that Kennecott is doing business in New York and files a tax return and pays tax on that basis, as it is required by New York law to do. As we point out at page 47, the Commission is under a complete misapprehension as to the scope and effect of the New York law on this point.

(1)  
Point

**The Commission's argument is contrary to judicial authority.**

In support of its contention that, despite the activities carried on in Kennecott's New York office as an essential part of the operations of the Utah Copper Division, all the income of that Division is to be allocated to Utah, without any apportionment, the Commission cites two cases. These cases, it argues, support its contention that the existence of what it refers to as an "administrative office" outside the State does not entitle Kennecott to an apportionment, and that, at the most, it is entitled to deduct the cost of such office in arriving at net income.

The first case is *Shaffer v. Carter*, 252 U.S. 37, 64 L. ed. 445 (1920), sustaining the validity of the Oklahoma income tax law as applied to net income from oil and gas producing property located within the State of Oklahoma owned by a non-resident individual. It is difficult to see any applicability of that decision to the present case. That case did not involve any question of the right to an apportionment under a corporate franchise tax statute based on net income. Rather, the only question before the Court was whether the State income tax law could be applied at all to a nonresident individual as respects income earned from property located within the State. The Court held that Oklahoma could so apply its income tax law to a nonresident individual, and that

the fact that some activities with respect to the local property were carried on by the taxpayer outside the State did not prevent the State from taxing the "income which arose from within its own borders." As expressly stated by the Court in the portion of its opinion quoted in Defendant's Brief, it expressed no opinion as to the effect, in determining the amount of the tax, to be given to the out-of-state activity, as the question had not been raised in the case.

The Supreme Court of Kansas in *Montgomery Ward & Co. v. State Tax Commission*, 151 Kansas 159, 98 P. 2d 143 (1940), after indicating that the *Shaffer* case related solely to the issue as to whether Oklahoma had no jurisdiction to tax a nonresident because an income tax was a personal tax, discussed the statement of the Supreme Court of the United States (relied upon by the Commission as indicating that no profit is attributable to executive functions) and stated as follows (98 P. 2d at 149):

"... it may be noted that the court said that 'there might be a question whether the *value* of the service of management rendered from without the state ought not to be allowed as an expense incurred in producing the income.' The *value* of such service is something entirely different from the *cost* of such service. '*Value*' would include a reasonable profit."

It is clear that the Commission cannot validly adduce the language of the Supreme Court of the United States in the *Shaffer* case as authority to the effect that no net

income of a corporate enterprise is attributable to such extensive and essential functions carried on outside the State as those carried on by Kennecott in New York.

The other case relied upon by the Commission is *Cottonwood Coal Co. v. Junod*, 73 Mont. 392, 236 P. 1080 (1925). The Court's comment, as is indicated in the paragraph quoted on page 119 of the Commission's Brief, related primarily to technical corporate actions, customarily carried on in a so-called "statutory office", in no way comparable to the manifold executive, supervisory and operating activities performed by Kennecott in New York as outlined above. Moreover, an examination of the case shows that the issue before the Court was very different from that here involved.

The Commission presents a most misleading interpretation of the issue in the *Cottonwood Coal* case. Thus, when on page 120 of its Brief it is stated that the Court held that the entire net income from the mining business was attributable in its full 100% amount to Montana, the Commission implies that the issue was whether any portion of net income was to be allocated outside of Montana.

Actually, because of the statute involved, the issue in the *Cottonwood Coal* case was not whether any net income should be allocated outside of Montana, but whether all of the net income of the taxpayer (as claimed by the taxpayer), or an amount *in excess* of its total net

income (as claimed by the State), should be taxed by Montana.\* The Court held for the taxpayer on the issue presented.

The Commission has thus cited no valid authority for its unrealistic position. There is, however, ample authority to the contrary, if any be needed (which we do not believe) to demonstrate the fallacy of the Commission's argument on this point.

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\*As opposed to the usual method of first determining and then allocating net income, the Montana statute in the case of a corporation engaged in business wholly within Montana, determined net income by allowing specified deductions from gross income, and, in the case of a corporation engaged in business partly within and without Montana, ascertained net income by deducting from gross income within Montana specified deductions relating to Montana business. In the Cottonwood Coal case, the taxpayer filed a return reporting *all* gross income as Montana income, and there was no issue between the parties as to this. In its return, it deducted from this reported gross income all the deductions allowed in computing net income (on the ground that it was engaged in business wholly in Montana). The State, claiming that the taxpayer was engaged in business both within and without Montana, restricted the deductions to those relating solely to Montana (apparently excluding all expense relating to the Minnesota office) while still insisting that the entire gross income was allocable to Montana. As a result the State was seeking to collect a tax on an amount of net income in excess of the total net income of the taxpayer for the year in question, under a statute imposing a tax upon "total net income received . . . from all sources within the State of Montana."



That net income is properly attributable to a State where only executive office functions are carried on is clear from the decision in *Commonwealth v. Minds Coal Mining Corp.*, 360 Pa. 7, 60 A. 2d 14 (1948), upon which case the Commission relied in its decision and which is discussed on pages 298-305 of Defendant's Brief and pages 50 to 53 of Plaintiffs' Brief.

In that case the tax involved was a tax for the privilege of doing business in Pennsylvania, based upon net income, with provisions in all material respects substantially identical to the Utah statute. The taxpayer was a West Virginia corporation which owned and operated a coal mine in West Virginia, mined no coal in Pennsylvania, and sold its products through an independent factor, located in New York. Although the taxpayer's sole connection with Pennsylvania was its executive office in that State, to which the independent factor reported, where but two of its officers were chiefly situated, the Supreme Court of Pennsylvania found as a fact that the taxpayer was engaged in business in Pennsylvania.\* Its decision taxed a substantial portion of the taxpayer's

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\*In discussing the case on page 303 of its Brief, the Commission specifically states that the West Virginia corporation was qualified to engage in business in Pennsylvania, was actually so engaged, and was thus taxable in Pennsylvania. This certainly completely contradicts the Commission's argument under its Point II that no net income under this type of statute is attributable to executive functions.



net income as attributable to business done in Pennsylvania. This decision is thus directly in conflict with the Commission's contention that executive office functions do not constitute doing business within a State for the purpose of allocating a portion of net income to such activities under a statute such as that of Utah.

Montgomery Ward & Co. v. State Tax Commission, 151 Kan. 159, 98 P. 2d 143 (1940) recognized the propriety and necessity of attributing net income to management functions. That case involved a tax on doing business based on net income derived from property located and business transacted within the State. The taxpayer operated retail merchandise stores nationally, some of which were in Kansas. The decision of the tax commission was that the net income derived from Kansas business was the receipts from sales in the Kansas stores less the cost of the goods sold and the full pro rata Kansas share of the cost of services of purchasing, handling, management, etc. In its returns, the taxpayer, having shown "net income" as so determined, then made an allocation between Kansas and the other states where the outside activities of purchasing, handling, management, etc., occurred, on the ground that some of the so-called "net income" was derived from such activities. Although the Court did not approve the specific allocation reported in the returns of the taxpayer, it rejected the tax commission's contention and accepted the principle advanced by the taxpayer that the statute was not satisfied merely by allowing the *cost* of goods and the *cost* of purchasing, handling, management, etc., services in determining net

income attributable to Kansas. It held that net income was derived from all of such activities, including the Kansas activities, and an equitable allocation was required.

The Supreme Court of Missouri, sitting in banc, in the case of *In re Kansas City Star Co.*, 346 Mo. 658, 142 S.W. 2d 1029, 130 A.L.R. 1168 (1940), which involved apportionment of net income of a newspaper company engaging in business both within and without the State, expressly stated that net income was attributable to executive functions in overruling a prior decision by one division of that Court. The Court stated (346 Mo. 658, 142 S.W. 2d at 1039) :

“We agree with appellants that the portion of respondent’s income attributable to capital and labor employed at the home office in Kansas City, Missouri, must be regarded as having its source in Missouri. Appellants say that conclusion is contrary to the holding in *F. Burkhart Mfg. Co. v. Coale*, Mo. Sup., 139 S.W. 2d 502 recently decided by Division 2 of this court, and ask us to overrule that case. There, a Missouri manufacturing corporation owned factories in several other states, which were operated as separate business units. Each factory had its own quota of salesmen; orders were sent in by these men from outside states to their respective plants and were accepted and filled there, and the bills collected there. The corporation retained only a ‘directory control’ over the outside plants vested in its executive officers who lived in Missouri. On these facts this court held income from these out-state plants was *wholly* derived from sources outside this state and was not subject to income tax in this state at all.

“Appellants contend that ruling was erroneous because the ‘directory control’ by the executive officers in Missouri over the foreign plants was labor performed in this state, at least in part producing the income of those plants, which made that income subject to allocation under Sec. 10115. The Burkhart case was submitted on an agreed statement of facts. It, or at least our opinion, does not disclose what if any actual supervision or control the executive officers exercised over the foreign plants. If it efficiently entered into the processes by which income was earned, we think appellants are right.”

### **Other Cases Cited by the Commission**

In addition to the cases discussed above, the Commission cites a multitude of cases which it contends supports various points of its argument made under its Point II. Reasonable regard for the time of this Court forbids even an attempt to discuss them all. We believe it can fairly be said that all of these cases are irrelevant or unnecessary to a decision of the question raised by the Commission under this point. These cases fall into one or another of the following classes:

1. Cases dealing with the interpretation of the “net proceeds” and mining occupation taxes. As pointed out above, these are inapplicable to the franchise tax:

*Mercur Gold Mining and Milling Co. v. Spry*,  
16 Utah 222,

*Salt Lake County v. Utah Copper Co.*, 294 F. 199,

Salt Lake County v. Utah Copper Co., 93 F. 2d 127,

Salt Lake County v. Kennecott Copper Corp., 163 F. 2d 484,

Kennecott Copper Corp. v. State Tax Commission, 116 Utah 556, 212 P. 2d 187.

2. Cases sanctioning the use of a separate accounting method rather than application of a formula where such separate accounting method shows, on a fair basis, the net income solely attributable to activities within the State. Such cases are irrelevant since, as shown under Point (b) above, the net income of the Utah Copper Division does not arise solely from activities within the State of Utah:

Edward Hines Lumber Co. v. Galloway, 175 Ore. 524, 154 P. 2d 539,

Fisher v. Standard Oil Co., 12 F. 2d 744,

Standard Oil Co. v. Thoresen, 29 F. 2d 708,

Standard Oil Co. v. Wisconsin Tax Commission, 197 Wis. 630, 223 N.W. 85,

Piedmont & Northern Railway Co. v. Query, 56 F. 2d 172.

3. Cases denying the right of a State to apply a statutory apportionment formula to consolidated totals of affiliated corporations where only one of the corporations is doing business within its borders. Such cases are irre-

levant here since Kennecott agreeably with this Court's decision in its Case No. 7298 requests application of the Utah apportionment formula to the net income of the Utah Copper Division only, which Division, as above shown, does business both in and out of Utah:

Burroughs Adding Machine Co. v. Wisconsin Tax Commission, 237 Wis. 423, 297 N.W. 574,

Northern States Power Co. v. Wisconsin Tax Commission, 237 Wis. 433, 297 N.W. 578,

First Security Corp. v. State Tax Commission, 91 Utah 101, 63 P. 2d 1062,

A. C. Lawrence Leather Co. v. Commission, 254 Mass. 609, 150 N.E. 851,

J. G. McCrory Co. v. Commissioner of Corporations, 280 Mass. 273, 182 N.E. 481,

State v. Oliver Iron Mining Co., 207 Minn. 630, 292 N.W. 407,

Curtis Companies, Inc. v. Wisconsin Tax Commission, 214 Wis. 85, 251 N.W. 497, 92 A.L.R. 1065.

4. Cases holding that a State may disregard and adjust unfair contractual arrangements between affiliated corporate entities resulting in an unfair attribution of net income upon a separate accounting basis to the taxing State. Such cases have no bearing here since both parties are agreed that the intercorporate contracts and divisional accounting result in the proper total net in-

come of the Utah Copper Division, the only question being whether, as contended by the Commission, such net income is fairly ascribable entirely to Utah:

Cliffs Chemical Co. v. Wisconsin Tax Commission,  
193 Wis. 488, 214 N.W. 446,

In re Morton Salt Company, 150 Kan. 650, 95 P.  
2d 335,

Palmolive Co. v. Conway, 56 F. 2d 83,

Buick Motor Co. v. City of Milwaukee, 48 F. 2d  
801,

Nutrena Mills Inc. v. Kansas State Tax Commis-  
sion, 150 Kan. 68, 91 P. 2d 15,

Wyandotte County Gas Co. v. State Commission-  
er of Revenue and Taxation, 155 Kan. 619,  
127 P. 2d 481,

Columbia Iron Min. Co. v. Iron County, et al., 230  
P. 2d 324.

The following two additional contentions made by the Commission under Point II in the Defendant's Brief require but brief mention.

(d)  
**Point**

**There is no reason why the same income should be the test in the Utah Mine Occupation Tax, the Ad Valorem Mine or "Net Proceeds Tax" and the State Franchise Tax.**



Another error of the Commission is its argument appearing at several places in its Brief (primarily Def's Brief, 110-115) that in some way the measures of the franchise tax, the mine occupation tax and the ad valorem mine tax ("net annual proceeds") are or should be the same. As already pointed out on page 8 above, the franchise tax is completely different from the other two taxes in application, basis and measurement. Neither of the other two statutes provides for any such determination and allocation of net income as is prescribed by the franchise tax statute. Absence of allocation provisions under the other two statutes is no basis for denial of the prescribed allocation under the franchise tax law. Nor does such prescribed allocation under the franchise tax law require that similar allocation must be made under the other statutes. In the computation of neither the net annual proceeds tax nor the mine occupation tax is any net income or profit assigned to smelting, transportation, refining or sales, or to any other of the several activities of this unitary operation.

That the franchise tax is otherwise clearly distinct from the other two taxes is demonstrated by assuming that the Sales Corporation were not in existence and that its activities were conducted directly by Kennecott. In such circumstances, the Commission concedes that the sale would be allocable outside of Utah and that accord-

ingly a substantial portion of the net income of the Utah Copper Division would be allocable outside Utah. (Def's. Br., pp. 229-230, 233). Yet, this change would not in any substantial way effect the values used for the net proceeds and mine occupation taxes.

The comparison of the franchise tax with the other two taxes as contained in the argument of the Commission, is completely unfounded in logic or legislative intent or statutory expressions. The cases discussed on pages 112-115 of the Defendant's Brief, relating to the property and mine occupation taxes, have nothing whatever to do with the issues before this Court.

**(e)**

**Point**

**The Commission's assertion that no part of the net income of the Utah Copper Division has been taxed or is legally subject to taxation in New York or elsewhere outside Utah is neither in accord with the fact nor justified by the record.**

In support of its contention that 100% of the net income of the Utah Copper Division should be taxed in Utah, the Commission asserts that no portion of such income has been taxed or is legally subject to tax in New York or any other jurisdiction as arising from or attributable to business done outside of Utah. (Def's. Br., p. 167). No support for this extraordinary statement can be found in the record or in fact. A fairly allocated portion of Kennecott's net income, including that of its

Utah Copper Division, is legally subject to tax by New York, in which State the corporation is incorporated and maintains its principal offices. That an allocated portion of net income from the production and sale of the mineral products of the Utah Copper Division is legally subject to tax by New York is clearly shown by the *Minds* case discussed subsequently at page 39 of this Brief. In that case the Pennsylvania court held a West Virginia corporation subject to the franchise tax in Pennsylvania, and allocated all of its sales to Pennsylvania under an allocation formula similar to that of the Utah law, although its activity in Pennsylvania was the maintenance of an executive office, all production being carried on in West Virginia and sales being conducted by an independent factor in New York.

Net income of the Utah Copper Division attributable to New York activities being subject to tax in New York, it is entirely irrelevant whether or not New York has imposed a tax measured by such net income or what the amount of a tax so levied is. Even though New York had failed to impose a franchise tax, applicable to Kennecott, measured by net income earned within that State, that fact would not serve to extend the power to Utah to tax income earned outside its own boundaries. The matter being irrelevant, Kennecott properly refused to participate in the Commission's fishing expedition concerning Kennecott's New York taxes (Tr. 212, 213, 448-449, 520, 527-533). Actually, New York does have a franchise tax, as the Commission well knows. Kennecott has reported to New York, as required, its entire net income from

sources within and without that State (including the net income of the Utah Copper Division) and has paid the tax determined by New York to be due.

**(f)**  
**Point**

**The contention made by the Commission under its Point II, that none of the net income of the Utah Copper Division is allocable outside Utah, is not properly at issue before this Court. (Def's Br., pp. 185 to 218.)**

As pointed out above, the Commission in its decision below found that, as respects the Utah Copper Division, Kennecott was doing business both within and without the State of Utah and was thus entitled to an apportionment of the net income of the Utah Copper Division (F. 69, p. 163). Consequently, it held that the apportionment formula of the Utah statute, was to be applied, though giving it an erroneous interpretation. It now seeks in its Brief to repudiate that decision and to claim that no apportionment whatever is required or justified.

While counsel for the Commission stated at the hearing that he reserved the right to contend that 100% of the net income of the Utah Copper Division was allocable to Utah, no such contention was advanced by him (Tr. 8, Def's Br., p. 209). The Commission did not accept or even mention this claim in its findings, opinion or decision. As appears at page 22 above, its findings included one which clearly entitled Kennecott to such an appor-

tionment - namely, the fact that Kennecott was doing business outside of Utah with respect to the Utah Copper Division.

The Commission admits that on its own initiative it cannot now order a rehearing to increase the alleged deficiency. It therefore asks the Court to reverse the case and remand it to the Commission when (so it claims) Utah procedure would permit it to redetermine the deficiency. (Def's Br., 188 et seq.)

It is difficult to comprehend why, if the Commission really believed (as its Brief would seem to contend) that 100% of the Utah Copper Division's net income should have been used as the basis for the tax, it did not so find in its decision. Nothing has happened since that date in any way affecting the question. The Commission, as representative of the State of Utah, was charged with the duty of making the initial determination of the amount of tax. If the Commission thought the tax should have been assessed on a different basis, it should have so assessed it. Obviously, it did not think so and its conclusion on the matter is evident from its own opinion.

It is also difficult to conceive any reason of public policy for permitting the Commission to fix the tax on one basis and then, when the taxpayer, accepting that basis, takes an appeal on other issues, to contend that the basis of its prior decision was wrong and should be changed.

As anyone would expect, and as the following discussion will show, the Utah statute neither contemplates nor permits any such extraordinary *volte face* by the Commission.

The Commission's argument first invokes Section 80-13-39, providing that the Commission shall have jurisdiction to redetermine a deficiency in a greater amount than that originally asserted if a claim therefor is made "at the hearing or prior thereto". The Commission quotes the statement of its counsel (Def's Br., 209) at the hearing that he reserved the right to the Commission and to the Supreme Court if the case again reaches the Supreme Court to amend the deficiencies by asserting a tax based on 100% of the Utah Copper Division's net income. It then relies upon the power of this Court under Section 80-13-47 to review the case upon the law and the facts and under Rule 76 (a) of the Utah Rules of Civil Procedure to reverse, affirm or modify the decision below or to remand it for a rehearing.

We need not argue the point as to the right of the Commission at the hearing held before it to determine a larger deficiency in the tax than that shown in its original notice to the taxpayer. The hearing having been held and concluded, and a final decision reached by the Commission, it has now no further power to determine a larger deficiency at any rehearing or on any subsequent proceedings.



Section 80-13-39, cited by the Commission, does not give it such authority. That section provides for a redetermination by the Commission of an increased deficiency if claim is made therefor "at the hearing or prior thereto". In enacting this section, which is almost identical with a similar provision in the Federal income tax law, the Utah Legislature expressly omitted provision for a redetermination by the Commission of an increased deficiency if claim were asserted "at a rehearing". On the other hand, the 1928 Federal statute, 26 U.S.C.A. Internal Revenue Acts, 1924 to date, p. 425, used as the model for the Utah legislation, provided for determination of an increased deficiency by a Board of Tax Appeals (now Tax Court) "if claim therefor is asserted by the Commissioner at or before the hearing *or a rehearing*". (Italics supplied). The intent of the Utah Legislature to limit the power of the Commission to increase a deficiency to the decision rendered at the close of the original hearing, is clear. In the light of the statute the Commission would have no such power to increase the deficiency even though the case be remanded by this Court.

The Commission also suggests that Section 80-13-46 authorizes it to take the same action at a rehearing ordered by the Court as it could at the initial hearing held before it. This argument is clearly invalid. That Section, as its title provides, "Decision of Tax Commission - When Final", relates only to the time at which the Commission's decision will become final. It has nothing whatever to do with the issues which can be tried before the

Court or the Commission. The last part of the Section, relied on by the Commission, merely provides that the requirement of notice to the taxpayer and the thirty-day limit on appeal to this Court shall apply after a decision rendered on a rehearing to the same extent as in the case of the original decision.

Furthermore, the Commission's claim that this Court, or the Commission upon a rehearing, may increase the deficiency, in effect requires this Court to hold that the Commission itself can take an appeal from its own decision - from its own rejection of a claim made at the hearing held before it. The Commission itself admits (Def's Br., 187) that the statute does not authorize it to take an appeal to this Court.

Under the Utah franchise tax law an appeal from the decision of the Commission can only be taken by the taxpayer. This procedure is eminently fair because under the Utah tax system the final action of the Commission is in a quasi-judicial capacity and not as a litigant. And the procedure is quite different from that under Federal law where the Tax Court (formerly Board of Tax Appeals) is independent of the Commissioner of Internal Revenue and, as the Commission points out (Def's Br., 187), the Commissioner of Internal Revenue is specifically given the right of appeal from decisions of the Tax Court.

In attempting to circumvent the prohibition against an appeal by it, the Commission calls upon the general

powers of this Court. It is, however, quite clear that such powers relate only to issues in a law suit properly before this Court. This is most readily shown in cases where one party, although having the right to appeal, has not duly exercised that right and is thus in the position of the Commission here in attempting, on an appeal by the other party, to seek a more favorable decision.

The general rule, followed in Utah, is that an appellee, where he does not cross-appeal, may not present for review any exceptions taken by him to rulings or decisions of the lower tribunal, e. g., *Wilcox v. Cloward*, 88 Utah 503, 56 P. 2d 1, 9 (1936); 5 C.J.S. Appeal and Error §1498 (1). There is nothing in the statute giving the Commission the right to cross-appeal its own decision where taxpayer seeks review in this Court. Indeed, it would be inconsistent to allow the Commission that right if it cannot appeal where taxpayer is satisfied with the decision and by his acquiescence bars any further proceeding.

In the Federal courts, the Commissioner of Internal Revenue has no right to raise objections to the decision of the Tax Court on a taxpayer's appeal unless he himself has appealed that decision. In *Helvering v. Pfeiffer*, 302 U. S. 247, 82 L. ed. 231 (1937), the taxpayer appealed the decision of the Board of Tax Appeals. The Commissioner did not file a cross-appeal but attempted on the appeal to argue a contention not advanced before the Board. The lower court held that the deficiency determined by the Board could not be sustained *pro tanto* by

an argument that "was not in issue before or decided by the Board of Tax Appeals." 88 F. 2d 3, 5. The Supreme Court, in an opinion by Mr. Justice Brandeis, held that the Commissioner's argument was properly rejected.

This rule with respect to appeals has also been followed where the Commissioner was barred from taking an appeal, as by the statute of limitations, as well as in cases where his abstention was voluntary. *Rosenthal v. Commissioner*, 205 F. 2d 505 (2d Cir. 1953.)

State courts have also followed this rule in cases where the taxing authority took no appeal from the decision of a lower tribunal. In *Central Life Assurance Soc'y v. Des Moines*, 212 Iowa 1254, 238 N. W. 535 (1931), the Court said that the section of the code authorizing courts to increase or decrease an assessment on an appeal from the Board of Tax Appeal was not intended by the Legislature to benefit the party who did not appeal.

"Except where it is otherwise expressly provided, the appellee in any appeal can only defend that given him by the ruling appealed from. If the appellee desires more than obtained in the ruling appealed from, he must also appeal . . . Unless there is clear indication to the contrary, we cannot assume that the legislature intended to penalize the taxpayer by raising the assessment because he takes an appeal." 238 N. W. at 538.

See also *Thomas v. Wisconsin Dep't of Taxation*, 250 Wis. 8, 26 N. W. 2d 310 (1947); *Wheeling Steel Corp. v. Evatt*, 143 Ohio St. 71, 54 N. E. 2d 132 (1944). And

in criminal cases, where the State is normally barred from taking its own appeal, as the Commission was here, the general rule is that "on accused's appeal the prosecution cannot contend that accused was sentenced under the wrong statute, and that he should have received a heavier sentence." 24 C.J.S. Criminal Law §1841; *State v. McDowell*, 61 Wash. 398, 112 P. 521 (1911).

The Commission cites only two cases in support of its argument that this Court may increase *Kennecott's* tax on the basis of a theory rejected by the Commission in the proceedings below, neither of them relevant to the question of whether a taxing authority may attack its own decision on an appeal by taxpayer. *Olds & Whipple v. United States*, 22 F. Supp. 809 (Ct. Cl. 1938), stands only for the proposition that where the taxpayer's appeal from a determination of the Board of Tax Appeals is successful, he cannot complain if the tax determined under his own theory is greater than that originally assessed by the Commissioner. And *Insular Sugar Refining Corp. v. Commissioner*, 157 F. 2d 673 (2d Cir. 1946), held simply that an appellate court could remand a case to the Tax Court for a "rehearing" under Federal law.

As the Commission points out, the proceedings of this Court in an appeal from a decision of the Tax Commission are to be conducted as far as possible in the same manner as appeals from lower courts. Under Rule 76 (a) of the Rules of Civil Procedure, this Court is to "pass upon and determine all questions of law involved in the



case presented upon the appeal and necessary to the final determination of the case.” The issue of whether the income of the Utah Copper Division is to be attributed entirely to this State without any attempt at apportionment is not one of the “questions of law . . . presented upon the appeal” and under the applicable Utah statutes and rules of law developed in prior decisions of this Court the Commission has no right to raise it.

It is clear that the Legislature intended that the Commission should grant a hearing and make its decision, acting in a quasi-judicial capacity, and that once this was done its decision was final, subject only to the taxpayer’s right of appeal to this Court. If the Commission were authorized at will to repudiate its own decision and reassess the tax, there would never be an end to the matter.

### **(g)**

#### **Summary**

The foregoing demonstrates that the Commission’s claim that 100% of the net income of Utah Copper Division is allocable to Utah is erroneous and not a proper issue before this Court. The divisional accounting system of Kennecott did not purport to and did not show net income attributable to Utah, but, rather, it showed the net income of the Utah Copper Division attributable to its activities both within and without the State of Utah.



Furthermore, the activities in Kennecott's New York office, directly related to and a part of the operations of the Utah Copper Division, conclusively show that Kennecott is doing business in New York within the meaning of the Utah franchise tax law and therefore is expressly entitled to an allocation within the express provision of Section 80-13-21 (6) of that act. In the light of the facts, the Commission's present position that these activities in no way contributed to the earning of the income of the Utah Copper Division is incredible - it is contrary not only to general knowledge and the evidence in this case, but also to the applicable court decisions. In addition, the Commission's contention in its Point II is completely contrary to its own decision rendered below and to its own findings of fact.

Lastly, the issue is not one which can properly be raised in these proceedings before this Court to which Kennecott alone is authorized to, and has taken an appeal.

### **III**

#### **Point**

**The Commission has erroneously interpreted and unconstitutionally applied the Utah franchise tax statute by allocating to Utah, under the apportionment formula, receipts from sales of products of the Utah Copper Division. (Def's. Br., pp. 219-332.)**

Under its Point III, the Commission argues that, even if 100% of the net income of the Utah Copper Division is not allocable to Utah and accordingly the statu-

tory formula is to be applied, nonetheless 100% of the gross receipts from sales of the Division of copper, molybdenite, platinum and palladium (87.803% of total sales of the Division\*) are to be allocated to Utah under the gross receipts factor of the formula. This provision of the formula assigns to Utah gross receipts from sales

“ . . . except those negotiated or effected in behalf of the corporation by agents or agencies chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the corporation outside this state. . . ”

It is Kennecott's position that the gross receipts from the sales of all of the products of the Utah Copper Division are to be allocated outside Utah. Full support for this contention is, we believe, given on pages 19-67 of Plaintiffs' Brief. Receipts from the sales of Kennecott's products were not gross receipts attributable to business carried on within this State.

The tax statute, consistent with constitutional limitation, is designed to tax only the portion of the corporation's net income fairly attributable to the business done by it within this State. For this purpose it has established

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\*The Commission properly allocated outside the State of Utah the sales of gold and silver made directly by Kennecott to A.S. & R. Sales of platinum and palladium were made by A.S. & R. as agent for Kennecott and amounted to 1/100th of one per cent of the total sales.

a three-part formula in which equal weight is given to the separate factors of property, payroll and gross receipts. If a fair allocation is to be obtained, a reasonable and proper application of the gross receipts factor, as a balance to the property and payroll factors, is necessary. The strained and narrow interpretation given to the gross receipts factor by the Commission, under which substantially all of the sales would be allocated to Utah although no sales activity whatsoever took place within this State, not only does violence to the legislative intent in enacting the gross receipts factor but also to its language. Moreover, the position of the Commission in this case is directly contrary to its consistent administrative interpretation of the provision, as applied to Kennecott (or its predecessor), since enactment of the franchise tax statute in 1931.

The Commission admits, as it must, that no sales activities of any character with respect to the sale of any of the products of the Utah Copper Division are conducted within Utah either by employees of Kennecott or by anyone else and that the Utah office had no jurisdiction whatsoever over such sales (Def's Br. 37, 42-44, 164, 170, 183). It also admits that all such sales activities were conducted by persons operating out of offices permanently maintained and located outside of Utah - in the words of the statute, by agents or agencies "chiefly situated at, connected with or sent out from premises . . . outside of this state." (Def's Br., 261-329.) It concedes that, if there were no Sales Corporation and all selling

activities of both Kennecott and the Sales Corporation were conducted by Kennecott itself, these sales would be allocated 100% outside of Utah. (Def's Br., 34, 229-230, 233, 258.) It admits the Sales Corporation and all its officers and employees occupy offices which are an integral part of office space in New York rented by Kennecott from the owner of the building, and in most cases are persons who are employed by Kennecott. (F. 63, p. 113, Def's Br., 20, 38). It admits that the Sales Corporation is the agent of Kennecott, that Sales Corporation sells only the products of Kennecott (and of its subsidiary), that its sales for Kennecott are as an agent for Kennecott's account, and that, as such agent, it is subject to the control and direction of Kennecott as to all matters affecting sales of Kennecott's products.

What then is the Commission's basis for contending that *all* of such sales, having no relation whatsoever to any sales activities in Utah, should be allocated 100% to Utah. It is merely:

(1) that the Sales Corporation is what the Commission calls an "independent factor", as such its sales activities are not the activities of Kennecott, and that sales made by it are not made in the name of Kennecott and therefore are not made "in behalf of" Kennecott within the meaning of the statute;

(2) that even if such sales are made on behalf of Kennecott, they are made by the Sales Corporation's "own" employees operating out of its "own" offices

and therefore are not made by "agents or agencies chiefly situated at, connected with or sent out from premises . . . rented" by Kennecott.

It is clear from these admissions in the Commission's Brief (as it was already clear in the record) that from any realistic, economic, or, we might say, rational point of view, the sales of Kennecott's products were not made and no sales activities occurred in Utah. They were exclusively attributable to activities outside the State.

Yet as a result of its narrow and incorrect construction of the statute, the Commission has allocated to Utah a greatly disproportionate part of the net income of the Division. Despite the length of its argument, the Commission has totally failed to justify its interpretation or to answer the arguments made in Plaintiffs' Brief, briefly summarized above.

We will not attempt to reiterate that argument here, and beg leave to refer the Court to Plaintiffs' Brief (pp. 39 to 59) for a complete answer to the argument of the Commission. We would also respectfully refer the Court to the description commencing on page 29 of this Brief of the character of and amount of activities of the New York office as respects the Utah Copper Division and the obvious contribution which they make to the earning of the Division's net income. We believe these clearly show the unreasonable result of the Commission's position which would allocate over 93% of the entire net income of the Utah Copper Division to Utah.

We will, however, at this point, endeavor to set the record straight as to some of the facts and cases relied upon by the Commission, and to discuss certain of the Commission's contentions made in its Brief under its Point III.

**(a)**  
**Point**

**If the sales made by the Sales Corporation are not to be regarded as having been made in behalf of Kennecott, then the sales of Kennecott's products must be assigned to the jurisdiction where Kennecott's own sales activities took place.**

As will be demonstrated by the discussion later in this Brief, under any reasonable interpretation of the statute as applied to the facts of this case, the sales made by the Sales Corporation were sales made in behalf of Kennecott by agents of Kennecott situated at, connected with and sent out from its office in New York, and accordingly fall squarely within the above quoted clause of the statute.

However, as pointed out on page 49 of Plaintiffs' Brief, even if we assume, *arguendo*, that, for any reason, the sales made by the Sales Corporation are not to be regarded as having been made in behalf of Kennecott, as contended by the Commission, it does not follow that all gross receipts from sales are to be assigned to Utah.



In such case the location of selling activities of Kennecott itself in effecting or negotiating sales must control the sales allocation.

The Commission has attempted to answer this argument by asserting that the Sales Corporation conducted all sales activities, that no sales activities can be attributed to what the Commission terms the "administrative work" conducted by Kennecott in its New York office and that such office never negotiated or effected the sale of a single pound of metal (Def's Br., 230).

The record is directly to the contrary of the Commission's assertion. As pointed out at page 79 herein, Kennecott's officers direct what is to be done with respect to the sale of copper and molybdenite and the Sales Corporation acts upon their oral instructions. Kennecott's officers prescribe the general policy of conducting sales and are required to be consulted as to any out-of-the-ordinary occurrences. Kennecott's officers decide all important questions on sales, including questions of price and whether or not sales will be made at any particular period. Kennecott and the Sales Corporation "act together as a unit", in effecting the sales of Kennecott's products. (Tr. 632.)

As this Court well knows, the sales of a corporation like Kennecott, aggregating up to \$150,000,000 per year, (Utah Copper Division alone) are not made solely through the activities of the salesmen who communicate

directly with the customers, or even their immediate superiors. Sales are as vital to Kennecott's well-being as production. Neither can exist without the other. But the Commission's Brief would have us believe that, having years ago made an agreement with its sales agent, (a wholly owned subsidiary) the responsible officers of Kennecott for all time thereafter have left all matters as to sales to such agent, including such vital matters as the fixing of prices, allocation among customers in times of scarcity such as were experienced in the years here in question, the obtaining of new customers, advertising, relations with the government and other customers, selling programs, the development of new uses for the metals to encourage greater sales, etc. Satisfactory sales are the responsibility of Kennecott's own officers. While day-to-day contacts with customers may be made by employees of the Sales Corporation, the formulation of all major sales policies was by Kennecott's own officers and Board of Directors, and in many instances such policies were actually executed by Kennecott's officers. Their participation in and direction of the sales cannot be dismissed, as the Commission seeks to do, by referring to Kennecott's activities in New York as an "administrative office". Just as Kennecott's New York office not only directs and supervises but also actively participates in the production process (see page 31 et seq., supra), so it does in the sales process.

When discussing the Minds case, the Commission exposes the fallacy of its own argument when it says (Def's Br., 300) that the only difference between the facts in the present case and in the Minds case is the

fact that the mine was located not in the taxing state (Pennsylvania), but in West Virginia. But the location of the mine in Utah is the whole basis of the Commission's argument in this case, and in the Minds case, under a similar gross receipts factor, the sales (there made by a true independent factor) were assigned to the State where the executive office was located and not in the state of location of the mine.

The Commission (Def's Br., 301) uses certain language of the Court in the Minds case to argue that Kennecott's interpretation is incorrect. In the first place, the decision of the Court was exactly what Kennecott states - sales were allocated to the State where the executive office was located. In the second place, if we read on in the Minds opinion after the quotation on page 301 of the Commission's Brief, it is seen that the purpose of the Court in its discussion of the independent factor, quoted by the Commission, was to answer the argument that the sales were negotiated or effected in the state of production. (West Virginia).

On pages 304-5 of its Brief the Commission agrees that, if its interpretation of the gross receipts factor be correct, 100% of sales could be allocated to every State in which a corporation did any business whatsoever, if the corporation marketed its products through an independent factor. The Commission suggests that a corporation's only recourse in such circumstances is a re-arrangement of its method of conducting business, or of the keeping of its accounts so as to permit direct allocation, or by ap-

plication for special relief. Kennecott submits that this Court, and the Courts of other states, should not so construe their statutes as to force a corporation to such extremities, when the reasonable construction of the gross receipts factor, as contended for by Kennecott, results in the allocation of the sales to the single state in which the selling activities of the taxpayer itself take place.

When it cites the case of *Superior Coal Co. v. Department of Finance*, 377 Ill. 282, 36 N. E. 2d 354 (1941) (Def's Br., 311-14), the Commission merely confirms Kennecott's position because in that case the Court held that a wholly-owned subsidiary was engaged in the business of selling, even though all of its output was sold to its parent company. Here the Commission repeatedly insists (for example Def's Br., 263-264) that the Sales Corporation's sales are not made in behalf of Kennecott but that Kennecott sells its products to the Sales Corporation which in turn resells them. Kennecott does not sell its products to the Sales Corporation, and the Commission so found (F. 46 c, pp. 60-61). But if Kennecott did sell to the Sales Corporation, the *Superior Coal* case is authority that a parent selling to its subsidiary is engaged in the business of selling. If Kennecott sells its products to the Sales Corporation so the latter can resell, it is the selling activity of Kennecott in New York in selling its products to the Sales Corporation which governs the allocation of its sales.

At pages 31, 45, 174 and 258 of its Brief the Commission asserts that in any event transfers of copper to the fabricating subsidiaries could not be considered as sales outside Utah. The stated reason, and so far as we can discover from the Brief, the only reason, appears on page 174, as follows: "for the reason that such intercompany sales are on fair and reasonable terms and thus covered by the separate accounting cases heretofore mentioned". That is no reason at all. Sales to the fabricating subsidiaries are in no respect handled differently from sales to others. Copper is sold to the fabricating subsidiaries at the same prices and on the same terms as to others and is paid for in cash by the subsidiaries.

The Commission (Def's Br., 244-53) also discusses certain cases decided by this Court. The Commission argues that, under the facts involved in the California Packing case the sales were not made by an affiliated sales subsidiary. This does not answer the applicability of the basic principles stated in both the majority and minority opinions in that case (see Plfs' Br. at pp. 36-37) viz, that sales not made within the State, or by personnel operating from offices within the State, or otherwise related to sales activities within the State, are not attributable to the State, and that, if the statute were otherwise construed, serious questions as to its constitutionality would be raised.

Again it is said by the Commission that in so far as the California Packing case adopts the sole test of whether the sale was made outside Utah, the decision has sub-



sequently been overruled by this Court. The Commission refers to *American Investment Corp. v. State Tax Commission*, 101 Utah 189, 120 P. 2d 331 (1941) and *J.M. & M. S. Browning Co. v. State Tax Commission*, 107 Utah 457, 154 P. 2d 993 (1945). To the extent applicable, these cases confirm Kennecott's view that a sale is attributable to the office having authority and direction over the sale and to which the selling agent is accountable.

The American Investment case concerned the investment business of a foreign corporation carried on in Utah. The questions were whether dividends received in Utah from an out-of-state corporation were from business done in Utah under paragraph (3) of Section 80-13-21 and whether gain from the sale of stock, sold on the New York Stock Exchange by a member of that Exchange, was to be allocated to Utah under paragraph (4) of that section. This Court answered both questions in the negative. The Browning case, also relating to an investment business carried on in Utah, held that dividends from a corporation doing no business in the State and rentals from properties located without the State were derived from business done in Utah under paragraph (3) of Section 80-13-21. In respect of dividends, it overrules the American Investment case. Neither case directly involved paragraph (6) of Section 80-13-21, the statutory apportionment formula in issue in this case.



Although the point was not specifically in issue in the Browning case, assuming that the American Investment case is in effect overruled as to the point relating to gain on sale of stock, what then is the essence of the view of this Court? If it be assumed, as the Commission does, that the dissenting opinion in the American Investment case now expresses the law, then the law as stated in the quotation on the bottom of page 250 of the Commission's Brief directly supports Kennecott's views. The dissent argued that the majority opinion failed to distinguish the business done by the broker in New York in making the sale and the business done by the taxpayer in Utah in placing the stock with the broker for sale and receiving the returns therefrom. It was this latter business which was being taxed and that business was being carried on by the taxpayer in Utah. Had that investment business and the orders to the broker been conducted in New York, the gain on the sales would have been allocated to New York. Similarly in this case, the Commission, although emphasizing the independence of the Sales Corporation, fails to distinguish the business done by the Sales Corporation and that done by Kennecott. The making of the sales arrangements with the Sales Corporation, and supervision and direction thereof and the making of major decisions with respect thereto, were activities of Kennecott carried on in New York. All accounting for sales and payments therefor were made to the New York office and not to the Utah office. It is to New York that the sales proceeds must be allocated. In the Browning case this Court made exactly the same point (154 P. 2d at 996):

“If in making the allocation of net income of the taxpayer to Utah, the Tax Commission is required to look not at the business done by the taxpayer, but at the business done by some third corporation this reasonable basis (of attributing income to where the taxpayer does business) is almost totally destroyed.”

At several places in the Browning case this Court emphasized the importance of the executive office function and the attribution of income thereto. It stated, for example (154 P. 2d at 995), that the investment activity was managed from the general office in Utah, and that the general executive and general accounting offices were maintained in Utah.

Again, in *Emerald Oil Co. v. State Tax Commission*, 1 Utah 2d 379, 267 P. 2d 772, decided by this Court on March 1, 1954, royalty income received from leases of property located outside the State was held to be derived from business done in Utah, the relevance of that opinion being the recognition by this Court, among other things, of the importance locationwise of the following activities of the taxpayer: all directors' meetings (normally, monthly) were held in Utah; the corporate books, muniments of title and the leases were kept in Utah; correspondence, management, and clerical activities connected with the leases were normally conducted in or from Utah. The analagous activities of Kennecott in the present case were carried on in New York.

**(b)**  
**Point**

**The sales were made in behalf of Kennecott by agents or agencies of Kennecott.**

The foregoing argument demonstrates that even if Kennecott sold its products through a true "independent factor", the sales of the Utah Copper Division are properly allocable outside of Utah under any logical and fair interpretation of the statutory apportionment formula, because the sales activities of the officers and employees of Kennecott performed wholly in the New York office are the controlling activities in the allocation of sales.

However, as discussed on pages 39-45 of Plaintiffs' Brief, the facts as to the Sales Corporation and its activities, and those of Kennecott in New York, with respect to the sales of Kennecott's products do not support the Commission's contention that the Sales Corporation was an "independent factor".

First of all, the Utah statute by its language in no way limits the broad term "agents or agencies" so as to exclude factors or commission merchants. The cases cited by the Commission which do not regard the activities of factor or commission merchant as those of the taxpayer are cases in which the taxpayer was not doing business in the State where the factor was located. Also, the cases cited by the Commission dealing with whether a

corporation is engaged in business in a state by virtue of the selling activities of its agents therein are not apposite to the situation in this case. Here it has already been determined that Kennecott was doing business in New York through its general office. The question is not whether the activities of the Sales Corporation, considered alone, would justify a conclusion that Kennecott itself was doing business in New York, but whether the sales effected by Kennecott and its sales subsidiary are assignable to New York under the specific wording of the Utah statute. Likewise, under the Commission's own franchise tax regulation, cited on page 238 of its Brief, foreign corporations selling in Utah through "independent factors" are to be treated as not doing business in Utah only "if such corporations engage in no other activities which amount to doing business in this state through the medium of an agent of the corporation".

Moreover, even if we assume *arguendo* that the proper interpretation of the statute is to exclude "independent factors" from the term "agents or agencies", there is still a complex of agency relationships in the zone between the true independent factor or commission merchant and the employee who is a servant which clearly fall within the statutory term. The Commission, in effect, refuses to recognize any agency relationship as falling within the meaning of the statute, other than that of an individual employee and admits (Def's Br. 231) that it construes the words "agents or agencies" in the sales factor to mean only "employees". And the Commission does this despite the fact that, as the Commission re-

cognizes, in the payroll factor of the formula the word "employees" is used in striking contrast to the much broader terms "agents or agencies" used in the gross receipts factor in the same section of the law. As will be noted, in enacting the gross receipts provision the Legislature did not merely substitute "agent" for the narrower term "employee", but it also coupled with it the term "agency", thus obviously intending to include organizations as well as individuals acting as agents in connection with sales.

The Commission has not cited a single authority for restricting the term "agents or agencies" to individual employees. On the other hand, Kennecott's view that, by the intentional use of the two terms, the Legislature desired a broader interpretation to be accorded "agents or agencies" is confirmed by the understanding as to the meaning of this term in the similar Pennsylvania Franchise Tax Law, as expressed in Stradley & Krekstein, *Corporate Taxation and Procedure in Pennsylvania* (2 Ed. 1952) at p. 251 :

“(E) ‘*Agents or Agencies*’—*Statutory Provision*

By using the words ‘agents or agencies’ in the Statute for the allocation of gross receipts as contrasted with ‘employees’ for wages and salaries it seems obvious that less stringent qualifications apply to gross receipts. This distinction recognizes the prevailing marketing practices of selling through representatives who may not be employees, but represent the taxpayer in the capacity of sales agent.



The statutory provision offers another advantage to the taxpayer. It recognizes independent contractors, and apparently partnerships and corporations are not excluded. Many sales agencies conduct their operations in corporate or partnership form, in which event the gross receipts arising from their efforts would be subject to out-of-state allocation if they conduct their activities from an office maintained by the taxpayer out of the state.

There seem to be no reported cases directly in point, but there is little doubt that agents or agencies include all employees as well as independent contractors who are authorized to negotiate transactions for the taxpayer."

The Sales Corporation is indubitably not an independent factor or commission merchant as those terms are customarily used.

Both the present and historical relationship between the Sales Corporation and Kennecott is not that customarily found between a principal and an independent factor. The relationship of an independent factor normally arises in cases where a producer, without its own sales outlets or organization, engages an existing and unaffiliated organization, already experienced in the sale of the particular products and having its own sales outlets, to assume substantially the entire sales and distribution job. Here the Sales Corporation was never an independently existing corporation with its own sales outlets and



experience. Rather, it was established by Kennecott itself, and its policies are directed by Kennecott. Moreover, as will be shown, the details of the working arrangement between Kennecott and the Sales Corporation are not those normally existing between principal and independent factor, but, rather between a principal and a sales agent.

The Commission admits (Def's Br. 263-64) that the true factor normally sells to his own customers, that he pays to the consignor a price fixed by the contract, and that he retains for himself the amount by which the price to his customer exceeds such contract price. In the present case, it is emphasizing form as opposed to substance to say that the customers are those of the Sales Corporation and not of Kennecott. While it is true that in *Irvine Co. v. McColgan* the customers of the independent produce brokers, commission merchants and the cooperative marketing association were dealing with and relying upon such agents, having no knowledge of the particular producer of the agricultural products purchased, the purchaser from "Kennecott Sales Corporation" of copper and molybdenite produced by the Utah Copper Division is under no illusion as to the principal involved. Advertisements to the trade were in substance always the same and were under the following joint heading (F. 41, p. 53):

**“KENNECOTT COPPER CORPORATION  
KENNECOTT SALES CORPORATION  
PRODUCERS AND SELLERS OF**

**Electrolytic Copper**

**Chino Fire Refined Copper (K.C.M.)**

**Braden Fire Refined Copper (\*\*\*)**

**Molybdenite**

**161 E. 42nd Street**

**New York 17, N.Y.”**

and the business address furnished was that of Kennecott's office in New York City. This is no sale by a factor in its own name for an undisclosed principal in the usual context relied upon by the Commission. Likewise, the customer list of the Sales Corporation is no secret to Kennecott as is customarily the case with a factor.

Again, the Sales Corporation does not purchase the goods from Kennecott and become entitled to all of the profit between a purchase price and whatever price it can obtain. Rather, the Sales Corporation is entitled to a commission and is to obtain the best price possible for the product (real price decisions being made by the senior officials of Kennecott). That price, less the commission, delivery and other expenses, is paid to Kennecott, it is Kennecott not the Sales Corporation, which bears the risk as to price as well as the risk as to collection of the proceeds. Moreover, Kennecott determines the commission; it is not established by contractual negotiations as with an independent factor negotiating with his principal. For example, when Kennecott in 1940 de-

sired to reduce the commission on copper sales, the Sales Corporation was informed that as of a certain date the change would be effected. The Sales Corporation was not consulted but told (Tr. 675-76). Yet the article cited by the Commission on page 235 of its Brief cites as one of the indicia of a factor the "paying to the consignor for the goods so sold a price fixed by contract and retaining for himself the amount by which the price his customer pays him exceeds that which he is required to pay to the consignor."

As admitted by the Commission, in the case of a true independent factor there is customarily a sale by the principal to the factor and then a sale by the factor to the purchaser. Kennecott did not sell products to the Sales Corporation; the record makes perfectly clear that the title to the copper and other mineral products of Kennecott remains in Kennecott and does not pass from Kennecott until delivery of the metal to purchasers at the destination specified by them (Tr. 171, 175-176, 609). This is reflected in the accounts of Kennecott in appropriate entries to inventory and profit and loss accounts. The title does not pass from Kennecott to the Sales Corporation but directly from Kennecott to the buyer. The Commission found this as a fact (F. 46 c, p. 60). The Commission is in error in its method of first classifying the Sales Corporation as a factor and, as a consequence thereof, concluding that Kennecott sells and transfers title to the Sales Corporation.

The Commission admits (Def's Br. 236) that the Sales Corporation did not guarantee accounts for col-

lection, the risk being upon Kennecott, whereas the quotation given on the same page of its Brief lists as one attribute of a true factor that he sells at his own risk.

The Commission repeatedly urges that an independent factor is not an agent because it is conducting its own business. But any agency must conduct its work as an agent and the Sales Corporation did that and no more. It is not a factor. It sells only the products of Kennecott and its mining subsidiaries. The senior officials of Kennecott direct what is to be done with respect to the sale of copper and molybdenite and the Sales Corporation acts upon the oral instructions of Kennecott as given from time to time (Tr. 615,623). Kennecott lays down the general policy for conducting sales and there is a standing instruction that if anything unusual occurs its officials are to be consulted before any action is taken in regard to sales matters; all important questions respecting sales are decided by Kennecott (Tr. 616). The President of Kennecott advises the President of the Sales Corporation as to many problems relating to sales, and in many instances the President of the Sales Corporation consults with the President of Kennecott before proceeding with any general or unusual course of action (Tr. 616). Kennecott and the Sales Corporation "work together as a unit" (Tr. 632).

In addition to showing the complete direction and control over the Sales Corporation as to matters directly related to sales, the record is replete with evidence refuting the Commission's thesis of "independence",

which constitutes the basis of its contention that the Sales Corporation is not an agent or agency of Kennecott. Kennecott hires all employees of its New York office, including those who serve the Sales Corporation, Kennecott's divisions and other subsidiaries (Tr. 610). Kennecott pays the salaries of all employees in the New York office, deducts as to social security, income tax withholding, retirement plan contributions, and in every respect deals with all of the employees of the New York office as employees of Kennecott (Tr. 610-11). The officers and employees who conduct the business of the Sales Corporation receive no pay from the Sales Corporation but are hired by Kennecott, paid by Kennecott and assigned by Kennecott to their duties with the Sales Corporation just as all other employees in the New York office are assigned to duties with various departments and subsidiaries (Tr. 611). For the services of these employees, as well as other services rendered to the Sales Corporation, in its divisional system of accounting Kennecott charges the Sales Corporation a service charge monthly, which includes the service of furnishing the Sales Corporation with the persons who conduct its activities. The Sales Corporation owns no property, even the furniture used in its work being owned by Kennecott (Tr. 631).

All the detailed accounting for the Sales Corporation was handled by persons assigned to do so by Kennecott (Tr. 581). The employee assigned during the period July 1, 1936 to November 30, 1942 to keep the accounts and records of the Sales Corporation specifically testi-



fied that he was an employee of Kennecott assigned to these duties with the Sales Corporation for that period, and that he reported directly to the Comptroller of Kennecott, who supervised his work (Tr. 581). That this employee's services were charged to the Sales Corporation in the monthly service charge for furnishing the employees and other matters does not change the fact that the accounting records were kept and maintained by and in the office of the Comptroller of Kennecott. Thus, there existed no such independent business as exists in the case of a factor.

Of perhaps greater importance in establishing the status of the Sales Corporation as an ordinary sales agent is the method followed in handling the proceeds from the sale of metals. The Sales Corporation maintained separate books and a separate bank account (in effect, a trust fund) with respect to the receipts of proceeds from metal sales and accounted to Kennecott therefor (Tr. 624-25). Expenditures not borne by the Sales Corporation, such as those made in the handling and delivering of products, were made directly from this special account and so recorded in the separate books. The general books of account and bank account of the Sales Corporation related only to the commission (paid from the separate bank account maintained on behalf of the producing units) and the various expenses of the Sales Corporation itself. Only by check transfers from the special "trust" account to the Sales Corporation general account, did any of the receipts from sales become available to the



Sales Corporation for its general purposes. Such transfers were made by employees of Kennecott acting under the Comptroller of Kennecott (Tr. 624-25).

The above accounting and disbursement procedure was one which manifestly would be virtually unthinkable if the Sales Corporation had been a separate independent organization. No independent factor would have considered having all of its accounting and the handling of its cash conducted by the principal for which it was acting.

Just as the employees and activities of the Sales Corporation were completely mingled with those of Kennecott in the New York office, so also the space from which the Sales Corporation conducted its business was merely part of the general offices of Kennecott (Tr. 565). All of the leases of the space for the New York office were made by Kennecott; and it was in this space that the Sales Corporation's activities were conducted (Tr. 574-575). Furthermore, the Sales Corporation did not even occupy a segregated portion of the area leased by Kennecott; it occupied such space and in such location as Kennecott from time to time assigned to it.

In the light of this uncontradicted testimony, it is clear that the Sales Corporation is not an independent factor or commission merchant as contended by the Commission in its Brief. Certainly the Sales Corporation is an agent or agency of Kennecott within the meaning of the statutory gross receipts factor. Indeed, as the testi-

mony previously summarized indicates, except for the fact that it is a separate corporate entity, the Sales Corporation is no more independent and no less subject to direction by Kennecott on every sales matter than would be an individual employee.

Equally unjustified is the Commission's admitted revision (Def's. Br., 227) of the statutory words "in behalf of the corporation by agents or agencies" to read "by agents or agencies acting and operating representatively and in the name and behalf of the corporation." Not only is there no basis for this revision in the statutory language, but a sale in the name of the Sales Corporation is of little practical importance since not only does the word "Kennecott" appear in its title, but Kennecott Copper Corporation itself was named along with Kennecott Sales Corporation in the advertisements to the trade (p. 77 *supra*, F. 41, p. 53). Certainly the single fact that sales are made in the name of the Sales Corporation is not, and can not be, decisive of the whole question of the allocation of sales under the gross receipts factor. The statute does not so require, yet, in substance, the Commission's argument comes down to this.

The Commission seems to contend at pp. 277-286 of its Brief that (a) Kennecott's position is that the separate corporate identity of the Sales Corporation should be completely disregarded in applying the statutory formula and (b) unless it is disregarded, any sales made through the Sales Corporation cannot be considered as having been made by an "agent or agency" of Kennecott within

the wording of the formula. Neither assertion is correct, Kennecott's position is not, and does not need to be, premised upon a disregard of the separate identity of the Sales Corporation. What Kennecott contends is that this Court can, and should, look at the true relationship between Kennecott and the Sales Corporation in determining whether the sales of Kennecott's products were made by an "agent or agency" of Kennecott within the meaning of the statutory sales factor. Kennecott believes that the testimony discussed above conclusively shows that the Sales Corporation was such an agency under any fair and reasonable interpretation of the statute.

Accordingly, the authorities discussed by the Commission on pp. 277-286 of its Brief, to the effect that the income of a subsidiary is the subsidiary's income, are irrelevant to the present case. Similarly, the charge made by the Commission that Kennecott in filing its returns deducted only the expenses of the Sales Corporation (rather than the commissions paid to it) in order to improve its position under the statute is purely a "red herring." As pointed out at page 6 above, this practice was followed at the express direction of the Commission.

(c)

### **Point**

**The sales were negotiated or effected by agents or agencies "chiefly situated at, connected with or sent out from" premises rented by Kennecott outside of Utah.**

The Commission fails to answer the argument of Kennecott (Pltfs' Br., 54-58) that the sales are made by "agents or agencies chiefly situated at, connected with or sent out from the premises for the transaction of business owned or rented by the corporation outside the state."

In the light of the facts as outlined above at page 80 and in Plaintiffs' Brief (p. 54, et seq.) as to the conduct of the business of the Sales Corporation by persons employed by Kennecott and assigned to full time or part time service with the Sales Corporation, the constant direction and control of their activities by Kennecott's officers, and the performance of their duties in the New York office space leased by Kennecott, it seems hardly necessary to answer an argument that the employees of the Sales Corporation were not "chiefly situated at" or were not "sent out from" premises rented by Kennecott in New York. Moreover, it is clear that the Commission fails completely to recognize or give any effect to the other alternative in the statute that the agents or agencies need only be "connected with" such premises. The agents can be "chiefly situated at" the premises. The agents can be "sent out from" the premises. The statute having expressly covered both the case of agents working at and away from the premises, the only possible interpretation of "connected with" is to cover other relationships with premises regularly maintained by the taxpayer such as would fairly attribute the activities of the agents to that office rather than to the operations in Utah. Certainly, however this Court may view the testi-

mony, and even under the Commission's finding (Def's Br., 316-17), there can be no question but the Sales Corporation and its employees were "connected with" the premises of Kennecott in New York within the meaning of the Utah statute.

#### IV. Point

**The Commission's method of computing depletion is not in accord with the views of this Court in Case No. 7298, and is contrary to the intent of the Utah statute and the Federal practice which that statute adopted, and unjustly discriminates against Kennecott. (Def's Br., pp. 332 to 354.)**

Under Point II of Plaintiffs' Brief (pp. 67 to 116), Kennecott gave its reasons why the statutory term "net income from the property," for the purpose of computing percentage depletion, should be held to mean the gross receipts from the sales of the products less only costs and expenses. In brief, these reasons were:

1. This meaning is the normal and logical interpretation of such term "net income from the property." It is consistent with the use of the term "net income" elsewhere in the same statute and other Utah statutes. It is a meaning that may reasonably be assumed to have been intended by the Legislature, whereas it is not reasonable to assume that the Legislature intended a meaning of the term which would require use of (a) the erroneous assumption that profits accrue ratably



to costs\* and (b) an algebraic computation, both of which are involved in the formula employed by the Commission.

2. The legislative history of the statutory depletion provision, at the time the Utah franchise tax statute was enacted in 1931, clearly shows that the term "net income from property" was intended by the Legislature to have the meaning given to it under the Federal treasury practice. As the undisputed testimony in this proceeding shows, where as here there is no representative market or field price for the mineral products in a stage prior to that in which they are sold, the Federal practice has always been to consider the net income from the property to be the gross receipts from the actual sale of the products less production expenses. Even under the present Federal statute and regulations the computation would be no different in this case because the so-called "post-mining processes" are not carried on by the taxpayer itself and the cost thereof to Kennecott includes any profit attributable to the parties

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\*The Commission (Def's Br., p. 12) asserts that Messrs. Peat, Marwick, Mitchell & Co., independent certified public accountants, solely from the accounting standpoint, did not regard as unreasonable the apportioning of profits ratably to costs. The assertion of this opinion has no basis in the record; no representative from Messrs. Peat, Marwick, Mitchell & Co. testified in support of the Commission's formula.



conducting such operations. The Federal method of computing percentage depletion for Kennecott's Utah Copper Division has always been and continues to be in accordance with Kennecott's contention, as the record expressly shows.

3. The Commission itself, in applying the Utah statute from the time of its enactment in 1931, consistently interpreted the percentage depletion provision as Kennecott contends it should be interpreted. It was not until 1945 that the Commission for the first time, and solely in this case, introduced its algebraic method of computation. That long continued administrative interpretation should be followed, and must be deemed to have been accepted by the Legislature when it reenacted the franchise tax statute in 1933 and when it thereafter changed the statute in several respects without, however, changing the percentage depletion provision.

4. Kennecott's computation of the percentage depletion allowance is in accord with the objective of this Court in Case No. 7298. The Commission's method would produce a double reduction of the depletion allowance, contrary to the intent of this Court as expressed in that case. (Pltfs' Br., 114)

In reply to these points the Commission, in substance, makes the following two arguments:

(1) The Commission contends that the decision of this Court in Case No. 7298 required that "some" of Kennecott's net income be allocated to post-mining operations before computing depletion. Although the Commission recognizes that its method results at best only in "*a reasonable starting or tentative figure*" for allocating "*some net income*", (Def's Br., 338) nevertheless it urges that it should be approved since, it claims, Kennecott's method of computation effects no such allocation.

(2) The Commission advances its own conception of recent Federal tax regulations and contends that they require the deduction of profits attributable to transportation and processes beyond "ordinary treatment processes" in computing percentage depletion, and cites certain cases which it regards as supporting this view.

Both of these points are, we believe, unsound. We will discuss them in the order given above.

### (1) Point

**Kennecott's method of computing depletion is in accord with the decision of this Court in its Case No. 7298; it ef-**

**fects the allocation to Utah of only that portion of the total depletion allowance which is attributable to the portion of the taxpayer's net income allocated to Utah.**

As more fully discussed in Plaintiffs' Brief (pp. 103, et seq.), the position taken in Justice Latimer's opinion was in essence as follows:

(1) If the total net income from the mineral products were to be allocated to Utah, and thus were to serve to increase the net income before depletion used in computing the Utah tax, it would be unfair to deny to the taxpayer a deduction of the full  $33\frac{1}{3}\%$  of all such net income so assigned to Utah; but

(2) If only a part of the total net income from the mineral products were to be allocated to Utah, the net income before depletion corresponding to the allocated net income should be decreased by (but not by more than) an applicable deduction for depletion thereagainst of  $33\frac{1}{3}\%$  of the amount of such net income before depletion.

As demonstrated at page 103 of Plaintiffs' Brief, Kennecott's method of computing the percentage depletion allowance is entirely in accord with the views so expressed by the Court; on the contrary, the use of the Commission's algebraic formula would result in giving Kennecott against its net income allocated to Utah an

allowance for depletion substantially less than  $33\frac{1}{3}\%$  of the net income allocated to Utah for purposes of the tax.

In discussing the computation of depletion (118 Utah at 157, 221 P. 2d at 866), Justice Latimer applied two tests to determine the propriety of the respective deductions claimed by Kennecott and allowed by the Commission—one by using the total net income of the Utah Copper Division and the other by using the portion of such net income allocated to Utah at the 66.926% rate then agreed to by both Kennecott and the Commission.

In both instances the method followed by the Court was to take net income after depletion, to add back the depletion deducted, and then to apply to that figure (representing net income before depletion) the statutory percentage of  $33\frac{1}{3}\%$  to obtain the proper depletion deduction.

(A) If we take these tests of Justice Latimer and apply them to the results sought by the Commission in this case, both the one relating to total net income (Test I) and the one relating to the portion of net income assignable to Utah (Test II), it is perfectly obvious that the allowance for depletion made by the Commission is grossly inadequate. This is readily demonstrated by the following table, in which, for purpose of illustration, we have used the Commission's present determinations for the year 1942, confining ourselves to net income from mineral production.

# TABLE A — COMMISSION'S DETERMINATIONS

Year 1942

	Test I Total Net Income of Utah Copper Division	Test II Portion of Total Net Income Assigned to Utah at 93.306%
Net Income from mineral pro- duction after depletion....	\$17,740,627 <sup>(a)</sup>	\$16,553,070 <sup>(a)</sup>
Add back depletion allowed by Commission .....	6,074,475 <sup>(b)</sup>	5,667,850 <sup>(d)</sup>
Net Income from mineral pro- duction before depletion....	\$23,815,102	\$22,220,920
33 $\frac{1}{3}$ % thereof as depletion allowance .....	<u>\$ 7,938,367<sup>(c)</sup></u>	<u>\$ 7,406,973</u>

	Before Apportionment	After Apportionment
<sup>(a)</sup> Commission's Findings, page 193 .....	\$18,034,187	\$16,834,253
Less Income from other than mineral production ..	293,560	281,183
Net Income from mineral production .....	<u>\$17,740,627</u>	<u>\$16,553,070</u>

<sup>(b)</sup> Commission's Findings, page 185.

<sup>(c)</sup> It should be remembered that the reason that the depletion deduction claimed by Kennecott in its 1942 return (\$13,568,213) exceeded so greatly the amount arrived at by Justice Latimer (\$7,395,269) in applying his test to total income was that Kennecott's depletion deduction was based on net income *before deducting Fed-*

As is evident, the depletion of \$6,074,475 allowed by the Commission is very substantially less than the depletion of \$7,938,367 allowable against total net income before depletion as shown by Test I; and the \$5,667,850 of the Commission's allowance for depletion which is applicable against the 93.306% of the net income assigned to Utah is substantially less than the depletion of \$7,406,973 allowable against the portion of net income assigned to Utah as shown by Test II.

If the Commission, in computing the depletion allowance had followed Kennecott's method, the depletion allowance would have come out precisely to the figures obtained by applying Justice Latimer's tests.

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*eral taxes* (which at that time had been the practice of the Commission). Justice Latimer himself recognized this fact. Kennecott's present computations give full effect to the deduction of Federal taxes before computing depletion. This point is no longer in dispute.

(d) The theory of Justice Latimer's second test, as related to net income allocated to Utah, is clear. However, in applying it in his opinion he inadvertently made the error of adding to the 66.926% of net income after depletion allocated to Utah the total depletion deducted by Kennecott instead of 66.926% thereof to arrive at net income before depletion allocated to Utah. Of course, this was basically immaterial in that, as previously stated in the preceding footnote, Kennecott's total depletion deduction was excessive because of the failure to deduct Federal taxes. Moreover, Justice Latimer specifically disclaimed any attempt to reconcile the figures.



(B) We may next similarly apply Justice Latimer's tests to the amounts claimed by Kennecott for the year 1942, still confining ourselves to net income from mineral production — first, as respects the total net income of the Utah Copper Division, as to which Kennecott, for purpose of illustration, has accepted the Commission's determinations in all respects except depletion (Test I), and second, to the portion (66.926%) of the net income Kennecott claims to be assignable to Utah, and the corresponding portion of the depletion which is applicable thereto (Test II). The results are as follows:

**TABLE B—METHOD CLAIMED BY KENNECOTT**

	Test I	Test II
	Total Net Income of Utah Copper Division	Portion of Total Net Income Assigned to Utah at 66.926%
Net Income from mineral production after depletion....	\$15,876,735	\$10,625,664
Add back depletion claimed.....	7,938,367	5,312,831
Net Income from mineral production before depletion..	\$23,815,102 <sup>(a)</sup>	\$15,938,495
33⅓% thereof as depletion allowance .....	\$ 7,938,367	\$ 5,312,831

<sup>(a)</sup> The amount of Net Income from Mineral Production before depletion of \$23,815,102 shown in Test (I) above as claimed by Kennecott is the same as the corresponding amount in Test (I), Table A, as determined by the Commission.

The depletion of \$7,938, 367 claimed by Kennecott is the same amount as the depletion allowable against total net income as shown by Test (I); and the \$5,312,831 of such depletion which is applicable against the 66.926% of the net income assigned to Utah is the same amount as the depletion allowable against the portion of net income assigned to Utah as shown by Test (II).

Either of the foregoing tests, i.e., Test I — depletion calculated at 33 $\frac{1}{3}$ % of net income before application of the apportionment fraction, and Test II — depletion calculated on the net income after application of the apportionment fraction, results in the same taxable net income, after applying the apportionment formula, as shown in the following table:

	Test I	Test II
Net Income from mineral production before depletion.....	\$23,815,102	\$23,815,102
Apportionment fraction.....(Applied below)		.66926
Net Income subject to depletion .....	\$23,815,102	\$15,938,495
Depletion at 33 $\frac{1}{3}$ % .....	\$ 7,938,367	\$ 5,312,831
Net Income after depletion.....	\$15,876,735	\$10,625,664
Apportionment fraction .....	.66926	(App. above)
Taxable net income from mineral production .....	<u>\$10,625,664</u>	<u>\$10,625,664</u>

Under the Utah statute, and as expressly called for by the Commission's own forms and instructions, the depletion deduction is to be made from the total net income before depletion and before any allocation of that income within and without the State. It is such net income, after the depletion deduction has been made, which is thereafter to be allocated. Accordingly, the reasonableness and amount of the depletion deduction is to be determined (as is true of all other deductions made in arriving at net income) from the standpoint of the total income, whether within or without the State. After applying the allocation factor to the net income after depletion so determined, this results in the portion of the income thus allocated to Utah being reduced only by the ratable portion of the deductions corresponding to the allocated income and, accordingly, in a deduction for depletion equal to  $33\frac{1}{3}\%$  of the net income allocated to Utah.

It is this normal procedure, actually spelled out in the statute and regulations of the Commission, for computing the deduction for which Kennecott contends. The Commission's method not only yields an inadequate allowance but violates the statute's express provisions, the Commission's own regulations and as well the normal accounting procedures.

## (2) Point

**The Federal regulations do not and never have required an allocation and deduction from net income for the depletion computation, of profit from transportation or**

**any of the beneficiation processes, when such services were performed by others who made their own profit therefrom already once deducted by the taxpayer as a part of the cost for such services charged taxpayer.**

The Commission's Brief (pp. 347-348) refers to the Federal income tax statutes and regulations, but misinterprets their provisions. Its argument is based only on its own interpretation thereof, and is directly contrary to the uncontradicted expert testimony contained in the record.

The record presents the testimony of Mr. Fernald, an authority on the subject, as to the Federal regulations with respect to depletion of mines and the interpretation given to them by the United States Treasury Department. Those regulations dealt particularly with the determination of gross income from the property in the case of mines where there was not a market or field price for the product at the close of the concentrating stage (for example), but further processes were necessary to obtain the first products for which there was a representative market or field price.

The regulations as originally in effect provided in such a case for deduction of the cost of such further processes and transportation from the selling price of the products in order to determine the gross income from the property. Later regulations made provision for a profit allocation, but only if the later processes or transportation were performed by the taxpayer itself, to the

end that, if the producer was itself performing these processes, it should take into account a reasonable profit such as would be charged if the processes or transportation were performed for it by others. The Treasury has always recognized that there was no occasion for any such allocation of profits to later processes where performed by others who made their own profit therefrom, which was included as part of the costs they charged the taxpayer.

The testimony sets forth (Tr. 487 et seq.) the proper application of these regulations in computing depletion for the Utah Mine under the Federal statute - that is without attributing any profit to the smelting, refining, etc., which were performed for Kennecott by others and the costs of which included a profit to such other parties. The Federal law and regulations give no authority for any such procedure as that which the Commission has followed, on the contrary they fully support the computation made by Kennecott. The testimony in this regard in the record is undisputed.

Kennecott has shown (Pltfs' Br., 81-97) that the Utah Legislature intended that "net income from the property" convey the meaning then contemplated by the Federal authorities, shortly thereafter enacted into law by Congress and embodied in the Treasury practice, and to be computed in accord with such Federal practice (that is, deduction of costs only as to further processes even when performed by the taxpayer itself). The Treasury

practice has never been otherwise and the Utah statute was so applied by the Commission for years after its passage in 1931. But for the purpose of this case, it is not necessary to argue at length whether the Federal rule of 1931, or its later modified rule, should be followed, for both produce the same result in the present case, since the further processes and transportation are performed by others.

The Commission states (Def's Br. 348) that cases involving the Federal depletion allowance, for both mines and oil and gas wells, all show clearly that surface activities beyond the mouth of the mine or well must be segregated and a gross value of the output at the mouth of the mine or well arrived at on a basis which will allocate a proportionate part of the total realized profit to the surface processing activities that take place beyond the mouth of the mine or well.

The cases cited by the Commission, however, in no way support this statement, particularly in respect to mines. The Federal law, discussed at page 347 of the Commission's Brief, clearly recognizes that ordinary treatment processes are included in the base for computation of depletion with respect to mines and that there is thus no required segregation of surface activities beyond the mouth of the mine. More important, most of the cases, alleged by the Commission to be to the contrary, relate to oil and gas wells, which under Federal law and regulations are treated differently



from mines, and do not at all bear upon the question of determination of gross income from the property in the case of mines where there is deducted only the cost of processes subsequent to the last process which constitutes a part of the mining operation.

Thus, the Brea Cannon Oil case (Def's Br. 348-349) involved only the question of whether the gross income from the property as applied to wells producing what is known as casinghead gasoline (a very volatile gasoline which is in the wet gas as it comes from the well) was the entire gross receipts from sale of the casinghead gasoline after such gasoline had been extracted from the wet gas by an admitted manufacturing process. Obviously, the Court held that depletion should not be computed on such total gross receipts. There was no question as to deduction of subsequent costs, as opposed to costs plus proportionate profits, because both parties agreed that an apportionment of 40% of the gross receipts from casinghead gasoline represented the value of the gasoline content of the wet gas as it emerged from the well.

Both the Consumers Natural Gas (Def's Br. 349-350) and the Greensboro Gas (Def's Br. 350-351) cases, cited by the Commission involved the extreme claim by a taxpayer, engaged in the businesses both of producing and of distributing natural gas, that the gross income from the property was the income derived from the sale of gas as distributed by the taxpayer to its customers. These opinions do not discuss the question

of deduction of costs, as opposed to costs plus proportionate profits, in arriving at the value of the product at the well.

The Commission is in error in stating that these cases which dealt with oil and gas wells and which held that subsequent manufacturing processes and distribution activities are not subject to depletion, have any bearing on the different question of depletion of mines, which is to be determined under separate provisions of the Federal law and regulations, and where the first marketable product of the mine is the refined metals resulting from the smelting and refining processes. The question here presented was not involved or considered in those cases.

At the bottom of page 353 of its Brief, the Commission cites two mining cases which are in no way relevant to its argument. The Sheridan-Wyoming Coal case related solely to whether interest payments on outstanding bonds and bond discount and expense of amortization of bonds were proper deductions in arriving at net income from the property. These expenditures were held to be properly deductible as items of overhead expense in computing net income from the property, both parties having agreed in general that overhead expenses were a proper deduction. The New Idria Quicksilver case involved the question whether the gross income from the property for percentage depletion was the selling price of the quicksilver (the first marketable product) as the tax-

payer claimed, or was the amount of such selling price less the cost of transportation, furnacing, condensing, cleaning, etc., together with an assumed profit thereon (based on a profit allocation related to costs), as the Commissioner of Internal Revenue had claimed and the Tax Court had approved. The Court sustained the taxpayer and held that the correct base for computing depletion was the gross sales of mercury in flasks, since this was the first marketable product. Consequently, the Court was never called upon to pass upon what deductions should be made from the gross proceeds from sales of mercury in arriving at gross income from mining, since all of the processes were deemed ordinary treatment processes. In addition, even had the contention of the Commissioner of Internal Revenue prevailed before the Court, the decision would not be applicable to the present case, since in the New Idria case the taxpayer itself performed all of the treatment processes up to the sale.

One other brief comment upon the Commission's depletion claim might be made. The Commission presents its depletion allowance as if it were computed on the basis of a valuation for the mill concentrates. However, the valuation amounts thus attributed to mill concentrates are simply amounts which result from working backwards from the results achieved by the Commission's formula. In other words, the Commission, having determined by its formula the amount of the net income from the property and the depletion as thus conceived by it, then adds these two amounts to get an amount for net

income from the property before depletion; to which amount it then adds the amount of costs and Federal taxes applicable and so arrives at an amount which it then presents as being the value of the concentrates. Having done this, it then presents that valuation, less the deductions, as working out to the same depletion with which the computation started. This is, of course, no proof whatever of the reasonableness or propriety of the depletion allowance.

Perhaps the reason the Commission has presented its computation as if made on a valuation basis is because of its misconception, apparent in its Brief, that percentage depletion is essentially a valuation problem. No evidence was presented at the hearings before the Commission which would justify any such misconception. Actually, percentage depletion was adopted, as clearly shown in the evidence and in Plaintiffs' Brief at pages 83, et seq., principally to avoid the valuation problem.

The uncontradicted testimony in the record evidences the intent of the Legislature, when it enacted the percentage depletion provision that it should be applied in a simple, direct manner, avoiding difficult and complicated valuation problems or abstruse computations and in accord with the method then established under the Federal statute and regulations. The Utah statute was originally interpreted and long applied by the Commission in accord with the method for which Kennecott contends.

The nature and defects of the Commission's depletion formula have been considered at length in Plaintiffs' Brief at pp. 74 to 81. No testimony was presented at the hearing to substantiate the formula. The Commission's Brief recognizes the doubts of the Commission as to the propriety of the method used by it (Def's Br., 14-15) and makes no attempt at its justification. Further discussion thus seems unnecessary.

The Commission's Brief also recognizes the bearing of the Federal standards of interpretation and application of the Utah provision, but its misstatement of the effect of the Federal provisions and its citations of inapplicable decisions under the Federal law fail to furnish support for the inadequate depletion allowance which the Commission proposes to grant. Depletion in this case should accordingly be allowed on the basis and in the amount claimed by Kennecott, and not as computed by the Commission.

### **(3) Point**

**The Commission's method of computing depletion would discriminate against Kennecott in favor of all others in the mining industry and such discrimination was not the legislative intent.**

The operator who sells his crude or semi-crude product to a custom smelter is paid by the smelter on the net smelter return basis, i.e.:



The smelter after weighing and sampling the product delivered, renders the seller a statement setting forth the gross metallic content of the shipment, the net metallic content after deduction of anticipated treatment losses, and the market quotation; deduction from the net value for the charges of freight, treatment, penalties if any, and the owner is paid the difference, the net smelter return (Tr. 76). Any profit in the freight, smelting or refining accrues to the carrier or other person performing the service and the owner computes depletion on the basis of his net smelter return without ascribing any of his profit to the processes of smelting, transportation or refining. By far the great majority in number of producers dispose of their product in this manner.

The operator-owner who does not sell his product in a crude or semi-crude state but retains title until sale of the refined product, and who does not have the complete plant facilities for smelting, transportation and refining, is forced to engage the services of common carriers, custom smelters and refineries. Such was Kennecott's situation. In fairness to Kennecott the fundamentals of the "net smelter return" standard should be applied to Kennecott's operation for the purpose of this tax (Tr. 487). It is the purpose of the statute to place all producers on the same tax reporting basis, not to discriminate against one or the other.

The operator who sells to a custom smelter and the operator who retains title but hires a custom smelter, should be accorded the same treatment. Both pay the



carriers, the smelter and refiner their respective "profit" as a part of the cost paid for the services hired. Neither should be penalized by a double deduction when but one profit exists and that is of the smelting company and carriers, which both operators have once paid. The statute contemplates nothing else.

At page 170 of the Commission's Findings of Fact, Conclusions of Law and Decision appears the following statement:

"If Kennecott's operations were limited to mining (including milling of the ores) and it *sold* all of its concentrates to A.S.&R., for example, our problem would be a relatively simple one. The cash receipts derived from the sale of concentrates would constitute the gross income from the property from which we could subtract the costs and expenses of mining and milling, together with federal income and excess profits taxes attributable to the operation, \* \* \* and the resulting figure would be the net income from the property. Thirty-three and one-third per cent of such net income would be the proper amount of the deduction allowed by the statute for depletion of the mining property."

It seems impossible for defendant to understand—or is it perhaps impossible for this defendant to admit?—that such is precisely the result for which Kennecott contends. Both Kennecott and defendant are bound by the statute (Tr. 429, 431), and defendant's example illustrates the only result possible under the statute. The de-

fendant is not authorized differently to classify Kennecott. For the purpose of this tax, there is no difference in fact between the operator who sells his product to the smelter and the one who sells it to the public. The statutory test is the net income from the property, and that phrase "net income from the property" was never intended to vary with the type of the purchaser.

Kennecott paid the costs of smelting, transportation and refining and the cost incurred by it in sales, and they are the same costs the smelters deducted from the value of the ores or concentrates sold to them by the operator on the net smelter return basis. The sum remaining, whether in the hands of the miner on the net smelter return basis or in Kennecott's possession is the same in principle, and from that sum each deducts his costs allowable under the statute, the sum remaining being his net income from the property as intended by the statute. No algebraic formula is required for that simple calculation.

As to depletion, this Court has directed the way, but this defendant refuses to follow. The case of New Park Mining Company et al, 113 Utah 410, 196 P. 2d 485, was a consolidation of three separate cases before this Court, wherein was involved a franchise tax for each the years 1942, 1943 and 1944. This Court there defined depletion and the phrase "net income from the property" as had the defendant itself ever since enactment of the statute March 12, 1931 to and until March 10, 1945, when defendant chose to create and apply to Kennecott alone its

abstruse algebraic formula in no manner whatever related to the statute. There is no basis in fact or in law for such discrimination.

## CONCLUSION

Point V of the Defendant's Brief purports to deal with the contention of Kennecott that, so far as the year 1942 is concerned, the allocation factor to be used has been finally determined by this Court in its decision in Case No. 7298. Point VI of the Defendant's Brief touches upon the question of what interest, if any, is to be allowed on any deficiency found by this Court to be due. Both of these points have been fully discussed in Plaintiffs' Brief at pages 116 to 125 and 125 to 145, respectively, and accordingly, no further comment is required.

On page 2 of the Defendant's Brief we are charged with having failed to mention what the deficiency in tax should be under Kennecott's theory of the case. Therefore, we are placing in an Appendix hereto a calculation of the tax and deficiency cumulated over the years 1942 to 1950, both inclusive. This computation has been made as required by the statute, which is neither ambiguous nor subject to interpretation.

The Commission would ignore the Utah statute and all constitutional limitation upon its authority and conduct and devise a levy upon Kennecott's operations far beyond the reach of any possible justification.

Kennecott's sales may not be assigned to Utah, because made by Kennecott from its established office and place of business outside Utah through its agents and agencies there engaged beyond the territorial limits and jurisdiction of the State of Utah.

Depletion may not be computed by the Commission's self-serving algebraic formula, because the Legislature intended and the statute requires another and wholly different computation, one so simple and direct as to forbid misinterpretation.

The Commission's decision should be reversed and the Commission be required to adhere to the statute.

Respectfully submitted,

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## APPENDIX

During the course of the hearing Witness H. B. Fernald prepared and introduced Exhibits 55(2) and 56(2), the purpose of which was to correct Exhibit PPP (2) to conform to Kennecott's contentions and show its liability corrected accordingly. As stated in Defendant's Brief (p. 2) those Exhibits 55(2) and 56(2) indicate a tax liability of \$4,028,608.40 and a deficiency of \$1,076,045.49.

In those exhibits an allocation fraction of .64676 was used for the year 1942, being the result of application of the statutory formula. However, the return for that year as filed adopted the basis of .66926. It was the latter fraction which was presented to the Court in Case No. 7298, without contest from either party, and as stated in Plaintiffs' Brief at pages 116-125 must be applied in the determination of 1942 taxable income.

Furthermore, in those exhibits the full amount of the selling commission paid to the Sales Corporation was

deducted in accordance with the Commission's determination made in 1951. However, in the attached statement, only the net expense of selling the products (gross commissions less profits) has been deducted in accordance with the Commission's earlier determination made in 1942, on the basis of which Kennecott's returns were made for the periods here involved.

The attached statement shows Kennecott's computation of its total tax liability for the years 1942 to 1950, inclusive, and the amount thereof remaining unpaid. This computation is submitted solely for the purpose of this suit, and for that purpose only it accepts all determinations made by the Commission except as indicated above and except as respects the Commission's computation of the depletion allowance and of the gross receipts factor of the allocation formula.

For comparative purposes, the statement also shows Kennecott's understanding of the Commission's computation of the total tax for the years in question.



# COMPUTATION OF TAX LIABILITY

## A. DEPLETION

	<i>Kennecott</i>	<i>Commission</i>
Total net income from mineral products before depletion.....	\$312,647,869.44	\$312,647,869.44
Add profit in selling commission <sup>(a)</sup> .....	394,383.92	
	<u>\$313,042,253.36</u>	<u>\$312,647,869.44</u>
Deduct income claimed by Commission to be attributable to smelting, refining, transportation and selling.....		69,211,360.48
Net Income subject to percentage depletion .....	\$313,042,253.36	\$243,436,508.96 <sup>(c)</sup>
Depletion allowance — 33 $\frac{1}{3}$ %.....	<u>\$104,347,417.79</u>	<u>\$ 81,145,502.98<sup>(c)</sup></u>

## B. TAXABLE NET INCOME

Total net income from mineral products before depletion .....	\$312,647,869.44	\$312,647,869.44
Add profit in selling commission.....	394,383.92	
Add income not subject to depletion.....	1,067,720.20	1,067,720.20
TOTAL .....	<u>\$314,109,973.56</u>	<u>\$313,715,589.64</u>
Deduct depletion allowance.....	104,347,417.79	81,145,502.98
Total Net Income after depletion.....	<u>\$209,762,555.77</u>	<u>\$232,570,086.66<sup>(c)</sup></u>
Deduct income specifically allocated to Utah (deficit) .....	950,877.67	950,877.67 <sup>(c)</sup>
Net Income subject to apportionment.....	\$210,713,433.44	\$233,520,964.33 <sup>(c)</sup>
Apportionment fraction (average) <sup>(b)</sup> .....	.64433	.93484
Apportionable income allocated to Utah.....	\$135,769,340.28	\$218,304,372.05 <sup>(c)</sup>
Add income specifically allocated to Utah (deficit) .....	950,877.67	950,877.67 <sup>(c)</sup>
Total taxable income .....	<u>\$134,818,462.61</u>	<u>\$217,353,494.38<sup>(c)</sup></u>
Franchise tax at 3% <sup>(b)</sup> .....	\$ 4,044,553.88	\$ 6,520,604.83 <sup>(c)</sup>
Less tax paid with returns.....	2,952,562.91	2,952,562.91 <sup>(c)</sup>
Deficiency .....	<u>\$ 1,091,990.97</u>	<u>\$ 3,568,041.92<sup>(c)</sup></u>
Less: Tax paid as condition to review Case 7298.....	\$189,683.82	
Tax paid under stipulation Dec. 15, 1953.....	895,089.65	1,084,773.47
Present deficiency .....	<u>\$ 7,217.50</u>	<u>\$ 2,483,268.45</u>

(a) Selling expense per Commission.....	\$ 2,490,894.01
Selling expense less profit thereon.....	2,096,510.09
<hr/>	
Profit in selling commission.....	\$ 394,383.92

(b) Plaintiff's Exhibit 56 (2) indicates a total liability of \$4,028,608.40 and crediting only payments made with returns, a deficiency of \$1,076,045.49. The increase in liability to \$4,044,553.88, and in deficiency to \$1,091,990.97, is accounted for in part in the year 1942; the previous computation was based on allocation fraction of .64676 for that year. The above calculation uses for 1942 the allocation fraction of .66926, being that conceded by both parties in Case No. 7298 before this Court.

The tax increase over the tax computed in Exhibit 56(2) due to the correction in the allocation fraction for 1942 is \$10,841.60, and the tax increase due to adding the sales profit to income is \$5,103.88, a total increase of \$15,945.48.

(c) Commission's Findings of Facts, pp. 185, 193.