

1980

Kennecott Copper Corporation v. Bingham and Garfield Railway Company : Unknown

Utah Supreme Court

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UTAH SUPREME COURT

BRIEF

T NO. 8091D

IN THE SUPREME COURT
of the
STATE OF UTAH

KENNECOTT COPPER CORPORA-
TION, a corporation, and
BINGHAM and GARFIELD RAIL-
WAY COMPANY, a corporation,
Plaintiffs,

vs.

THE STATE TAX COMMISSION,
Defendant.

DEFENDANT'S BRIEF

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Recd 6/30/54

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**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.

Case No.
8091

DEFENDANT'S BRIEF

STATEMENT

This is a certiorari proceeding to review the lawfulness of a decision of defendant, dated July 23, 1953, that there is owing by plaintiff deficiencies of corporation franchise tax for the years 1942 to 1950, inclusive, of \$3,568,041.92. Interest calculated on such deficiencies to June 15, 1953 was in the amount of \$1,283,647.81, a total of \$4,851,689.73.

Plaintiffs' brief does not mention what the deficiencies in tax should be under plaintiffs' theory of the case. However, on page 3 of plaintiffs' brief before the Tax Commission it is stated ". . . the taxpayer's contention as to the correct determination of the tax is set forth in Schedule 2 of Petitioner's Exhibit 56 (2)." Turning to this Exhibit, we find plaintiff admitted a corrected tax liability for the period here involved of \$4,028,608.40. Tax paid under the returns as filed was in the total amount of \$2,952,562.91. This would thus leave deficiencies owing, according to plaintiff, of \$1,076,045.49, excluding interest.

From the correct deficiencies finally determined to be due, including interest thereon, by the Court on this appeal will be taken into account certain cash amounts heretofore deposited by plaintiff with defendant in connection with perfecting its appeal in Case No. 7298, involving the year 1942 and again involved here, together with the amount heretofore paid to defendant under stipulation filed with this court following the hearing by this Court on plaintiff's motion to enlarge the time within which to file its brief on the ground that it did not know what, if any, issues in the case it was required to brief and argue before the Court.

In reviewing the case, the Court will be called upon to decide whether the decision of defendant in its dollar and cent amount should be affirmed or modified. Plaintiff in its writ asks that the decision be modified by *reducing the deficiencies to zero and granting a claim for*

refund against the state in the sum of \$3,205,443.06 because the imposition of any franchise tax whatsoever on plaintiff contravenes the commerce clause of the Federal Constitution. Presumably, if overruled on this point which is not pressed in its brief, plaintiff asks for a modification of the decision to an amount equal to 3 per cent of the net income shown on its Exhibit 56 (2).

Defendant on this appeal asks the court to affirm its decision but if modified that the deficiencies be increased to an amount equal to 3% of 100% of plaintiff's Utah division net income in accordance with the reservation of jurisdiction and claim therefor asserted at the hearing under the provisions of Sec. 80-13-39, U.C.A. 1943. Such total income in the amount of \$232,570,086.66 (line 1 Tax Computation Schedule) at 3% would give a total tax liability of \$6,977,102.60. Subtracting the total taxes paid under the returns as filed in the amount of \$2,952,562.91 would make deficiencies presently owing for the years involved in the amount of \$4,024,539.69, excluding interest.

The primary issue presented on this appeal is whether under the mandate of the court and the applicable statutes and authorities, plaintiff may apportion any net income of its Utah Division outside Utah and, if so, how much. Secondary questions relate to the propriety of defendant's calculation of plaintiff's depletion deductions, whether plaintiff in any event is entitled for the year 1942 to apportion 66.926 per cent to Utah and 33.074 per cent outside under the Court's mandate in Case No.

7298 and finally whether the assessment of interest at the statutory 6 per cent rate on any deficiencies to be found herein constitutes an unlawful abuse of discretion on the part of defendant.

Put simply, the Court in No. 7298 decided, first, with one judge dissenting, that plaintiff's tax is to be calculated not on the basis of the statutory formula, but on the basis of the separate accounts of the Utah Division, and, second, that in computing plaintiff's depletion deductions some of its net income must be allocated to post-mining operations. The case was then remanded with instructions to determine and enter a deficiency judgment in accordance with the views expressed in the opinion.

No. 7298 was presented to the Court by both plaintiff and defendant on the basis that "principles" were to be adjudicated, not figures. The Court accepted that approach and, after deciding the principles, remanded the case to determine the deficiency. The mandate thus required a continuation of the hearing on the matter to get more facts pertaining to how much, if any, of the net income reflected on the separate accounts of the Utah Division was attributable to *business done* outside Utah and how much of the net income should be allocated to post-mining operations before computing depletion.

The Court is respectfully requested on this occasion, if it be possible to do so, and based on the more complete record before it to anchor all principles to be readju-

dicated herein down into specific dollars and cents. A judgment with figures would appear to have a better chance of finally disposing of this seemingly never-ending controversy.

Under the heading "Varying Positions Taken by the Commission" in its brief (pp. 14-19), plaintiff outlines somewhat chronologically "the various and inconsistent positions which the Commission has taken with Kennecott over a period of years." The events described merely represent the difficulties which are involved in any tax litigation of this magnitude. The record will show that as the controversy has developed, new facts have come to light. The only matter of importance is the correct determination of the tax imposed annually by law for plaintiff's privilege as a corporation of operating at Bingham, Utah, the world's largest copper mine. This mine, with a capacity of 500,000,000 pounds of copper a year, accounts for around 30 per cent of the total annual production of copper in the United States and approximately 10 per cent of the reported annual primary production of copper in the world. From the Bingham ore is produced, not only copper, but gold, silver, platinum, palladium and molybdenite as well. Plaintiff's various operations make it the largest producer of copper, the second largest producer of gold, the third or fourth largest producer of silver, and the second largest producer of molybdenite, in the United States.

The backbone of plaintiff's vast industrial enterprise is the Utah Mines Division. Some conception of the size of this division's operation can be gained when it is noted that the total gross revenues from the metals produced from the ores of the Bingham Mine, before any expenses, during the years 1942 to 1950, inclusive, were greatly in excess of the total gross revenues of the State of Utah, including all taxes collected by the State Tax Commission and all property taxes collected in the state by municipalities, counties and school districts.

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.

To get a rough idea of what plaintiff did in filing its returns, let us turn to the Utah Division 1942 return as an example. Showing a gross income from its Utah Division operations of about 86 millions, plaintiff subtracted 44 millions of total direct and indirect expenses of operations. This left a net income of 42 millions to the Utah Division before Federal taxes, depletion, and exclusion of net income attributable to out-of-state activities, if any.

From this 42 millions of Utah Division net income, plaintiff subtracted 20 millions of Federal taxes (plaintiff as a whole paid 22 millions). This cut the 42 millions down to 22 millions of net income.

Plaintiff next subtracted about 13 millions for depletion. This cut the 22 millions down to 9 millions of net income.

Plaintiff next cut the 9 millions down one-third by applying an "apportionment formula" to the nine millions of 66.926 per cent. This cut the 9 millions down to 6 millions of net income (actually about 5.8 millions).

These three adjustments which adjusted 42 millions of net income of the separate Utah Division, after all direct and indirect expenses of operations, down to less than 6 millions of adjusted taxable income to Utah, represent the problem which faced the Court in No. 7298. The Court was also faced with plaintiff's request that any attempt by defendant to adjust the above adjustments of plaintiff, entitled plaintiff to file an amended return for 1942 on the statutory formula covering all of its operations and not merely those of its Utah Division. Under this amended return as filed 3.4 millions were assigned by plaintiff to Utah (Ex. QQ(2)).

Defendant's decision here on appeal assigns 16.8 millions of net income to Utah for 1942, using an apportionment fraction slightly over 93 per cent. A 100 per cent apportionment would assign 18 millions to Utah.

As compared with its original 1942 Utah Division return assigning 5.8 millions and its amended corporate return on the statutory formula assigning 3.4 millions to Utah, plaintiff in Petitioner's Ex. 56(2) at the hearing conceded a total net income assignable to Utah (Line 7) of 10.4 millions for 1942, using an apportionment fraction of 64.676 per cent. However, on this appeal and listed as

a separate contention is the argument that this Court by its mandate in Case No. 7298 directed defendant to use the arbitrary 66.926 per cent apportionment fraction which had been used by defendant in filing its 1942 Utah Division return.

Plaintiff's appeal in Case No. 7298 covering 1942 had been preceded by an earlier appeal to this Court in Case No. 6324 covering the years 1935 and 1936. This latter appeal was dismissed as a part of the settlement compromising all of the years 1935 to 1941, inclusive. This compromise is now past history and comment thereon at this time is unnecessary. It is material to point out, however, that the arbitrary apportionment fraction of 66.926 per cent was used in this compromise. This figure seems to have been arrived at somewhat on the following basis:

Plaintiff had very stubbornly insisted from the beginning on its right under the statute to use the statutory formula on its Utah Division separate accounts and to consider no payment to the state which did not recognize that all of its gross receipts from sales should be allocated outside the State. Allocating 100 per cent of the property of the Utah Division to Utah and 100 per cent of the payroll of the Utah Division to Utah and 100 per cent of the gross receipts of the Utah Division outside Utah, gives a straight fraction of $66\frac{2}{3}$ per cent. Under the compromise, in return for the Commission's concession that all sales receipts could be allocated outside the

State, plaintiff conceded that all of the property and payroll of the Utah Division could be allocated to Utah, together with certain miscellaneous small receipts admitted by plaintiff to be assignable to the state. These miscellaneous small receipts account for the difference between $66\frac{2}{3}$ per cent and the 66.926 per cent figure. Also, under the compromise, plaintiff was allowed to take depletion deductions from gross income equal to one-third of the total Utah Division net income for the period. Such amount was arrived at before any deduction for Federal taxes and without any reference to a value on plaintiff's mill concentrates which would take into account the principle that some net income must be allocated to post-mining operations before computing depletion.

It is out of this background that plaintiff's argument of long-standing administrative construction emerges in its effort to validate the franchise tax returns involved here.

Perhaps, at this point, a few remarks concerning the course of the trial or hearing below might be helpful to the Court. Following receipt of the remittitur and the Court's mandate in No. 7298, defendant was faced with the necessity of making a computation of tax for 1942 and the intervening years.

On the one hand, the Court had decided the tax should be calculated not on the statutory formula as applied to plaintiff as a whole, but on the basis of the

separate Utah Division accounts under the so-called subdivision (8) provision of the law. (Sec. 80-13-21 (8) U.C.A. 1943). Under this provision, defendant is required in lieu of the statutory formula to make such allocation as is fairly calculated to assign to this state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation. At the same time, the Court had decided that in computing the depletion deduction *some* net income must be allocated to plaintiff's post-mining operations. On the brief and sketchy record before it, the Court was in no position to determine what portion of the net income of the Utah Division was attributable to business done outside the State, nor was it prepared without more to put its final stamp of approval on the cost allocation formula used by defendant in allocating some of plaintiff's net income to post-mining operations for depletion purposes. Extensive discussions with plaintiff, following the remittitur, seemed to indicate plaintiff took quite a contrary view from defendant of what the Court had decided in Case No. 7298. Plaintiff continued to insist that it derived no net income from post-mining operations for depletion purposes and that no adjustments should be made to the separate Utah divisional accounts which did not allocate (1) some property outside (inventory), (2) some payroll outside (New York administrative expense) and (3) all sales outside.

Defendant had hired Messrs. Peat, Marwick, Mitchell & Co., independent certified public accountants, to assist it in computing the tax. Solely from the accounting standpoint, this firm did not regard as unreasonable apportioning the net income of the Utah Division ratably to the costs of the successive stages of mining, smelting, transportation, refining and selling for both depletion and allocation. This basis had several features to commend it. In the first place, profit or net income is what is left over after the costs or expenses of the business are paid or incurred. In a practical way, either profit or loss is tied down to all the costs incurred, not just to some costs. In the second place, it made an assessment inwardly consistent in that "net income from the property" (mining) could be used for the depletion deduction and it only became necessary to add to this figure the net income attributable to the next activity in Utah (smelting) to get the total net income assignable to Utah. The net income assignable to the transportation, refining and selling outside the State became out-of-state non-taxable income. Depletion "net income" was thus incapable of overrunning the state line and exceeding the net income assignable to the State. Roughly speaking, this method allocated about 70 per cent of the net income of the Utah Division to the mine for the depletion deduction and 80 per cent to Utah for taxation. In the third place, this basis had some practical precedent in the construction business where a building job may require two or more annual periods to complete. In these circumstances, an acceptable basis for tax reporting prior to completion

is to apportion that proportion of the estimated total profit to be realized to a particular year that the costs of the particular year bear to the total estimated costs of the whole job. In fact, the formula worked even better in the present case for the reason that defendant was not apportioning an estimated future profit but a definite, presently known and ascertained profit.

This apparently liberal formula was to plaintiff very objectionable. As the hearings got under way, plaintiff's witnesses analyzed the formula and criticized its legal applicability to the case. It was algebraic; it gave a distorted picture because the higher the costs, the higher the profit; it had no warrant in the statute, etc. A large part of this criticism was valid and persuasive and impressed the Commission insofar as it was directed against the apportionment of net income within and without the State. It became clearly apparent that the determination of the "net income reasonably attributable to the business done within this state" for apportionment purposes was one thing and determination of the "net income from the property" for depletion purposes another thing. They rested on different footings in the statute.

Aside from the numerous prejudicial imperfections of the formula pointed out by plaintiff, the Commission also realized as the facts developed that its use for apportionment purposes could not be justified under the Court's mandate of computing the tax on the Utah Division's separate accounts. The effect of the formula

was to automatically apportion net income reflected on the Utah Division accounts to an out-of-state *source* merely because out-of-state expense was being incurred and irrespective of whether such out-of-state expense *constituted out-of-state business*. For example, a Utah ranch company may ship cattle to the Omaha market unloading the stock intransit in Colorado for feed and water. The incurring of such transportation and feeding expense may be out-of-state expense but it is not attributable to out-of-state business requiring an apportionment of income within and without the state. The expense is outside but the business is inside. Furthermore, the formula, from another point of view, was in effect converting a franchise tax law on the privilege of doing business into an income tax and making source of the income rather than value of the corporate franchise the criteria for the tax.

On the other hand, the formula had a legally useful application on the depletion question. The problem here was not to determine where the business was being done but merely to determine the gross income from the mine before the mill product entered the post-mining furnace and metallurgical treatment stages. The mining expenses were known so that to compute the net income from the property, the gross income need only be determined. This represented primarily a valuation problem which would take into account the Court's mandate of allocating *some* net income to the post-mining operations. The formula was retained but viewed by the Commission through the

Court's opinion with considerable caution and merely as a means for getting at a correct figure. The formula, it must be admitted, allocated *some* net income to post-mining operations. Whether it allocated too much or too little remained to be determined. The Commission waited patiently for plaintiff to come forward with its own experts or formulas and allocate *some* income, even a little bit, to post-mining operations. It is still waiting. The reams of testimony of plaintiff on the depletion question were directed solely to showing the Court's decision in No. 7298 to be erroneous. The testimony, however, merely fortifies the good common sense of the Court's judgment. In fact, the evidence leaves one with the impression that a formula which puts a value on a *mineral* product of 70 per cent of the total net income ultimately derived after this product is smelted, transported, refined and sold, is excessive. This is perhaps because statutory depletion and Federal taxes were allowed and included by defendant as mining costs under the formula. Defendant, in these circumstances, had no other recourse than to sit tight on its depletion values.

The apportionment problem, on the other hand, took an interesting turn during the trial because the evidence as it developed had taken an odd and surprising turn. Abandonment of the cost allocation formula for apportionment purposes on the persuasive testimony and insistence of plaintiff required a redetermination of the net income of plaintiff's Utah Division reasonably attributable to the business done within Utah which would

fit the new facts in the record. The deficiency letters using the cost formula had initially been sent out in a preliminary way and on the best information and advice then available to defendant following the remand of No. 7298. The hearings, however, had developed a lot of facts, some of them very interesting indeed.

At the outset, plaintiff, vigorously rejecting the cost formula's apportionment of a mere 20 per cent of net income of the Utah division outside the State, claimed the right to use the statutory formula on its Utah divisional accounts. Under its interpretation of the formula, which it insisted was applicable, from 91.270 to 98.106 per cent of property is assigned to Utah, the balance outside; from 96.582 to 98.150 per cent of payroll is assigned to Utah, the balance outside; from 00.004 to 00.779 per cent of gross receipts is assigned to Utah, the balance outside. Average of the three factors thus ranges from 63.192 to 65.198 per cent to Utah. Thus, approximately *36 per cent* of the net income of the *Utah* division is claimed to be attributable to out-of-state business.

To justify exclusion of 36 per cent of the Utah divisional net income from the Utah tax base, plaintiff felt called upon at first to present a picture of large and extensive business activities in the New York Equitable Building Office. These activities were described under the headings of operational, development, purchasing and

selling matters. No stress was placed on activities at the mine, nor on the supervisory activities of plaintiff's administrative staff in the Salt Lake Kearns Building Office.

This testimony went on at considerable length describing plaintiff's operations everywhere, including those in and out of Utah, as one continuous, indivisible, closely integrated operating unit with indivisible, continuous and uninterrupted operations from the mining of the crude ores through the smelting and refining stages to the ultimate sale, distribution and delivery of the marketable products to the customer. The income from such a unified business was claimed to be incapable of separate partition and was exactly what the statutory or Massachusetts formula was invented to cover. Activities of plaintiff's sales office in New York were given especial importance and significance as contributing to the production of plaintiff's income because without sales, no cash. Everything prior to the sale was merely expenses. The sale was the important thing. It put the income in the bank and the sale was not made in Utah.

However true the picture of the one indivisible, continuous, uninterrupted, integrated operating unit may be in a broad economic sense, it collapsed completely under the facts pertinent to our statute.

In the first place, it appeared that plaintiff never sold any copper or molybdenite at all but merely produced them. Plaintiff's sales subsidiary, Kennecott Sales

Corporation, made all sales to customers in the regular course of the subsidiary's business and in the name of the subsidiary. The customer paid his money and dealt with the sales subsidiary exclusively.

In the second place, it appeared that title to the copper and molybdenite was transferred from producer parent to sales subsidiary, contemporaneously with the sale from subsidiary to customer, under an intercompany contract at the actual market price realized by the subsidiary less certain expenses and a commission of \$1.00 per net ton of copper and \$3.50 per net ton of molybdenite. The evidence clearly showed that this inter-company contract price was arms-length, fair and reasonable.

In the third place, it appeared that not being legally entitled to file a consolidated return with its sales subsidiary because such subsidiary has never done or qualified to do business in Utah, plaintiff's Utah tax returns have nevertheless ignored completely both the separate corporate identity of and the fair and reasonable inter-company contract with the sales subsidiary. The separate net income derived by the sales subsidiary under its intercompany contract was treated in the Utah tax returns of plaintiff as the net income of plaintiff even though consolidated returns were not and could not be filed and notwithstanding that such separate net income was the source of the payment of dividends aggregating \$1,240,000.00 by the sales subsidiary to plaintiff during the years here involved.

In the fourth place, it appeared that *25 per cent* of the total copper produced by the Utah Division was not sold out on the market, but was transferred on an inter-company basis through the sales subsidiary at fair market prices to plaintiff's fabricating subsidiaries, Chase Brass and Copper Company and Kennecott Wire and Cable Company for fabrication and sale by the fabricating subsidiaries to their customers. As in the case of the sales subsidiary, neither fabricating subsidiary did or was qualified to do business in Utah.

In the fifth place, it appeared that the one-third of the net income of the Utah Division which plaintiff was seeking to apportion outside Utah as attributable to business done in New York was not being and never had been picked up for taxation by New York as business done in New York under its similar franchise tax statute. No question of double taxation was therefore involved under the subdivision (8) provision of our statute.

In the sixth place, it appeared that the business of refining Utah blister copper by American Smelting and Refining Company under contract at its Baltimore, Maryland refinery or elsewhere, was not *business done* by plaintiff at Baltimore, but business done by A. S. & R. at Baltimore for plaintiff.

In the seventh place, it appeared that historically speaking the producing function has always been separated from the selling function. In the years prior to

1920, A. S. & R. did the selling. From 1920 to 1934, Guggenheim Bros. did the selling. From 1934 to the present, the sales subsidiary has done the selling.

In the eighth place, it appeared that the sales subsidiary maintained joint offices with plaintiff, its parent, in New York and actually paid its full proportionate share of the rent and other New York office expenses.

In the ninth place, it appeared that from 1931, when the Utah tax law became effective, to 1936, when Utah Copper Company was dissolved to become the Utah Division of plaintiff, Utah Copper Company's New York Office was at 25 Broad Street, whereas the offices of Guggenheim Bros. and Kennecott Sales Corporation were at 120 Broadway. Thus, to begin with and covering the period involved in No. 6324 before this Court (covering 1935 and 1936 and later compromised and dismissed), plaintiff did not even have the benefit of the producing company or division sharing joint office premises with the selling firm or company to give argumentative support to its present position that the sales subsidiary is an "agent" operating in plaintiff's behalf in premises owned or rented by plaintiff outside Utah.

In the tenth place, it appeared that the separate books of account of the Utah Division of plaintiff, the sales subsidiary and the fabricating subsidiaries properly and truly reflected the net income from the business and operations of the Utah Division and each of the sales and fabricating subsidiaries.

In the eleventh place, it appeared that the Utah Division was charged with its fair and proportionate part of plaintiff's New York office administrative expense, including salaries and office expenses, and that such sums were deducted as expense on the Utah tax returns.

These significant facts, among many others, set forth in the Findings, put an entirely different complexion on the case. In fact, in its bare essentials, all there is here is a company producing fruit in Utah, having it sorted, packed and graded under contract by an independant firm in Idaho and sold to an independent broker, commission merchant or distributing company in Wyoming for resale outside Utah. The fact that the Utah producer also establishes an office in the same state, or in the same town, or in the same office building, or on the same floor does not make the broker's or commission merchant's activities his activities. The only inquiry under our statute is to ascertain the nature and extent of the out-of-state office activities of *the taxpayer* in the light of its intercorporate arrangements and the way it keeps its books of account to determine whether such out-of-state activities, if any, require an *apportionment* of Utah net income out-of-state in addition to being allowed as an expense deduction to the business done within the state.

Unless the separate corporate entity and selling operations of the sales subsidiary are ignored, all the Court is faced with here is the existence of an out-of-state

management office in New York concerned with world-wide operations, superimposed on a management office in Salt Lake more directly concerned with operating problems of the Western Divisions, including the Utah Division. The activities of the New York office are extremely important, of course, and should not be minimized. Corporate housekeeping duties, plans and policies, investments, financial matters, directors' and stockholders' meetings are important corporate functions. The problem here, however, is the extent to which these out-of-state over-all management services require an out-of-state apportionment of the income of its Utah Division where already a fair share of the applicable expense of these services has been deducted on the division's separate accounts and served to reduce by that amount the net income attributable to the business of the Utah Division. The allowance of the substantial expense of the New York management services as a deduction on the Utah returns itself allocates outside Utah, on this record, the full value of such services to the production of net income by the Utah Division. Furthermore, it has to be remembered that the income being earned by the Utah Division is not from New York housekeeping duties or management services but from the production of metal by the Utah Division.

We ask the Court to keep constantly in mind the fact that the Utah copper and molybdenite product is transferred from the Utah Division directly to the sales sub-

sidiary at a fair price (market less fair and reasonable commissions, together with certain expenses). The Utah Division is credited with its fair price by the sales subsidiary.

The molybdenite, which accounts for approximately 8 per cent of total sales, is fully marketable in Utah, requires no further processing, and is moved directly out of Utah to out-of-state customers by the sales subsidiary. Plaintiff conducts no activity or business outside Utah with respect to molybdenite whatsoever. It is produced here and sold outside by another company.

What about the copper, platinum, palladium, gold and silver? Is any of the net income derived from these products earned from or attributable to out-of-state business. No, even though a slightly different factual situation is presented from that pertaining to the molybdenite.

Plaintiff's Utah mills turn out along with the marketable molybdenite, copper concentrates which are smelted in Utah for plaintiff's account by A. S. & R. These copper concentrates were smelted by A. S. & R. at cost plus a fee of \$1.35, then \$1.00 and now 85c per ton of dry product to produce blister copper. This blister, although 99 plus per cent pure copper, has mixed up with it small but very valuable amounts of gold, silver, platinum and palladium. These "impurities" were refined out of the blister by A. S. & R. at its Baltimore or other refinery at cost plus a fee of \$1.50 per ton of

returnable refined copper. The refined copper as produced was sold by the sales subsidiary to customers out of A. S. & R.'s yard at the refinery. Copper is thus in exactly the same boat as molybdenite except that the Utah blister on its way to market must be stopped in transit in Maryland for some additional processing, not by plaintiff or by the sales subsidiary, but by an independent third party, A. S. & R. This out-of-state processing of the Utah product is not out-of-state business of plaintiff, but the business of A. S. & R.

The platinum and palladium product is again in the same boat as the molybdenite and the copper but with the difference that this product is sold not by the sales subsidiary, but by A. S. & R. for an agreed fee not to exceed \$5.00 per ounce less certain costs and expenses. Plaintiff does not ask, as in the case of its sales subsidiary, that the separate corporate entity of A. S. & R. be set aside. These receipts are merely so small in the over-all picture as to require no comment.

Defendant in its final decision allocated all receipts from gold and silver outside the State after having at the hearing in Ex. PPP (2) attributed them to Utah business. Was this out-of-state assignment proper? The deficiencies were cut down substantially by this action because these receipts account for about 12 per cent of total sales. For one month (May, 1950,) for example, they ran over \$900,000.

The problem on the gold and silver is somewhat unique. As set forth in *Salt Lake County v. Utah Copper Co.*, 93 Fed. (2) 127 (1937) (CCA10), in the years from 1909 to 1932, the Copper Company shipped its copper concentrates to the smelter where they were sampled, assayed, purchased and paid for by the smelter except for the copper which was returned in kind out-of-state on payment of the smelting and refining toll charges, the smelter being unable to purchase such large quantities of copper. Effective January 1, 1933, the Copper Company made a new smelting contract whereby gold and silver were no longer purchased in Utah by the smelter, but were thereafter delivered back in kind out-of-state to the copper company along with the blister copper.

The early testimony at the trial below on the gold and silver was, to say the least, garbled, contradictory and confused with respect to what happens after the delivery back in kind. (See F. pp. 83 et seq.) The fair conclusion at this time, however, was that the "sales" to the Federal government were effected by A. S. & R. as an independent sales agent, and not by plaintiff or by the sales subsidiary, on about the same basis as the platinum and palladium. For this reason they were claimed in Ex. PPP(2) as Utah business. Also, to be noted is that, at that time, there was in evidence the basic agreement of November 29, 1940, (Ex. III(2)) between plaintiff and A. S. & R. calling for the delivery back in kind of the copper and the gold and silver as well. The

witnesses were clear enough on what happened to the copper but the circumstances surrounding the delivery of the gold and silver to the government were not clear.

This mystery was solved at later hearings by Mr. Gervin, assistant to plaintiff's president, who introduced in the evidence another agreement, hitherto unheard of, and dated the 29th of November, 1940, under which plaintiff did not on taking delivery sell the gold and silver to the government itself. After being constructively delivered up in kind by A. S. & R. at the refinery to plaintiff, plaintiff concurrently and constructively delivered back and sold the gold and silver to A. S. & R. On its face, this contract had been negotiated and executed in the New York offices of plaintiff and A. S. & R.

The sale price to A. S. & R. for the month of May, 1950 of \$908,416.12 of Utah Division gold and silver was \$901,185.28, A. S. & R. thus realizing a net gain on the purchase and resale of \$7,230.84, or roughly eight-tenths of one per cent.

It might be asked whether this sale of gold and silver is not in substance exactly the same situation as prevailed on a net smelter return basis prior to January 1, 1933. For example, what difference did the new arrangement make in shifting from a sale of the gold and silver in the concentrates on a net smelter return basis in Utah to a delivery up in kind to plaintiff outside Utah if simultaneously with the new delivery up in kind agreement there

was executed a separate agreement under which A. S. & R. from the moment of the delivery of the concentrates in Utah became legally entitled by contract to the product, merely postponing passage of title and payment until the gold and silver were stripped out of the blister outside the state by A. S. & R. Again, for example, what difference would it make taxwise if wool on the sheep is sheared after the sheep are driven across the state line if grown on the sheep in Utah. Furthermore, if, as here, the out-of-state shearing is done by the purchaser, the shearing is not out-of-state business of the Utah ranch owner and the net income attributable to the growing of the wool in Utah would be attributable in full to Utah business.

Other features pertaining to the gold and silver gave defendant considerable difficulty. For example, Mr. Lenz, President of the Sales Subsidiary, testified (F. p. 85):

“You see, to me — while they are precious metals — they have in my opinion no commercial value. In other words, we spend no time on the sale of them, it is automatic.”

In other words, no sales effort or marketing problem is involved with respect to gold and silver. The “sale” to the Federal government does not contribute to the earning of the income. From this testimony it conclusively appears that the income is solely in the production of the metal.

Another thing was whether the one letter contract of sale, dated November 29, 1940, negotiated and executed, it is true, in the respective New York Offices of A. S. & R. and plaintiff at 120 Broadway, but covering the complete inter-company transfer of all future production of gold and silver, was of such a character that all gross receipts from such transfers year after year should be attributable to New York business solely by reason of initial formal execution of the agreement in New York. This difficulty was accentuated when it is borne in mind that the full amount of the gross receipts from the transfers of gold and silver in the Utah blister to A. S. & R. at the Baltimore refinery were reflected in the separate accounts of the Utah Division and attributed to the business of the Utah Division. Again and of paramount importance is the fact that in substance and effect the transfers of the gold and silver to A. S. & R. differ not one whit from the transfers of platinum and palladium to A. S. & R. and the transfers of copper and molybdenite to the sales subsidiary. All are for resale. The Utah Division is merely a producer. A. S. & R. and the sales subsidiary are the marketing instrumentalities.

Notwithstanding the Court's mandate to compute the tax under subdivision (8) on the separate accounts of the Utah Division and not on the basis of the statutory three-factor formula as applied to plaintiff and notwithstanding that jurisdiction had been reserved and claim made at the hearing to assess the tax on the full net income shown and reflected on such separate accounts, Defendant

(a) Allocated in the gross receipts fraction all receipts of gold and silver outside the State, such receipts comprising about 12 per cent of total sales.

(b) Allocated in the payroll fraction all New York administrative expense as payroll outside the State, such expense comprising roughly about 3 per cent of total payroll.

(c) Allocated in the property fraction all inventories in transit or in process or on hand at the refinery awaiting sale as tangible property outside the State, such outside property comprising roughly about 6.5 per cent of total property.

(d) All property and payroll in Utah were allocated to Utah. All receipts from sales of copper and molybdenite collected by plaintiff from the sales subsidiary following sales by the latter to customers and from platinum and palladium collected from A. S. & R. following sales by the latter to customers, were included as Utah business for the reason that such sales were not made by and in the name of plaintiff but by and in the name of the sales subsidiary and A. S. & R. and in the regular course of the latters' business and from the latters' premises.

This decision may be erroneous. It is erroneous, however, only if the tax should be laid under the mandate of this Court on the full separate net income of the

Utah Division and in accordance with Sec. 80-13-16 (1), U. C. A. 1943, which requires the net income to be computed upon the basis of the taxpayer's annual accounting period *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer*. The net income from the intercompany transfers to A. S. & R. of Utah gold, silver, platinum and palladium is earned from Utah business. The net income from intercompany transfers of Utah copper and molybdenite to the sales subsidiary at a fair price is earned from Utah business. The full value of the New York management services has been allowed as an expense deduction against Utah business and inventory in transit outside the State to market may be interstate business but it is not out-of-state business requiring apportionment.

Defendant, in its decision, faced the choice of assessing the tax on the full net income of the Utah Division or, on the theory that these separate accounts reflected in part net income from some out-of-state business, applying the formula to the separate accounts merely as a discretionary adjustment under subdivision (8) and not as a matter of statutory right to the taxpayer. The discretionary adjustment to the accounts first made by plaintiff based on the cost allocation formula did not assign enough (only about 20 per cent) net income outside the state according to plaintiff. Application of the formula as an adjustment, however, applied literally, assigned from 6 to 10 per cent outside.

An interesting, and perhaps amusing, sidelight of the attack on the original cost allocation assignment by defendant is that even if the sales subsidiary's business is treated as plaintiff's business and the formula applied as plaintiff insists here, the receipts from the sales of 25 per cent of total production of Utah copper to the fabricating subsidiaries in no event should be excluded from the sales numerator. Such intercompany sales, under the regular practice of the Commission, cannot for obvious reasons have the formula applied to them. This is Utah business, separately accounted for. If the sales numerator here instead of being substantially zero, as plaintiff contends, includes the receipts from the 25 per cent of copper production to the fabricating subsidiaries, it is interesting to note how close the figure comes to the assignment of income to Utah under defendant's original cost allocation formula which proved to be such anathema to plaintiff.

Plaintiff in its brief devotes pages 4 to 13, inclusive, and more particularly pages 6 to 13, to the "facts" and pages 14 to 19 to the "Varying Positions Taken by the Commission". The "facts" set forth are not the facts in the Findings or in the record. This is apparently because of plaintiff's desire, contrary to the rules of this Court, not to "burden this Court by pointing out the many instances where the findings of fact by defendant are not supported by the testimony and evidence presented before it." How better to present the picture of the one continuous, indivisible, uninterrupted, inte-

grated operation than to ignore completely the Findings and record which show that the production, sales and fabricating functions have been separately broken down and incorporated, corporate-wise and accounting-wise.

The record below made it abundantly clear to defendant that plaintiff has been playing both ends against the middle. The sales subsidiary was incorporated and has been utilized for valid business purposes as a marketing or sales outlet for plaintiff's entire production of copper and molybdenite. The value at which this production was transferred from plaintiff, as producer, to sales subsidiary, as seller, by intercompany contract was fair and reasonable. Nothing in the record would permit defendant to move in on this contract and have it set aside by this Court as a fraudulent device to siphon out of Utah income earned here. Defendant must recognize and accept it; plaintiff also. Use of a sales subsidiary gave plaintiff the practical benefits of limited liability and, more especially, prevented plaintiff from subjecting its tremendous income to the risk of income or franchise taxation in New York and in the various states and foreign countries where the product is sold every day. By giving the sales subsidiary a relatively small but at the same time fair and reasonable profit on the sales, it was the subsidiary's profit, not plaintiff's, which became subject to the risk of an apportionment of income to the place of sale. Furthermore, the allocation of a larger profit to the subsidiary or having plaintiff do its own

selling, would have taken a larger share of income now allocated by plaintiff to Utah out of Utah but at the same time allocated it to New York. This would be jumping from the frying pan into the fire because New York with a franchise tax rate of $5\frac{1}{2}$ per cent before Federal taxes has a much stiffer rate than the modest Utah rate of 3 per cent after the heavy Federal tax has been deducted.

The authorities establish the right of a state to rest the tax on the income apportioned by the taxpayer to business done within the state on the taxpayer's separate books of account. Indeed, if such allocation made by the taxpayer properly reflects net income and excludes the net income of operations in other states, the state must accept it. Allocation by separate accounting fairly and accurately made precludes the use of the statutory formula. In the absence of a showing of the income attributable to the business done within the state by separate or segregated accounts, the formula merely represents a crude, rough approximation which Courts have been reluctant to set aside except where it reaches a palpably arbitrary and unreasonable result. No taxpayer is entitled of right to the statutory meat-chopper where his own segregated bookkeeping system meticulously, precisely and fairly with a sharp pen-knife carves out of the whole of the taxpayer's net income everywhere derived, that portion which reasonably reflects the true extent of business done within the taxing state.

The present case is the most important case ever to come before the defendant below. It involves a large sum of money it is true, but even more important is the fact that it involves the relationship of the State to the State's largest business enterprise and a matter of principle of general application, that is to say, the tax status of production within and sale without the State. Adjudication of the question involved here will have large and far reaching significance involving as it does production in Utah by one company and the sale of the product outside the State by other independent marketing instrumentalities. Utah with its natural resources and small population is, and for many years will probably remain, a producing rather than a consuming state. Its tax laws, as we will see, have been designed around and take cognizance of these economic facts. Much of the state's agricultural and livestock production is marketed outside the state through brokers, commission merchants or other independent marketing instrumentalities. Our statute does not contemplate attributing sales outside the state to out-of-state business where the selling function has been by contract taken over by some third person acting independently and in the regular course of his own business. To exclude the out-of-state sale from Utah business, it is necessary that the taxpayer producing the article of sale sell his product outside the state out of his own office by his own agents or employees and in his own name and behalf and in the regular course of his own business.

The picture is made even more clear when looked at in the reverse. We find, for example, that if the Bingham pit were in New York and if plaintiff and its sales subsidiary occupied joint offices not in the Equitable Building, New York City, but in the Kearns Building in Salt Lake City, our statute would not in the case of plaintiff purport to allocate to Utah the gross receipts from sales of metal produced out-of-state but marketed here nation-wide by the sales subsidiary, a separate corporation from plaintiff. The sales here by the sales subsidiary would not be the plaintiff's sales. Utah would have the right, of course, to assess a franchise tax on the sales subsidiary but it would be a tax based upon the separate net income of the sales subsidiary realized under its contract with its parent.

In order to prevent any possible misunderstanding and misinterpretation of defendant's position on this appeal, may we restate the position as follows :

Defendant first asks that its decision be affirmed. It makes this suggestion to the Court on the ground that there is not the slightest showing here that defendant has reached outside the state to tax \$1.00 of net income of the Utah Division attributable to business done by this Division outside the State. At the same time, it asks the Court to consider the facts of record and contained in the Findings in the light of the pertinent legal authorities hereafter to be discussed and increase the tax to the applicable 3 per cent rate of the full net income shown

and reflected on the separate accounts of plaintiff's Utah Division, if in the Court's judgment such authorities so require. Jurisdiction and claim to make this increase of deficiency were appropriately reserved at the hearing and defendant asks the Court to exercise this jurisdiction and direct the assessment of tax on such basis if the law so requires. This Court under the statute in these circumstances, has the authority and jurisdiction to inquire into and determine the *lawfulness* of defendant's decision and to *modify* such decision to the extent required by the law and the facts, whether such modification result in an increase or a decrease of the deficiency in tax.

SUMMARY OF FACTS

Plaintiff, a New York Corporation, owns and operates four mining properties in the United States and through a wholly owned subsidiary, Braden Copper Company, a fifth property in the Republic of Chile. The four United States properties are known as the Western Mining Divisions and consist of Utah Mines Division, Nevada Mines Division, Chino Mines Division (New Mexico) and Ray Mines Division (Arizona). In Nevada, New Mexico and Chile (through Braden Copper Company), plaintiff operates its own smelters. Mill concentrates produced by plaintiff in Arizona are smelted under contract by American Smelting and Refining Company at the latter's smelter in Arizona. The mill concentrates produced by the Utah Division are smelted under contract by A. S. & R. at its Garfield Utah Smelter.

The blister copper produced by the Utah, Nevada, Chino and Ray Mines Divisions, during the period here involved, was shipped back to A. S. & R.'s Baltimore, Maryland refinery or other out-of-state refinery where the copper was all smelted up together and refined. From this refining process are produced copper, gold, silver, platinum and palladium. In the case of the Utah Division, during plaintiff's mill operation to produce copper mill concentrate for shipment to the A. S. & R. smelter in Utah, is also produced a fully marketable molybdenite concentrate requiring no further processing prior to sale.

The foregoing divisions of plaintiff are operated as separate departments and separate books of account are kept and maintained for each division which segregate and properly reflect the business done by and the net income of each division.

Plaintiff has three wholly owned subsidiary companies, among others, known as Kennecott Sales Corporation, Chase Brass and Copper Company and Kennecott Wire and Cable Company.

Kennecott Sales Corporation, the sales subsidiary, is engaged in the business of selling all of the copper and molybdenite produced by the four United States mining divisions and the copper produced by plaintiff's subsidiary, Braden Copper Company, in Chile. The sales subsidiary's offices are in New York City, shared jointly with plaintiff, and all sales are made by and in the name

of and in the regular course of business of the sales subsidiary. Plaintiff itself makes no sales of copper and molybdenite but transfers the same to the sales subsidiary, at the time of sale by the sales subsidiary to the customer, at the market price actually realized less certain expenses and a commission of \$1.00 per net ton of copper sold and \$3.50 per net ton of molybdenite sold. The price received by plaintiff from its sales subsidiary by such intercompany contract is fair and reasonable and the terms of such contract were arrived at upon an arms-length basis.

Chase Brass and Copper Company and Kennecott Wire and Copper Company are wholly owned subsidiaries engaged in fabricating refined copper into various marketable fabricated forms. 25% of the total production of the four United States Mining Divisions and more particularly 25% of the production of copper of the Utah Division are transferred by the sales subsidiary to the fabricating subsidiaries at the prevailing market prices at time of transfer.

Separate books of account for each of the fabricating subsidiaries and the sales subsidiary are kept and maintained which segregate and properly reflect the business done by and the net income of each such wholly owned subsidiary.

The sales subsidiary occupied joint offices with its parent, plaintiff, in the Equitable Building, 120 Broadway, New York City, under lease arrangements entered

into by plaintiff with the Equitable Office Building Corporation, authorizing premises to be used and occupied by plaintiff "as Executive and Sales Offices for itself and subsidiaries." For convenience all disbursements and records pertaining to the New York office were handled by the "Disbursing Department" of plaintiff. The Disbursing Department each month sent a bill to the sales subsidiary for the subsidiary's proportionate share of the New York Office expense, including rent as a separate item.

The sales and fabricating subsidiaries were operated as separate, distinct and independent corporations. Plaintiff from time to time received dividends from its subsidiaries and in the case of the sales subsidiary during the period here involved received dividends aggregating \$1,240,000.00.

Plaintiff maintained a subordinate administrative office in the Kearns Building, Salt Lake City, Utah, supervising generally the operations of its Western Mining Divisions and supervising more particularly operations of its Utah Division. The Utah Division had approximately 5,000 employees. Plaintiff owned and operated by virtue of its franchise from the State of Utah large and extensive properties, which include mines, mills, improvements, equipment and machinery, town sites, power plants, dumps, tailing ponds, etc. Real estate owned is about 30,000 acres.

The copper mill concentrates produced by the Utah Division were smelted by A. S. & R. on a toll or cost-plus

a fixed fee basis. The smelting charge was on the basis of cost plus \$1.35 per ton of dry product for the period up to January 1, 1948, such fee being reduced to cost plus \$1.00 per ton for the period 1948 to 1952 and being reduced further to cost plus 85c per ton beginning January 1, 1953. The smelting facilities of A. S. & R. in Utah are substantially all dedicated to the smelting of plaintiff's concentrates, there being no other substantial production of high grade copper ores or concentrates in the area. Payments by plaintiff to A. S. & R. are called for convenience "Smelting Charge," "Freight Charge," "Lighterage Charge," "Refining Charge," and certain amortization charges covering costs of plant improvements payable monthly. The freight charge represents the reimbursements to A. S. & R. of freight paid by A. S. & R. on Utah blister shipped from A. S. & R.'s Garfield smelter to its Baltimore, or other refinery, including insurance. The lighterage charge covers certain charges in connection with movements of Utah blister to the Baltimore Refinery by water. On shipping the blister to its Baltimore Refinery the bills of lading are stamped by A. S. & R. with plaintiff's name and plaintiff is shown as both shipper and consignee.

Upon receipt of the blister at the refinery, the gold, silver, platinum and palladium are separated from the copper by electrolytic means. A. S. & R. charges plaintiff a refining charge equal to cost plus a fee of \$1.50 per ton of returnable refined copper.

By arrangements between plaintiff, its sales subsidiary and A. S. & R., all copper is made available to the sales subsidiary for sale to customers by the latter in the regular course of its own business and in its own name and behalf. (See F. page 71, for form of contract of sale.) The platinum and palladium are transferred by plaintiff to A. S. & R. for sale by the latter for plaintiff's account at the best price obtainable less an agreed commission not exceeding \$5.00 per ounce and certain other costs and expenses (See F., page 79). Such proceeds realized by A. S. & R. of such prices are periodically paid by A. S. & R. to plaintiff covering the production of platinum and palladium. The gold and silver are transferred by plaintiff to A. S. & R. for resale by the latter to the Mint. The amounts paid for such gold and silver are determined under a formula tied into the official Mint prices less certain agreed deductions. (See F., page 93.) During the month of May, 1950, for example, \$908,416.12 of Utah gold and silver were transferred by plaintiff to A. S. & R. for \$901,185.25, A. S. & R. thus realizing a net gain on the month's transaction of \$7,230.84, or roughly eight-tenths of one percent.

Thus, under the arrangements described in the record and set forth in the Findings, plaintiff transfers all platinum and palladium and gold and silver to A. S. & R. for resale by the latter in the regular course of the latter's business. Such intercompany transfers from plaintiff's Utah Division to A. S. & R. are at fair and reasonable prices. Also, all copper and molybdenite pro-

duced by plaintiff's Utah Division are transferred to the sales subsidiary for resale by the latter in its own name and behalf and in the regular course of its own business. The amounts paid by the sales subsidiary to plaintiff for copper and molybdenite produced by the Utah Division under the intercompany contracts in force were fair and reasonable. 25 per cent of the copper produced by the Utah Division was in turn resold by the sales subsidiary at fair market prices to the fabricating subsidiaries, Chase Brass and Copper Company and Kennecott Wire and Cable Company. Neither the sales subsidiary nor the fabricating subsidiaries have done nor have they been qualified to do business in the State of Utah. The sales and fabricating subsidiaries file separate Federal income tax returns.

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. Although the separate books of account of the Utah Division reflected the regular and systematic deduction of the full amount of commissions paid to the sales subsidiary, in filing its Utah returns such commissions were added back for tax purposes into the net income of the Utah Division. 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.

The Utah tax returns as filed for the years 1942 to 1948, inclusive, purported to be and were consolidated returns of plaintiff's Utah Division and plaintiff's wholly owned subsidiary, Bingham and Garfield Railway Company. The returns from 1949 to 1950, because of the dissolution of the railway company in 1948, purported to be and were the separate return of plaintiff's Utah Division. None of the returns for the period here involved were or purported to be, nor could they be, consolidated returns of plaintiff's Utah Division, the separate sales subsidiary or the separate fabricating subsidiaries. Neither the sales or fabricating subsidiaries have done or qualified to do business in Utah. The Utah Division's proportionate share of the New York administrative expense was deducted as expense on the Utah Division's separate books of account. Such expense was also deducted on its Utah tax returns and allowed by defendant.

The separate corporate entity of the sales subsidiary and the intercompany contract between plaintiff and sales subsidiary covering the transfer of copper and molybdenite, were not recognized or given any force or

effect on the Utah tax returns. This was done notwithstanding the copper and molybdenite products of the Utah Division were transferred to the sales subsidiary at a fair value (market price less fair and reasonable commissions and certain expenses).

The only out-of-state activity with respect to the molybdenite produced and fully marketable in Utah, was the out-of-state sale by the sales subsidiary. The only out-of-state activity with respect to the blister copper, produced entirely in Utah, was the out-of-state sale of the refined copper by the sales subsidiary following the out-of-state separation by A. S. & R. of the commingled gold, silver, platinum and palladium. This out-of-state separation by A. S. & R. of the products commingled in the blister copper merely constituted out-of-state processing of products in transit to market. The out-of-state business of separating the commingled products was the business of A. S. & R. done for but not by plaintiff or its Utah Division. This out-of-state refining or separation expense including freight, was deducted as expense on the Utah divisional accounts and was deducted and allowed also on the Utah tax returns.

As in the case of the copper and molybdenite product transferred to the sales subsidiary at a fair value for resale, the gold, silver, platinum and palladium products were transferred to A. S. & R. also at a fair value for resale. Thus, the entire product, consisting of copper, molybdenite, gold, silver, platinum and palladium produced by plaintiff's Utah Division, was transferred to

the sales subsidiary and A. S. & R. at fair value for resale by and in the name of and in behalf of and in the regular course of business of the sales subsidiary and A. S. & R. The full amount of the gross proceeds as collected by plaintiff from the sales subsidiary and A. S. & R. was credited on the separate accounts as gross income of the Utah division. Such gross proceeds less the out-of-state freight, refining, administrative and selling expense properly reflect the fair market value of the molybdenite and blister copper produced in Utah by the Utah Division prior to departure from the State destined for out-of-state markets in inter-state commerce. Such proceeds less all of the mining, milling, freight and smelting expenses within the state and the freight, refining, administrative, and selling expenses outside the state (together with other deductions allowed by the statute) constitute and reflect the separate taxable net income of the Utah Division. Such net income attributable entirely to business done within the state reflects the value to plaintiff of exercising its corporate franchise in Utah.

The transfer of 25 per cent of the copper produced by the Utah Division from plaintiff to the sales subsidiary at a fair value and from the sales subsidiary to the fabricating subsidiaries at a fair value must also be classed as arms' length transactions. The separate entity and intercompany arrangements between plaintiff and sales subsidiary are to be recognized to the same extent as plaintiff, on its returns, recognized the separate entity and arrangements with the fabricating subsidiaries. The

profits allocated by intercompany contracts between producer, seller and fabricator reflect the profits and true net income of each.

Each of the Western Divisions, including the Utah Division, is a separate department or unit to itself. Each is engaged in the integrated business of mining, smelting and refining of copper and other products. Each is a producing unit. Neither plaintiff nor any of these divisions, however, undertakes to *sell* the products. The operation is a unity up to but not including the sale. The sales are handled by A. S. & R. and the sales subsidiary, separate and distinct corporations from plaintiff and its producing units. Production is in one compartment, sales in another compartment and fabrication in still another compartment. Each compartment has been separately incorporated and represents an independent function. The separate accounts for each function reflect the proper net income attributable to each function. The compartments deal with each other at arms' length and on fair and reasonable terms.

Plaintiff in this proceeding makes no claim that *any* part of the full net income shown and reflected on its Utah Division separate accounts would be or is taxable as business done or earned in New York or any other state or foreign country.

QUESTIONS PRESENTED

On pages 2 to 4 of its brief, plaintiff sets forth five questions which it feels are presented to the Court on

this appeal. Defendant raises no objection to the form of questions 2, 4 and 5. Question 2 is whether the taxes imposed are constitutional. Question 4 is whether defendant is required for the year 1942 to use the arbitrary allocation factor of 66.926 per cent under the Court's mandate in Case No. 7298. Question 5 is whether defendant is empowered to assess statutory interest on any deficiencies to be found herein as a result of this appeal.

Objection is taken, however, to the phrasing of question 3 relating to the depletion deduction. Plaintiff states the question to be whether the term "net income from the property" means the net income derived from the sale of the mineral production obtained from the property, less all costs and expenses incurred in the production and sale of such products. This may have been the question in Case No. 7298 but it is not the question now. The question now is whether in allocating *some* net income to post-mining operations in the calculation of the depletion deduction, as required in the next to the last paragraph of this Court's opinion in Case No. 7298, defendant allocated too much or too little or just the right amount of net income. On the other hand, if we construe the question as a petition for rehearing for the year 1942 and as a request to relitigate the issue for subsequent years, the question as phrased is still objectionable in that it refers to the matter as a sale of "mineral production." Except for the molybdenite mineral mill concentrate, plaintiff sells none of its crude ore or mill concentrates which is the "mineral" production. The

thing sold is not the mineral mined but the metals extracted from the mineral in the post-mining smelting and electrolytic refining stages. Mineral is associated with mining and metal with the post-mining operations. As this Court has already decided, depletion is on the mineral, not on the metal.

Objection is also taken to the phrasing of question 1 which seeks to limit the question on appeal here to whether defendant may attribute to Utah as the amount of plaintiff's gross receipts from business assignable to Utah the gross receipts from sales of copper, molybdenite, platinum and palladium produced by its Utah Copper Division and sold outside of Utah. This question as phrased is merely one aspect of the larger question involved here of whether defendant's decision on the law and the facts has imposed a tax which is too low, too high or in the right amount. The case is here for an overall appraisal and plaintiff cannot, it is suggested, accept the favorable rulings on the property and payroll fractions and exclusion of receipts from gold and silver and then isolate for attack what defendant did with respect to the copper, molybdenite, platinum and palladium. The decision of the Commission must be reviewed as a whole. Also involved is whether this court is required under the facts and pertinent authorities to modify defendant's decision by imposing the tax on the full net income of the Utah Division as reflected on the separate accounts of

such division. In other words, the lawfulness of the whole decision is here, not just the portion plaintiff wishes to contest.

We take up the case from the standpoint, first, of the constitutionality of a franchise tax measured by the fair value of the molybdenite and blister copper product produced in Utah but sold outside the state, second, whether any net income of the Utah Division may be apportioned outside the state, third, whether if some must be apportioned outside the state, defendant's decision is erroneous, fourth, whether defendant's depletion values were arbitrary, fifth, whether for 1942 this Court's decision in No. 7298 requires the apportionment of 33.074 per cent of the net income of the Utah Division outside the state and finally, sixth, whether the assessment of interest on deficiencies is proper.

STATUTES INVOLVED

References are to Utah Code Annotated, 1943, as amended.

80-13-1 (2)

"The term 'taxpayer' means any bank or corporation as hereinafter defined subject to the tax imposed by this chapter."

80-13-1 (5)

"The term 'doing business' includes any transaction or transactions in the course of its business by a bank or corporation created under the laws of this state, or by a foreign corporation

qualified to do or doing intrastate business in this state, and shall include the right to do business through such incorporation or qualification."

80-13-3

*"Every bank or corporation, other than a national bank and corporation exempted in Section 80-13-5, for the privilege of exercising its corporate franchise or for the privilege of doing business in the state, shall annually pay to the state a tax equal to three per cent of its net income for the preceding taxable year computed and allocated to this state in the manner hereinafter provided, or one-twentieth of one per cent of the fair value during the next preceding taxable year of its tangible property in this state, which ever is greater; but in no case shall the tax be less than \$10; * * *."*

80-13-6 (1)

"'Gross income' includes gains, profits and income derived from services, of whatever kind in whatever form paid, or from trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends or securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

80-13-8 (9) (b)

"The allowance for depletion shall be thirty-three and one-third per cent of the net income from the property during the taxable year, computed without allowance for depletion, or on the basis provided in subsection (9) (a), as the tax-

payer may elect. The basis which the taxpayer elects under this subsection shall be the basis used in subsequent accounting periods and shall be changed thereafter only with the consent of the tax commission."

80-13-16 (1)

"The *net income shall be computed* upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer*; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the tax commission does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year, or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year."

80-13-18

"*In any case of two or more corporations (whether or not organized or doing business in this state, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the tax commission is authorized to distribute, apportion or allocate gross income or deductions between or among such corporation, if it determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such corporations.*"

80-13-21

“The portion of net income assignable to business done within this state, and which shall be the basis and measure of the tax imposed by this chapter, may be determined by an allocation upon the basis of the following rules:

(1) Rents, interest and dividends derived from business done outside this state less related expenses shall not be allocated to this state.

(2) Gains from the sale or exchange of capital assets consisting of real or tangible personal property situated outside this state less losses from the sale or exchange of such assets situated outside this state shall not be allocated to this state.

(3) Rents, interest and dividends derived from business done in this state less related expenses shall be allocated to this state.

(4) Gains from the sale or exchange of capital assets consisting of real or tangible personal property situated within this state less losses from the sale or exchange of such assets situated in this state shall be allocated to this state.

(5) If the bank or other corporation carries on no business outside this state, the whole of the remainder of net income may be allocated to this state.

(6) If the bank or other corporation carries on any business outside this state, the said remainder may be divided into three equal parts:

(a) Of one third, such portion shall be attributed to business carried on within this state

as shall be found by multiplying said third by a fraction whose numerator is the value of the corporation's tangible property situated within this state and whose denominator is the value of all the corporation's tangible property wherever situated.

(b) Of another third, such portion shall be attributed to business carried on within this state as shall be found by multiplying said third by a fraction whose numerator is the total amount expended by the corporation for wages, salaries, commissions or other compensation to its employees and assignable to this state and whose denominator is the total expenditures of the corporation for wages, salaries, commissions or other compensation to all of its employees.

(c) Of the remaining third, such portion shall be attributed to business carried on within this state as shall be found by multiplying said third by a fraction whose numerator is the amount of the corporation's gross receipts from business assignable to this state, and whose denominator is the amount of the corporation's gross receipts from all its business.

(d) The amount assignable to this state of expenditures of the corporation for wages, salaries, commissions or other compensation to its employees shall be such expenditures for the taxable year as represents the compensation of employees not chiefly situated at, connected with or sent out from, premises for the transaction of business owned or rented by the corporation outside this state.

(e) The amount of the corporation's gross receipts from business assignable to this state shall be the amount of its gross receipts for the taxable year from

(1st) 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, and sales otherwise determined by the tax commission to be attributable to the business conducted on such premises,

(2nd) Rentals or royalties from property situated, or from the use of patents, within this state.

(f) The value of the corporation's tangible property for the purpose of this section shall be the average value of such property during the taxable year.

(7) In the allocation of net income, gain or loss shall be recognized and shall be computed on the same basis and in the same manner as is provided in this chapter for the determination of net income.

(8) *If in the judgment of the tax commission the application of the foregoing rules does not allocate to this state the proportion of net income fairly and equitably attributable to this state, it may with such information as it may be able to obtain make such allocation as is fairly calculated to assign to this state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation.*

80-13-23 (1)

“Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deduc-

tions allowed by this chapter. The return shall be sworn to by the president, vice president or other principal officer and by the treasurer or assistant treasurer. * * *

80-13-24

(1) *"An affiliated group of banks and/or other corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for any taxable year in lieu of separate returns.* The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (2) of this section prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a bank or other corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such bank and/or other corporation for such part of the year as it is a member of the affiliated group.

(2) "The tax commission shall prescribe such regulations as it may deem necessary in order that the tax liability of an affiliated group of banks and/or corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(3) *"In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected and adjusted in accordance with the regulations under subsection (2) of this section prescribed prior to the date on which such return is made."*

80-13-39

"The tax commission shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed; provided, that at the hearing or prior thereto claim therefor is asserted."

80-13-46

"Every decision of the tax commission shall be in writing, and notice thereof shall be mailed to the taxpayer within ten days, and all such decisions shall become final upon the expiration of thirty days after notice of such decision shall have been mailed to the taxpayer, unless proceedings are thereafter taken for review by the supreme court upon writ of certiorari as hereinafter provided, in which case it shall become final, (1) when affirmed or modified by the judgment of the supreme court; (2) if the supreme court remands the case to the tax commission for rehearing, when it is thereafter determined as hereinabove provided with respect to the initial proceedings."

80-13-47

"Within thirty days after notice of any decision of the tax commission, any party affected

thereby may apply to the supreme court for a writ of certiorari or review for the purpose of having the lawfulness of such decision inquired into and determined. Such writ shall be made returnable not later than thirty days after the date of the issuance thereof, and shall direct the tax commission to certify its record, which shall include all the proceedings and the evidence taken in the case, to the court. Upon the hearing no new or additional evidence may be introduced, but the cause shall be heard on the record before the tax commission as certified to by it. *The decision of the tax commission may be reviewed both upon the law and the facts, and the provisions of the code of civil procedure relating to proceedings in the supreme court shall, so far as applicable and not in conflict with this chapter, apply to the proceedings in the supreme court under the provisions of this section.*"

80-13-48

"No court of this state, except the supreme court, shall have jurisdiction to review, reverse or annul any decision of the tax commission, or to suspend or delay the operation or execution thereof."

80-13-58

"Upon making a record of its reasons therefor, the tax commission shall have the power, in its discretion, to waive or reduce any of the penalties or interest provided in this chapter or to compromise the same."

80-13-63

"Any person who attempts or purports to exercise any of the rights, privileges or powers of any such domestic corporation, or who transacts

or attempts to transact any intrastate business in this state in behalf of any such foreign corporation, is guilty of a misdemeanor and shall be punished by a fine of not less than \$250 and not exceeding \$1,000, or by imprisonment in the county jail not less than fifty days or more than five hundred days, or by both such fine and imprisonment. Jurisdiction of such offense shall be held to be in any county in which any part of such attempted exercise of such powers, or any part of such transaction of business, occurred. Every contract made in violation of this section is unenforceable by such corporation or person."

Regulation No. 4

Article 2 (b)

"The term 'affiliated group' includes the common parent corporation and every other corporation for the period during which such corporation is a member of the affiliated group within the meaning of section 80-13-24 (4) of the Act; but it does not include any corporation which is not subject to tax under the Act, nor does it include a corporation commencing to do business in this state for the period which is the basis of computing its first and second years' taxes under section 80-13-22."

Article 10 (a)

"The privilege of making a consolidated return for any taxable year of the affiliated group must be exercised at the time of filing the return of the parent corporation. Under no circumstances can such privilege be exercised at any time thereafter. If the privilege is exercised, separate returns cannot thereafter be filed for such year

(see, however, Article 16 (b), relating to the improper inclusion in the consolidated return of the income of a corporation)."

Article 12 (b)

"Each of the subsidiary corporations must prepare two duplicate originals of Form 22, consenting to these regulations and authorizing the filing of a consolidated return on its behalf for the taxable year and authorizing the filing of a consolidated return on its behalf (as long as it remains a member of the group) for each year thereafter for which, under Article 11, the filing of a consolidated return is required. One of such forms shall be attached to the consolidated return as a part thereof and the other shall be filed, at or before the time the consolidated return is filed. No such consent can be withdrawn or revoked at any time after the consolidated return is filed."

Article 16 (b)

"If a consolidated return includes a corporation not a member of the affiliated group as defined herein during the consolidated return period, the tax liability of such corporation will be determined upon the basis of a separate return. If a corporation commencing to do business in this state has been included in a consolidated return, its liability will be separately computed in accordance with sections 80-13-22 of the Act. (See Article 2 (b)). The consolidated return shall be considered as including only the corporations which were members of the affiliated group during such period, and the income and deductions of the corporation whose liability is separately computed shall be entirely excluded in arriving at the consolidated net income of the affiliated group

for the consolidated return period (See Article 31 (a)). Transactions with the excluded subsidiary for the consolidated return period shall not be considered as 'intercompany transactions' within the meaning of the regulation."

ARGUMENT

POINT NO. I

A STATE MAY CONSTITUTIONALLY IMPOSE A FRANCHISE OR OCCUPATION TAX ON THE PRIVILEGE OF DOING A LOCAL BUSINESS MEASURED BY THE GROSS OR NET VALUE OF THE GOODS PRODUCED WITHIN THE STATE NOTWITHSTANDING THAT ALL OR SUBSTANTIALLY ALL OF SUCH GOODS ARE SHIPPED AND SOLD OUT OF THE STATE IN INTERSTATE COMMERCE.

The question whether a state in the imposition of a tax has imposed a burden on interstate commerce and denied the taxpayer equal protection and due process of law, in contravention of the Federal constitution, has come before the Courts in a great variety of situations. The cases involve many different types and kinds of taxes such as ad valorem general property taxes, sales taxes, use taxes, gross receipts taxes, capital stock taxes, corporate net income taxes, excise, franchise, privilege or occupation taxes, etc. The cases also involve many different types and kinds of businesses such as merchandising concerns, banks, finance companies, manufacturing establishments, pipe lines, air lines, railroads, ferries, mining companies, telegraph and telephone companies, etc., etc. We also see the cases involving situations in which the company may be engaged *exclusively* in inter-

state commerce or, on the other hand, doing some local business in addition to its interstate business. In these circumstances, to prevent the discussion from wandering into fields not pertinent to the issue here, we refer the Court to those cases involving primarily the question of production within and sale outside the state, involving also an occupation tax or a franchise tax measure by value of or the net income from the products produced within the state and the extent to which an apportionment of the value or net income within and without the state is necessary to meet the requirements of both the commerce and due process clauses of the constitution.

Plaintiff makes no suggestion that Utah's corporation franchise tax law is unconstitutional as it stands in the books. The claim is merely that the statute as applied to plaintiff is unconstitutional. The deficiencies in tax are first claimed to be invalid by reason of defendant's erroneous construction of the statute and that the statute as so construed is unconstitutional. Secondly, it is claimed in the petition that plaintiff's mining and natural resources business in Utah is exclusively an interstate business and that any tax, including the tax already paid, is invalid. A refund of \$3,205,443.06, together with interest as provided by law, is requested as an overpayment.

The definition of "doing business" in the Utah statute refers to the qualification to do or the doing of *intra-state* business by a foreign corporation. (Sec. 80-13-1(5) U.C.A. 1943). The penalties of suspension or forfeiture

of corporate rights prescribed in Sec. 80-13-62 refer to the forfeiture of rights to do intrastate business. The misdemeanor prescribed in Sec. 80-13-63 refers to the transaction of or the attempt to transact *intrastate* business in this state.

Sec. 80-13-3 prescribes that every corporation “for the privilege of exercising its corporate franchise or for the privilege of doing business in the state, shall annually pay to the state a tax equal to three per cent of its net income for the preceding taxable year computed and allocated to this state in the manner hereinafter provided, or one-twentieth of one per cent of the fair value during the next preceding taxable year of its tangible property in this state, whichever is greater; but in no case shall the tax be less than \$10; . . .”

The tax has been construed by this Court to be not a property tax, nor an organization tax, nor an income tax, but a tax on the privilege of exercising the corporate privilege.

“The net income of the taxpaying corporation to be allocated to Utah is merely the measure of the amount of the tax. The tax is imposed on the privilege of exercising the corporate franchise or on the privilege of doing business in Utah.” *American Investment Corp. v. Commission*, 101 Utah 189 (1941).

“The more net income realized from doing business in Utah, the more valuable the privilege and the higher the tax.” *J. M. & M. S. Browning Co. v. Commission*, 107 Utah 457 (1945).

“Though not an income tax, the amount of the franchise tax a corporation must pay in Utah is based on the income yielded from exercising the privilege of doing business or exercising the corporation franchise in Utah.” *Emerald Oil Co. v. Commission*, 267 P. 2d 772 (1954).

The minimum tax of \$10 is thus payable where the net income is less than \$333 and the fair value of tangible property in the State is less than \$20,000. The statute by its terms and as construed and administered by defendant does not purport to impose a tax on the privilege of conducting an exclusive interstate commerce business.

Plaintiff, a New York corporation, is qualified in Utah to do an intrastate business. Whether this *privilege* alone, even if not exercised, would support a tax measured by some portion of its receipts exclusively derived from interstate commerce but fairly allocated to the business done within the State is not involved here. Plaintiff's returns show the difficulty of owning and operating properties of the size and magnitude owned and operated in Utah without engaging in some local business even were we to assume that its mining and metal activities are exclusively interstate commerce. Each of plaintiff's returns assign some net income or loss specifically to business done within Utah before attempting to allocate the bulk of the Utah Division's net income within and without the State under its interpretation of the formula. (See T.C. Ex. MMM(2), and Line 2, Schedule F., page 193.) However, it is unnecessary to rest the

validity of a franchise tax on plaintiff on the fact that it has the privilege and in fact does *some* local intrastate business consisting of holding and managing mining properties and collecting royalties therefrom or selling locally various miscellaneous items of property or that the Bingham and Garfield Railway Company under the consolidated returns may have been engaged in some local intrastate commerce.

The validity of a franchise tax on plaintiff in this proceeding rests squarely and solidly on the simple proposition that mining or manufacturing within the state is not interstate commerce. It is local commerce. Interstate commerce commences only when, after the manufacture or production of the molybdenite and blister copper in Utah, the products are loaded on cars for shipment and sale out-of-state. Local manufacture is intrastate commerce. A state may tax the privilege of engaging in local manufacture even though the entire product is subsequently sold out-of-state in interstate commerce. Furthermore, a state may impose a tax on the privilege of local manufacture measured by the full value of the product within the state and even though such value is measured by the actual cash receipts from sales outside the state. We take up at this point the development of this doctrine by the Federal Supreme Court.

American Manufacturing Company v. St. Louis, 250 U.S. 459 (1919), upheld, as applied to a foreign West Virginia corporation, an ordinance of the City of St.

Louis 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, whether sold within or without the state and whether in domestic or interstate commerce. The tax was in addition to the ad valorem property tax and was at the rate of \$1.00 on each \$1,000 of sales made. Suit was brought by the taxpayer against the city to recover so much of the tax as was measured by sales of goods manufactured by the taxpayer in the city afterwards removed to storage warehouses outside of the state and later sold from these warehouses to purchasers in states other than Missouri. The opinion quotes from the opinion of the State Supreme Court as follows:

“We hold that the tax in question is a tax upon the privilege of pursuing the business of manufacturing these goods in the City of St. Louis; that when the goods were manufactured the obligation accrued to pay the amount of the tax represented by their production and it should be liquidated by their sale by the manufacturer; that their removal from the City of St. Louis and storage elsewhere, whether within or without the state, worked no change in this obligation; that their sale by the respondent wherever they may have been stored at the time, whether it was done through its home office in New York or the office of its factory in St. Louis, should have been reported in its return to the license collector of the City of St. Louis and the amount included in fixing the amount payable on account of its license tax.”

The opinion of the Court by Mr. Justice Pitney then states:

“The admitted facts show that the operation and effect of the taxing scheme now under consideration are correctly described in what we have quoted from the opinion of the state court. No tax has been or is to be imposed upon any sales of goods by plaintiff in error except goods manufactured by it in St. Louis under a license conditioned for the payment of a tax upon the amount of the sales when the goods should come to be sold. The tax is computed according to the amount of the sales of such manufactured goods, irrespective of whether they be sold within or without the State, in one kind of commerce or another; and payment of the tax is not made a condition of selling goods in interstate or in other commerce, but only of continuing the manufacture of goods in the City of St. Louis.

“There is no doubt of the power of the State, or of the city acting under its authority to impose a license tax in the nature of an excise upon the conduct of manufacturing business in the city. Unless some particular interference with federal right be shown, the States are free to lay privilege and occupation taxes. (Citing cases.)

“The city might have measured such tax by a percentage upon the value of all goods manufactured, whether they ever should come to be sold or not, and have required payment as soon as, or even before, the goods left the factory. In order to mitigate the burden, and also, perhaps to bring merchants and manufacturers upon an equal footing in this regard, it has postponed ascertainment and payment of the tax until the

manufacturer can bring the goods into market. A somewhat similar method of postponing payment has been pursued for many years by the Federal Government with respect to the internal revenue tax upon distilled spirits. (Citing cases.)

“To the suggestion that the tax burdens the mercantile rather than the manufacturing business, because it would be possible for one to manufacture goods to an unlimited extent and pay no tax unless they were sold, or to sell goods and be required to pay the tax although they were not manufactured by the seller, it is sufficient to say—answering the second point first—(a) that, according to the state law as laid down by the court of last resort in this case, a manufacturer has no right to sell goods except those of his own manufacture; and (b) it is not to be supposed that, for the purpose of evading a tax payable only upon the sale of his goods, a manufacturer would pursue the ruinous policy of making goods and looking them up permanently in warehouses. In the outcome the tax is the same in amount as if it were measured by the sale value of the goods but imposed upon the completion of their manufacture. The difference is that, for reasons of practical benefit to the taxpayer, the city has postponed payment until convenient means have been furnished through the marketing of goods.

“In our opinion, the operation and effect of the taxing ordinance are to impose a legitimate burden upon the business of carrying on the manufacture of goods in the city; it produces no direct burden on commerce in the goods manufactured, whether domestic or interstate, and only the same kind of incidental and indirect effect as that which results from the payment of property taxes or

any other and general contribution to the cost of government. Therefore, it does not amount to a regulation of interstate commerce. And, for like reasons, it has not the effect of imposing a tax upon the property or the business and hence does not deprive plaintiff in error of its property without due process of law."

In the *Heisler v. Thomas Colliery Company* case, 260 U.S. 245 (1922), the Supreme Court in an opinion by Mr. Justice McKenna upheld a tax imposed by Pennsylvania on each ton of anthracite coal mined "washed or screened, or otherwise prepared for market," in Pennsylvania equal to "one and one-half per cent of the value thereof when prepared for market." The statute also provided that the tax should be assessed at the time when the coal had been subjected to the indicated preparation "and is ready for shipment or market."

The opinion refers to the assertion that the bulk of the anthracite production, or 80 per cent, was shipped into other states. The Governor of the state was quoted as having urged the tax because in effect the tax would be borne by consumers in other states. The Attorneys Generals of nine consuming states appeared before the court in an attempt to have the tax declared illegal and an attempt to regulate interstate commerce. In sustaining the tax the Court stated as follows:

"If the possibility, or indeed, certainty, of exportation of a product or article from a state, determines it to be in interstate commerce before the commencement of its movement from the state,

it would seem to follow that it is in such commerce from the instant of its growth or production; and in the case of coals, as they lie in the ground. The result would be curious. It would nationalize all industries; it would nationalize and withdraw from state jurisdiction and deliver to Federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other states at the very inception of their production or growth; that is, the fruits unpicked, the cotton and wheat ungathered, hides and flesh of cattle yet 'on the hoof,' wool yet unshorn, and coal yet unmined, because they are, in varying percentages, destined for and surely to be exported to states other than those of their production."

The decision of the Court was placed mainly on the old decision in *Coe v. Errol*, 116 U.S. 517, which had held that timber cut in the forests but intended for exportation in interstate commerce and partially prepared for that purpose was nevertheless subject to tax like other property within the state.

In *Oliver Iron Mining Company v. Lord*, 262 U.S. 172 (1923), the Supreme Court sustained, in the face of strong constitutional attack, the validity of a tax imposed by Minnesota on all who are "engaged in the business of mining or producing iron ore or other ores" within the state. The statute provided that the "occupation tax" so imposed should be equal to 6% of the value of the ore mined or produced during the preceding year, such tax

to be in addition to all other taxes. The statute likewise directed that the tax be computed on the value of the ore at the place where it is "brought to the surface of the earth" less certain deductions. The opinion by Mr. Justice VanDevanter states:

"The chief contention is that mining, as conducted by the plaintiffs, if not actually a part of interstate commerce, is so closely connected therewith that to tax it is to burden or interfere with such commerce, which a state cannot do consistently with the commerce clause of the Constitution of the United States.

"The facts on which the contention rests are as follows: The demand or market within the state for iron ore covers only a negligible percentage of what is mined by the plaintiffs. Practically all of their output is mined to fill existing contracts with consumers outside the state and passes at once into the channels of interstate commerce. Three fourths of it is from open-pit mines and one fourth from underground mines. At the open-pit mines empty cars are run from adjacent railroad yards into the mines and there loaded. Steam shovels sever the ore from its natural bed and lift it directly into the cars. When loaded the cars are promptly returned to the railroad yards, where they are put into trains which start the ore on its interstate journey. The several steps follow in such succession that there is practical continuity of movement from the time the ore is severed from its natural bed. The operations within the mine and the movement of the cars into and out of the mine are conducted by the plaintiffs. The subsequent transportation is by public carriers. At the underground mines the plaintiffs

dig the ore, bring it to the surface through shafts, and put it in elevated pockets where it readily can be loaded into cars. The subsequent movements are much the same as at the open-pit mines, but their continuity is not so pronounced. Some of the ore from both kinds of mines—between 10 and 20 per cent—is concentrated by washing or beneficiated after coming out of the mine and before starting out of the state; but our conclusion respecting the usual operations renders this deflection immaterial. Plainly the facts do not support the contention. Mining is not interstate commerce, but, like manufacturing is a local business, subject to local regulations and taxation.”

In *Lacoste v. Department of Conservation*, 263 U.S. 545 (1924), the Court sustained a severance tax levied by Louisiana of 2c “on the dollar on and of the value of all skins or hides taken from any wild furbearing animals or alligators within this state, which severance tax shall be paid by the dealer.” The Louisiana statute declared all wild furbearing animals and alligators in the state and their skins to be the property of the state until such tax shall have been paid. A dealer was defined to be one who buys such skins and hides from either a trapper or a buyer and ships them from the state or sells them for manufacture into a finished product in the state or one who ships or carries them out of the state. The opinion by Mr. Justice Butler states as follows:

“In their argument here, plaintiffs in error stated that skins and hides are not manufactured into finished products in Louisiana, and that all are shipped out of the state. But that is no ob-

jection to the tax. The state's power to tax property is not destroyed by the fact that it is intended for and will move in interstate commerce. Such skins and hides may be taxed while in the hands of dealers before they move in interstate commerce. Failure to levy and enforce the tax before the skins and hides reach the dealers does not make the necessary operation and effect of the law an interference with interstate commerce. The imposition of the tax on the skins and hides while in the hands of the dealers is calculated to make certain that all will be found for taxation. No interference with interstate commerce results from the enforcement of the act. It is not repugnant to the commerce clause of the Constitution."

In *Hope Natural Gas Company v. Hall*, the Court affirmed a decree by the Supreme Court of Appeals of West Virginia, sustaining a tax imposed by West Virginia upon the natural gas produced by the plaintiff based upon the value thereof within the state and before it enters interstate commerce. The opinion states that the chief objection was rested upon the direction of the statute that "the measure of this tax is the value of the entire production in this state, regardless of the place of sale or the fact that deliveries may be made to points outside the state." The trial court had held that the tax would substantially burden and interfere with interstate commerce and ordered an appropriate injunction. The Supreme Court of the state, however, upheld the tax, stating that a state may take into consideration the gross proceeds of a commodity produced in the state and sold in

another state for the purpose of determining the value of such commodity within the state and before it enters interstate commerce. The opinion of Mr. Justice Reynolds states:

“The chief business of plaintiff in error is production and purchase of natural gas in West Virginia and the continuous and uninterrupted transportation of this through pipe lines into Pennsylvania and Ohio, where it is sold, delivered and consumed. The corporation owns 3,178 producing wells located in twenty-five counties of West Virginia, from which it took in the year ending June 30, 1925, more than 23 billion cubic feet of gas. And during the same period it purchased from other producers more than 25 billion cubic feet. Most of this passed into interstate commerce by continuous movement from the wells.

“Here it has been argued that the challenged act burdens interstate commerce and therefore conflicts with Par. 8, article 1, of the Federal Constitution. Also, that to enforce the act would deprive plaintiff in error of property without due process of law and deny equal protection of the laws.

“Counsel admit that without violating the commerce clause the state may lay a privilege or occupation tax upon producers of natural gas reckoned according to the value of that commodity at the well. *American Mfg. Co. v. St. Louis*, 250 U.S. 459, 63 L. ed. 1084, 39 Sup. Ct. Rep. 522; *Heisler v. Thomas Colliery Co.*, 260 U.S. 245, 67 L. ed. 237, 43 Sup. Ct. Rep. 83; *Oliver Iron Mining Co. v. Lord*, 262 U.S. 172, 67 L. ed. 929, 43 Sup. Ct. Rep. 526. But they insist that, accepting

the statute under consideration as construed by the highest court of the state, plaintiff in error will be subjected to an unlawful direct tax upon gross receipts derived from interstate commerce. This argument rests chiefly upon certain language excerpted from the opinion below. But we review the final decree and must accept the statute as authoritatively construed and applied. The plain result of the opinion and final decree is to require that the tax be computed upon the value of the gas at the well, and not otherwise. If, hereafter, executive officers disregard the approved construction and fix values upon any improper basis appropriate relief may be obtained through the courts."

In *Utah Power & Light Company v. Pfof*, 286 U.S. 165 (1932), the Court sustained a license tax of one-half mill per kilowatt hour measured at the place of production levied by the State of Idaho against any person engaged in the generation, manufacture or production of electricity and electrical energy for barter, sale or exchange, notwithstanding that instantaneously with the generation of the electricity in Idaho, the power was conveyed by transmission lines across the boundary into Utah and sold to various consumers.

The issue involved was stated to be "upon the facts of the present case, is the generation of electrical energy like manufacture or production generally, a process essentially local in character and complete in itself; or is it so linked with the transmission as to make it an inseparable part of the transaction in interstate com-

merce?" The court stated that, while conversion and transmission are substantially instantaneous, they were essentially separable and distinct operations. It was said "The fact that to ordinary observation there is no appreciable lapse of time between the generation of the product and its transmission does not forbid the conclusion that they are nevertheless successive and not simultaneous acts."

The opinion of Mr. Justice Sutherland also stated:

"The point is stressed that in appellant's system electricity is not stored in advance but produced as called for. The consumer in Utah, it is said, by merely turning a switch, draws directly from the water-fall in Idaho, through the generating devices, electrical energy which appears instantaneously at the place of consumption. But this is not precisely what happens. The effect of turning the switch in Utah is not to draw electrical energy directly from the water-fall, where it does not exist except as a potentiality, but to set in operation the generating appliances in Idaho, which thereupon receive power from the falling water and transform it into electrical energy. In response to what in effect is an order, there is production as well as transmission of a definite supply of an article of trade."

In *Federal Compress and Warehouse Company v. McLean*, 291 U.S. 17 (1934), the court upheld a Mississippi excise tax against commerce clause objections. The statute imposed an annual license tax for the privilege of operating a cotton compress graduated according

to the number of bales of cotton compressed each year. The statute also levied a similar additional tax upon each person operating a warehouse whether in conjunction with a compress or not, graduated according to the storage capacity of the warehouse. In this case it appeared that cotton purchased locally after it was ginned was transported to appellant's warehouse for storage and compression. Upon delivery appellant issued its negotiable warehouse receipts for the cotton. All but a negligible part of the cotton so stored was ultimately shipped to points outside the state. The opinion by Mr. Justice Stone states:

“A non-discriminatory tax upon the business of storing and compressing the cotton, which is not itself the subject of a movement in interstate commerce, is not forbidden. Most articles, before their shipment in interstate commerce, have had work done upon them which adapts them to the needs of commerce and prepares them for safe and convenient transportation, but that fact has never been thought to immunize from local taxation either the articles themselves or those who have manufactured or otherwise prepared them for interstate transportation. *American Mfg. Co. v. St. Louis*, 250 U.S. 459, 63 L. ed. 1084, 39 S. Ct. 522; *Crescent Cotton Oil Co. v. Mississippi*, 257 U.S. 129, 66 L. ed. 42 S. Ct. 42; *Oliver Iron Min. Co. v. Lord*, 262 U.S. 172, 67 L. ed. 929, 43 S. Ct. 526; *Hope Natural Gas Co. v. Hall*, 274 U.S. 284, 71 L. ed. 1049, 47 S. Ct. 639; *Utah Power & Light Co. v. Pfof*, 286 U.S. 165, 76 L. ed. 1038, 52 S. Ct. 548. Here the privilege taxed is exercised before interstate commerce begins, hence the burden of

the tax upon the commerce is too indirect and remote to transgress constitutional limitations. See *Nashville, C. & St. L. R. Co. v. Wallace*, 288 U.S. 249, 77 L. ed. 730, 53 S. Ct. 345, 87 A.L.R. 1191. The case, therefore, stands on a footing different from those in which local regulations of the business of purchasing a commodity within and shipping it without the state have been deemed to impede or embarrass interstate commerce in those commodities."

In *Coverdale v. Arkansas-Louisiana Pipe Line Company*, 303 U.S. 604 (1938), the Court sustained the validity of a Louisiana statute imposing a privilege tax on the production of mechanical power as applied to an engine used to supply mechanical power to a compressor thereby increasing the pressure of natural gas for transportation to purchasers in other states. The statute provided that every person engaged within the state in any business which uses in the conduct of that business electrical or mechanical power of more than ten horse-power and does not procure all the power from a taxpayer subject to sections 1 or 2 of the act "shall be subject to the payment of an excise, license or privilege tax of One Dollar (\$1.00) per annum for each horse-power of capacity of the machinery or apparatus known as the 'prime mover' or 'prime movers' operated by such person for the purpose of producing power for use in the conduct of such business or occupation."

The taxpayer was engaged within Louisiana, Arkansas and Texas in the business of producing and buying,

transporting and selling natural gas. The gas was obtained from the Monroe and Richland Fields in Louisiana and transported through the taxpayer's twenty inch pipeline which extended from Sterling, Louisiana to Blanchard, Louisiana where one branch went West into Texas and the other North into Texas and Arkansas up to Little Rock. 96.6% of the gas through this line during the year ended July 31, 1933, was delivered outside the State of Louisiana. Transmission of this gas through the pipeline required application of pressure. This pressure was supplied by 10 pumps or natural gas compressors directly connected to 10 4-cylinder 1,000 horse-power Cooper Bessemer internal combustion gas burning engines. There were also involved two 250 horse-power gas burning engines for general power service at the station. In upholding the tax, the Court's opinion by Mr. Justice Reed states:

"The language of the state statute makes it quite certain that this privilege tax falls alike on those engaged in interstate or in intrastate commerce, or in both. While a privilege tax by a state for engaging in interstate business has frequently met the condemnation of this Court as a regulation of commerce, privilege taxes for 'carrying on a local business,' even though measured by interstate business, have been sustained. (Citing cases) The present case falls well within the line of state tax authority.

"Taxation by the states of the business of interstate commerce is forbidden only because it is deemed an interference with that commerce, the uniform regulation of which is necessarily reserv-

ed to the Congress. (Citing cases) As this source of revenue, even if treated in a non-discriminatory manner, is withdrawn from local reach by inference from the delegated grant, the exempting of those engaged in interstate commerce from the taxation others bear should not be extended beyond the necessity of keeping that commerce free from interference. Consequently, property taxes on the instrumentalities or net income taxes on the proceeds of interstate commerce are upheld. (Citing cases).

“Privileges closely connected with the commerce may be regarded as distinct for purposes of taxation. So, local privilege taxes on storage in transit, compressing or dealing in cotton, already moving in its interstate journey from plantation to mill, are validated as imposed upon operations in connection with a commodity withdrawn from the transportation movement. (Citing cases) And similar taxes are upheld for the privilege of mining ores or producing gas, notwithstanding the ‘practical continuity’ of the taxes productive operation and the interstate movement.”

The opinion states further:

“Other factors also show that the tax here does not interfere with interstate commerce. The tax is without discrimination in form or application as between inter and intrastate commerce and it cannot be imposed by more than one state. The course of interstate commerce is clogged by taxes designed or applied so as to hamper its free flow. Section three, however, bearing equally on all use, is only complementary to the taxes of sections one and two. (Citing cases) It bears generally on all use of power and is not discriminatory. It obvi-

ously adds to the cost of the interstate commerce. But increased cost alone is not sufficient to invalidate the tax as an interference with that commerce."

Although *Freeman v. Hewit*, 329 U.S. 249 (1946), invalidated the Indiana gross income tax under the commerce clause as applied to the receipt by a person domiciled in the state of the proceeds of a sale of securities sent out of the state to be sold, the Court's opinion with respect to the issue involved in the present proceeding stated as follows:

"This case . . . involves a tax imposed by the state on the seller on the proceeds of interstate sales. To extract a fair tithe from interstate commerce for the local protection afforded to it, a seller state need not impose the kind of tax which Indiana here levied. As a practical matter, it can make such commerce pay its way, as the phrase runs, apart from taxing the very sale. Thus it can tax local manufacture even if the products are destined for other states. For some purposes manufacture and the shipment of products beyond a state may be looked upon as an integral transaction. But when accommodations must be made between state and national interests, manufacture within a state though destined for shipment outside is not a seamless web so as to prevent a state from giving the manufacturing part detached relevance for purposes of local taxation. (Citing *American Mfg. Company* and *Utah Power & Light Company* cases)."

In *International Harvester v. Evatt*, 329 U.S. 416 (1947), the Court upheld the validity of the Ohio fran-

chise tax upon a foreign corporation doing business in the state as applied to goods produced within Ohio but shipped and sold to customers outside the state. The Ohio statute provided that each foreign corporation authorized to do business in the state must pay a tax or fee for the "privilege of doing business" or "owning or using a part or all of its capital or property" or "holding a certificate authorizing it to do business in the state." The taxpayer corporation held a certificate to do business in Ohio during the years involved and owned and operated two large factories at Springfield, Ohio which "produced millions of dollars worth of goods." It also operated four branch selling establishments associated with four warehouses and fourteen retail stores all located at various places in Ohio which stored and sold goods produced at the Ohio factory. It also appeared that the taxpayer owned and operated sixteen factories, nearly 100 selling agencies and numerous retail stores in other states. Goods produced at these Ohio factories were not only sold in Ohio, but in addition were shipped for storage out of Ohio warehouses to be sold by out of Ohio selling agencies to out of Ohio customers. Some were shipped directly to out of Ohio customers on orders from out of Ohio selling agencies. Conversely, goods manufactured by the taxpayer out of Ohio would be shipped to its Ohio warehouses and sold by its Ohio selling agencies to Ohio customers. The taxpayer contended that a tax assessed by Ohio had been determined in such a manner that a part of it was for sales made outside Ohio and another part for interstate sales. These consequences were alleged

to result from the formula used by Ohio in determining the amount in value of Ohio manufacturing and sales as distinguished from interstate and out-of-state sales.

The Ohio statute prescribed a formula to be used in determining what part of the taxpayer's total capital stock represents business and property conducted and located in Ohio. To determine this the total value of the issued capital stock is divided in half. One-half is then multiplied by a fraction, the numerator of which is the value of all the taxpayer's Ohio property and the denominator of which is the total value of all its property wherever owned. The other one-half is multiplied by another fraction whose numerator is the total value of the "business done" in the state and whose denominator is country-wide business. The tax rate of $1/10$ of 1% is then applied to the addition of these two products. In the "business done" numerator the state included as a part of Ohio business an amount equal to the sales proceeds of a large part of the goods manufactured at the taxpayer's plants in Ohio no matter where the goods had been sold or delivered.

In sustaining the tax as assessed by the state of Ohio, the Court in an opinion by Mr. Justice Black said as follows:

"A part of the measure of the tax is consequently an amount equal to the sales price of Ohio-manufactured goods sold and delivered to customers in other states. Appellant contends that the State has thus taxed sales made outside of

Ohio in violation of the due process clause. A complete answer to this due process contention is that Ohio did not tax these sales. Its statute imposed the franchise tax for the privilege of doing business in Ohio for profit. The State supreme court construed the statute as imposing the tax on corporations for engaging in business such as that in which taxpayer engaged. One branch of that business was manufacturing. It has long been established that a state can tax the business of manufacturing. The fact that it chose to measure the amount of such a tax by the value of the goods the factory has produced, whether of the current or a past year, does not transform the tax on manufacturers to something else."

The Court stated further:

"Furthermore, this Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of appellant, and has declared that 'rough approximation rather than precision' is sufficient. (Citing cases) Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments. (citing cases) A state's tax law is not to be nullified merely because the result is achieved through a formula which includes consideration of interstate and out-of-state transactions in their relation to the intrastate privilege. Since it has not been demonstrated that the apportionment here achieves an unfair result, (citing cases) and since it is assessed only against the privilege of doing local Ohio business of manu-

facturing and selling, we do not come to the question, argued by appellant, of possible multiplication of this tax by reason of its imposition by other states. None of them can tax the privilege of operating factories and sales agencies in Ohio."

We also invite the Court's attention to the same rule as declared by the Supreme Court with respect to state income taxes.

In *U.S. Glue Co. v. Town of Wolf Creek*, 247 U.S. 321 (1918) the Court sustained the validity of the Wisconsin income tax law as applied to the net income derived from goods manufactured within the state but sold and delivered to customers outside the state.

Under the Wisconsin law the net income of a corporation engaged in business within or without the state (other than certain items specifically assigned to the state) is taxed under an apportionment formula "under which the gross business in dollars of the corporation in the state, added to the value in dollars of its property in the state, is made the numerator of a fraction of which the denominator consists of the total gross business in dollars of the corporation both within and without the state, added to the value in dollars of its property within and without the state." Under the law the resulting fraction was taken as representing the proportion of the income which was deemed to be derived from business transacted and property located within the state. A controversy before the U. S. Supreme Court involved the inclusion in the numerator of two items designated (b) and

(c). Item (b) consisted of "\$65,000 from goods sold to customers outside the state and delivered from its factory." Item (c) involved about "\$31,000 from goods sold to customers outside of the state, the sales having been made and goods shipped from plaintiff's branches in other states and the goods having been manufactured at plaintiff's factory and shipped before sale to said branches."

The court in an opinion by Mr. Justice Pitney said that "stated concisely, the question is whether a state, in levying a general income tax upon the gains and profits of a domestic corporation may include in the computation the net income derived from transactions in interstate commerce without contravening the commerce clause of the constitution of the United States." It was further stated:

"Such a tax, when imposed upon net income from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the State are not exempted by the Federal Constitution because they happen to be engaged in commerce among the States.

"And so we hold that the Wisconsin income tax law, as applied to the plaintiff in the case before us, cannot be deemed to be so direct a burden upon

plaintiff's interstate business as to amount to an unconstitutional interference with or regulation of commerce among the States. It was measured not by the gross receipts, but by the net proceeds from this part of plaintiff's business, along with a like imposition upon its income derived from other sources, and in the same way that other corporations doing business within the State are taxed upon that proportion of their income derived from business transacted and property located within the State, whatever the nature of their business."

Also pertinent here is the leading case of *Shaffer v. Carter*, 252 U.S. 37 (1920). It sustained over commerce clause, due process and other objections the validity of the Oklahoma income tax law as applied to a non-resident owning and operating oil and gas producing lands within the state of Oklahoma but managed from outside the state. The Oklahoma law, in addition to levying a tax against the net income of residents, also levied a tax "upon the entire net income from all property owned, and of every business, trade or profession carried on in this state by persons residing elsewhere." Plaintiff was a non-resident of Oklahoma and a citizen of Illinois and a resident of Chicago. During the years involved he was engaged in the oil business in Oklahoma and during the year 1916 received net income from his oil and gas properties exceeding \$1,500,000. The Court in sustaining the tax stated in the opinion by Mr. Justice Pitney as follows:

"In well-ordered society, property has value chiefly for what it is capable of producing, and the activities of mankind are devoted largely to

making recurrent gains from the use and development of property, from tillage, mining, manufacture, from the employment of human skill and labor, or from a combination of some of these; gains capable of being devoted to their own support, and the surplus accumulated as an increase of capital. That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, is wholly inadmissible.

“Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay. Taxes of this character were imposed by several of the States at or shortly after the adoption of the Federal Constitution. . . .

“The rights of the several States to exercise the widest liberty with respect to the imposition of internal taxes always has been recognized in the decisions of this court.”

A paragraph of special significance to the present proceeding is the following statement:

“The fact that it required the personal skill and management of appellant to bring his income from producing property in Oklahoma to fruition, and that his management was exerted from his place of business in another State, did not deprive Oklahoma of jurisdiction to tax the income which arose within its own borders. The personal element cannot, by any fiction, oust the jurisdiction of the State within which the income actually arises and whose authority over it operates *in rem*. At most, there might be a question whether the value of the service of management rendered from without the state ought not be allowed as an expense incurred in producing the income; but no such question is raised in the present case, hence we express no opinion upon it.

“It is urged that, regarding the tax as imposed upon the business conducted within the State, it amounts in the case of appellant’s business to a burden upon interstate commerce, because the products of his oil operations are shipped out of the State. Assuming that it fairly appears that his method of business constitutes interstate commerce, it is sufficient to say that the tax is imposed not upon the gross receipts as in *Crew Levick Co. v. Pennsylvania*, 245 U.S. 292, but only upon the net proceeds, and is plainly sustainable even if it includes net gains from interstate commerce. *U. S. Glue Co. v. Oak Creek*, 247 U.S. 321. Compare *Peck & Co. v. Lowe*, 247 U.S. 165.”

For articles of general interest relating to the constitutionality of state taxes, we refer the Court to the following:

44 A.L.R. 1228:

“Excise tax on foreign corporation engaged exclusively in interstate commerce measured by net income from business within the taxing state.”

71 A.L.R. 256:

“Constitutionality of tax on corporations in nature of, or purporting to be, excise or privilege tax measured by income or receipts.”

105 A.L.R. 11:

“State excise, privilege, or franchise tax upon foreign corporations as affected by commerce clause.”

139 A.L.R. 950:

“State excise, privilege, or franchise tax upon foreign corporations as affected by commerce clause.”

130 A.L.R. 1183:

“State income tax in respect of business that extends into other states.”

167 A.L.R. 943:

“What constitutes doing business, business done, or the like, outside the state for purposes of allocation of income under tax laws.”

54 Harvard Law Review 949:

“State Taxation In a National Economy.”

As we look at the Supreme Court cases referred to above, it will of course be quite obvious to the Court

why the position of unconstitutionality taken in plaintiff's petition for certiorari has been to a large extent abandoned in its brief now on file with the Court. The petition (paragraph 9) claims that no franchise tax on plaintiff is valid under the Federal constitution and asks for a refund of \$3,205,443.06, with interest. Paragraph 17(b) further alleges that defendant's allocation on which the deficiencies here involved have been computed, is likewise repugnant to the Federal Constitution.

Turning from the petition to the brief, we see about six pages of apparently miscellaneous constitutional discussion and indiscriminate citation of cases, the relevance of which to the case at bar is not shown. The only case in which the facts are given is the *Hans Rees* case which merely held that the North Carolina one factor *statutory formula was invalid* where by separate accounting evidence the taxpayer was able to segregate and show the proper amount of net income attributable to its business activities in North Carolina. The taxpayer's sales office in New York was its own office where its own sales employees were selling merchandise in the taxpayer's own name and behalf. Not involved was manufacture in North Carolina and transfer of the product at a fair price to a sales subsidiary or other company for resale. The taxpayer showed by separate accounting and the Court recognized from such evidence that some profit should

be allocated to the sales activity in New York. In the case at bar the sales profit of the sales subsidiary and A. S. & R. has been fairly allocated by contract outside Utah.

Plaintiff's argument under this branch of the case adds up, we suggest, merely to an assertion that there are generally speaking constitutional restraints on a state's power of taxation. By reason of this, it is urged, the statute should be construed in such a way that any consideration of these restraints as applied to the case at bar may be avoided. In other words, the mere existence of constitutional restraints is suggested to justify the exclusion of more than one-third of the net income of the Utah Division outside Utah, even though such net income has been separately computed on the Utah books after deducting the sales subsidiary's and A. S. & R.'s fair selling profit, the Utah Division's fair share of plaintiff's New York administrative expenses, and other out-of-state expenses.

Defendant rests its case squarely on the Supreme Court cases cited heretofore. These cases show conclusively that local manufacture or mining is local business. A state has the power to tax the privilege of engaging in such a local occupation or business. No question of double or multiple taxation is involved. No other state can tax the privilege of engaging in a mining or manufacturing occupation or business in Utah.

The only constitutional problem presented here is whether in measuring the value of the privilege of operating the Bingham pit and producing molybdenite and blister copper in Utah, net income from operations conducted by plaintiff in other states or foreign countries and having no connection with Utah has crept into the measure. Defendant took extreme care to see that the net income base included only operations of the Utah Division. None of the net income of the Nevada Mines Division, Ray (Arizona) Mines Division, Chino (New Mexico) Mines Division or Braden Copper (Chile) operations has been included. Not a dollar of plaintiff's large investment income has been included, such income having been specifically assigned to the New York Office. Nothing has been included except net income of the Utah Division from business attributable entirely to Utah.

In the *American Manufacturing Co.* case the Supreme Court permitted the excise on local manufacturing to be measured by "\$1.00 on each \$1,000 of sales made" even though involved in the action were "sales of goods manufactured by plaintiff in the city, afterwards removed to storage warehouses outside of the state, and later sold from these warehouses to purchasers in states other than Missouri . . ." Such out-of-state proceeds were held to be a proper measure of a tax on the prior local manufacture of the goods within the state. Such sales proceeds were regarded as a proper substitute for value of the product at completion of production. Postponement of payment of the tax until financial returns were in was said to be

“a practical benefit to the taxpayer.” It was further stated that “in the outcome the tax is the same in amount as if it were measured by the sale value of the goods, but imposed upon the completion of their manufacture.” This case, involving a *gross receipts* and not a net income measure represents the farthest outpost in the field. It goes much further than is necessary to sustain a tax based upon the full net income, separately accounted for, of the Utah Division. The Utah franchise measure is one on net income. All of the out-of-state transportation, refining and marketing expenses have been deducted before computing the tax. As indicated in the *U. S. Glue Co. v. Oak Creek*, and *Shaffer v. Carter* cases a tax upon gross receipts affects each transaction more directly than a tax on net incomes. Inclusion of net gains from interstate commerce is plainly includible, either under a net income or a franchise tax, and inclusion of out-of-state sales is likewise clearly permissible in computing the value of the local franchise as the *International Harvester v. Evatt* case recently reaffirmed.

. By reason of the Utah statute resting upon a plainly taxable subject, that is, the privilege of engaging in local business (mining and manufacture), the tax could be measured by the *gross* value or the *net* value of the locally manufactured product. In the *American Manufacturing Co.* case the out-of-state gross proceeds of sales were used as the tax base and without any deduction whatsoever for out-of-state transportation, selling or other expenses. The out-of-state proceeds were treated as the equivalent of

the value of the product on completion of manufacture within the state. In the *Heisler* case, the taxing authorities were required to value the coal "when prepared for market." In the *Lacoste* case, the authorities were required to determine the value of the skins or hides from the fur-bearing animals or alligators in the hands of the Louisiana dealers. In *Hope Natural Gas Co.* the measure of the tax was the gross receipts from sales which were at or beyond the state line. In overruling the trial court, the West Virginia Supreme Court construed the law as taking gross receipts only to determine value at the mouth of the well. It indicated that to find such value there should be deducted from the gross receipts the cost of transportation. Upon appeal to the Supreme Court, Mr. Justice McReynolds stated "The plain result of the opinion and final decree is to require that the tax be computed upon the value of the gas at the well, and not otherwise. If, hereafter, executive officers disregard the approved construction and fix values upon any improper basis appropriate relief may be obtained through the courts." The state court decision was affirmed.

In the *Oliver Iron Mining Co.* case the 6 per cent rate was applied to the "value of such ore at the place where the same is brought to the surface of the earth" less the costs of mining and certain other deductions. In arriving at such "value" at the mouth of the mine, the Minnesota tax authorities in practice take as their starting figure the published prices for iron ore on the Lower Lake Ports and subtract therefrom the loading and unloading

charges, rail and water freight and other transportation charges. Defendant, following receipt of the mandate of this Court in *Columbia Iron Mining Co. v. Iron County*, 230 P. 2d 324 (1951), now uses these same mouth-of-the-mine values for corporation franchise, mining occupation and net proceeds tax purposes in the case of Utah's iron mines.

In the light of these authorities, a Utah franchise tax measured by the full net income derived from the molybdenite and blister copper product mined and manufactured in Utah but sold outside is clearly proper. From the gross proceeds from the out-of-state sales negotiated and effected by the sales subsidiary and A. S. & R. have been deducted the out-of-state profit and expenses of the marketing companies, the out-of-state refining expense and the out-of-state transportation expense. Subtraction of these items gives us the gross value of the Utah molybdenite and blister copper product in Utah prior to the departure of such product from the state in interstate commerce. From this gross value, in arriving at taxable net income of the Utah Division should be further deducted the mining, milling, transportation and smelting expenses in Utah together with statutory depletion, Federal taxes and a fair proportion of New York administrative expenses. Such net income as so separately computed represents the proper constitutional and statutory base for the tax and not any lesser percentage thereof.

These same authorities likewise sustain the validity of the Utah mining occupation tax and the mines valuations based on net annual proceeds. The same gross proceeds, or value, constitute the proper starting point in computing plaintiff's tax base under the franchise tax law, the occupation tax law and the net proceeds law. As will be discussed hereafter under Point II the gross proceeds, or their equivalent, derived from the out-of-state sales of the Utah Division's molybdenite and blister copper product less the out-of-state marketing, refining and transportation expenses, constitute the basis from which under all three statutes the value of plaintiff's mine, the value of its mining occupation privilege and the value of its privilege as a foreign corporation to exercise its corporate franchise in Utah, less the specific deductions allowed by each statute, are to be determined.

POINT II.

PLAINTIFF IS ENTITLED TO APPORTION NONE OF THE NET INCOME REFLECTED ON THE SEPARATE BOOKS OF ACCOUNT OF ITS UTAH DIVISION OUTSIDE UTAH AND THE DEFICIENCIES IN TAX HERE INVOLVED SHOULD BE INCREASED AND TAX ASSESSED ON THE BASIS OF THE FULL AMOUNT OF NET INCOME REFLECTED ON SUCH SEPARATE BOOKS OF ACCOUNT.

Under this branch of the case, we will undertake to show that if there be error in defendant's decision, it is that the tax under the Utah statute should be based on the full 100% net income shown and reflected on the sepa-

rate books of account of plaintiff's Utah Division and not on any lesser percentage thereof. Defendant's argument on this proposition will include a discussion on the following:

The net income shown on the separate books of account of the Utah Division is attributable entirely to business done in Utah and assessment of the tax on this basis will involve no question of double taxation. In lieu of the allocation of income to Utah under the statutory formula, the tax must be based on the income directly allocated to Utah by the separate accounting method employed by plaintiff.

Judicial precedent has already been established with respect to this plaintiff showing that the separate income of its Utah Division reflects Utah business exclusively and should be used for corporation franchise, mining occupation and net proceeds tax purposes.

The intercompany contracts between plaintiff and its sales subsidiary and A. S. & R. covering the transfer of the Utah product for resale by the latter companies, at a fair, reasonable and arms-length price, must be recognized and accepted for tax purposes. Such intercompany contracts between plaintiff and its sales subsidiary and A. S. & R. being fair, reasonable and arms-length, cannot be set aside as a fraud on the State of Utah or as an illegal device to syphon taxable income outside the state.

The separate corporate entity of the sales subsidiary which conducts the business of selling in its own name and behalf all copper and molybdenite must be recognized and respected for tax purposes.

The operations and net income of an affiliated "subsidiary" company cannot be included in a tax return filed by the parent company unless a Consolidated Return under the provisions of the statute is filed on behalf of both parent and affiliated subsidiary company.

This Court has jurisdiction under the statute to modify defendant's decision by increasing the tax to an assessment on the full separate and segregated net income of the Utah Division.

At the outset it might be helpful to the court to refer briefly to the terms "apportionment" or "allocation," "unitary and non-unitary businesses," "allocation by separate or direct accounting," and "allocation by formula." We quote from the annotation in 167 A.L.R. 943 entitled "What constitutes doing business, business done, or the like, outside the state for purposes of allocation of income under tax laws" (page 944):

"A preliminary question arises as to the meaning of the word 'allocate.' The taxing statutes do not ordinarily define it. Webster's New International Dictionary, 2d ed., defines allocate as '1. To distribute or assign; allot; apportion. 2. To determine the locality of.' In taxing statutes, an allocation of income seems to mean the

division or apportionment of income between one state and the rest of the world. *Depending upon the circumstances, income may be allocated either directly or by formula.* 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.

“A business conducted in two or more states is deemed to be unitary where it is impossible to separate the business done in one state from that done in another—where there is a unity of use and management. *Butler Bros. v. McColgan* (1941) 17 Cal. 2d 664, 111 P. 2d 334 (affirmed in (1942) 315 U.S. 501, 86 L. ed. 991, 62 S. Ct. 701.”

Again in Prentice-Hall, State and Local Tax Service, Vol. 1 “All States Unit” at paragraph 91, 400, it is stated:

“‘Allocation,’ otherwise referred to as ‘apportionment,’ is that process whereby corporations, doing business concurrently within the taxing State and other jurisdictions, determine the amount of income, from all operations which may properly be attributed to the taxing state, and upon which the taxing state may impose an income tax, or base an excise or franchise tax. It is well settled that such taxes may be imposed on the basis of such allocated or apportioned income.”

Again at paragraph 91, 428, it is stated:

“Unitary Business—What constitutes.—For allocation purposes it becomes important to determine whether the business is unitary or non-unitary in nature, in that statutory allocation formulas are ordinarily applicable to the former, whereas the latter lend themselves more appropriately to allocation by the use of separate account methods. A unitary business is one in which the units are closely allied and not capable of separate maintenance as independent profit making businesses. The business of manufacturing and selling is ordinarily unitary, and so is that of an express company, and of utilities such as telephone companies and railroads. But a business owning disconnected, independent railroad lines was held non-unitary and separable, and, likewise, an oil business was non-unitary and separable as to the operations of (a) producing, manufacturing and refining, and (b) selling and distributing. And a corporation with dissociated subsidiaries is conducting a separable business not subject to unitary allocation. A unitary business should not include in tax base for allocation purposes any income or losses not connected with such unitary business.”

Again at paragraph 91,430 under the heading “Separate Accounting” it is stated:

“If the corporation can separate its business into departments, and prove that a separate department operates in the taxing state and show what profits are derived from that department, it has been held entitled to use separate accounting in allocating income to the taxing state. Separate accounting is ordinarily appropriate for business of a non-unitary nature . . . and has been

applied to an oil business doing all producing, manufacturing and refining outside the taxing state, particularly where local sales outlets were 'charged at the market price with all products' received from the outside producers and refineries. Separate accounting has been held proper in the case of affiliated corporations for disconnected railroad lines in different states, although not adaptable to utilities such as telephone companies."

Again in Paragraph 91,281, it is stated:

"On the other hand, in allocating income of corporations doing business in more than one state, much can be done from a bookkeeping standpoint to separate manufacturing and sales so as to make available the use of separate accounting methods to reduce income, and to make unnecessary the application of an arbitrary statutory apportionment formula, particularly where the laws of the taxing state sanction separate accounting in allocation . . ."

Utah's corporation franchise tax law provides, in the first place (Section 80-13-16, UCA, 1943), that the "net income shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer . . ." Section 80-13-21, UCA, 1943, provides that the net income of the corporation may be assigned on the basis of the three-factor formula consisting of property, payroll and gross receipts, after assigning certain specific items within and without the state. Sub-paragraph 8 of this section provides, however, as follows:

“If, in the judgment of the Tax Commission, the application of the foregoing rules does not allocate to this state the proportion of net income fairly and equitably attributable to this state, it may, with such information as it may be able to obtain, make such allocation as is fairly calculated to assign to this state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation.”

The above sections when read together in the light of the applicable authorities, show that the statutory formula is designed to allocate to Utah a portion of the total net income of the corporation from all sources and operations where it appears from the facts and the book-keeping methods employed that the income attributable to a particular state cannot be separately and directly computed. The formula is ordinarily used as a rough and ready means in appropriate circumstances to allocate to business within the state that proportion of the corporation's total income from all sources which the corporation's property, payroll and gross receipts assignable to the state bear to the total. On the other hand, where the net income attributable to the 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 in accordance with the method of accounting regularly employed by him in keeping such books. The provisions of sub-section 8 tie into this command of the

statute and permit the assessment of the tax on the basis of the separate accounts employed by the taxpayer if, in the judgment of the Tax Commission, the income so separately computed and thereby allocated to the state fairly assigns to the state the net income reasonably attributable to business within the state.

With this reference to the statutory background, we now turn to the opinion and decision of this Court in Case No. 7298, reported in 221 P 2d 857. Although depletion was an important issue presented to the Court in this case, the primary issue presented and adjudged was the question whether plaintiff, under the Utah law, should have its tax computed on the basis of the statutory formula or on the basis of the separate accounts of its Utah Division. With respect to this issue, we point out those portions of the opinion relating to this issue. In the first place, the Court states at page 860:

“The errors assigned are as follows:

- (1) That the Tax Commission erred in refusing to follow the requirements of Section 80-13-21, U.C.A. 1943, which would permit Kennecott to allocate to Utah a proportionate part of its total income from all sources as distinguished from allocating a proportionate part of the Utah Division's income to this state.”

The Court after a discussion of the method of accounting employed by plaintiff in keeping the books of its Utah

Division "as a separate unit" then discussed the provisions of the statute including sub-division 8 and stated "petitioner's contention in this respect is over-ruled."

Also of considerable pertinence to the problem here concerned was the summary rejection by the Court of plaintiff's contention that subsidies paid by the Federal Government were improperly included as part of the gross proceeds realized from the sales or conversion of ore into metal.

Thus, under the clear mandate of this Court and the command of the statute, plaintiff's tax must be computed on the basis of the separate and segregated net income as computed on the books of account regularly employed and maintained by plaintiff for its Utah Division. The original separate account method used by plaintiff in filing its returns was regarded as controlling. Authority for this action was placed squarely on sub-division 8 of the statute after distinguishing the California Packing case. In addition, the Court in refusing plaintiff the right to use the statutory formula stated "In addition it might unjustly discriminate against this state or the taxpayer in that the tax assessed might bear no reasonable relationship to the value of the ore extracted or the amount of business done in this state."

The question now before the Court is what, if any, proportionate part of the Utah Division's income separately computed must be allocated outside the state based

upon the findings and record in this proceeding. A reading of the opinion shows very plainly and clearly that the Court was not prepared to determine on the record before it in No. 7298 what portion of the Utah Division's net income was attributable to out-of-state business. The record in that case on the sales activity was limited to the following stipulation: "The refined product is then sold for Kennecott's account by Kennecott Sales Corporation, which is a wholly owned subsidiary and which receives an agreed commission for such service." (Page 102 of Record #7298, Ex. QQ 2 of present proceeding.) This statement of agreed fact is repeated in the Court's opinion.

The present proceeding devotes several hundreds of pages of testimony and exhibits to the method and character of the out-of-state sales of copper and molybdenite by the sales subsidiary and the out-of-state sales of gold, silver, platinum and palladium by A. S. & R. This extensive evidence was necessary and in fact vital to the question of determining what, if any, out-of-state business has been conducted by plaintiff with respect to the sale of products of its Utah Division. With the extensive and detailed facts now in the record with respect to the out-of-state activities of the sales subsidiary, it is now somewhat interesting to look back and note how one carefully drafted and stipulated sentence is now sought to be used to justify the exclusion of more than $\frac{1}{3}$ of the net income of the Utah Division from the Utah tax base. Additional evidence was of course required. There is nothing in the one stipulated

sentence to show how or in what manner, or in whose name, or from what premises, or to what customers, or under what arrangements, or at what prices, or under what terms, or whether individually or representatively, the sales subsidiary was selling the Utah Division's product. The sentence made no distinction between molybdenite, refined copper, gold, silver, platinum or palladium. It made no mention of the fact that all sales of the copper and molybdenite were made by and in the name of and in behalf of the sales subsidiary and in the regular course of the sales subsidiary's own business, from its own premises and to its own customers. It made no mention of the fact that all proceeds of sales to customers were collected by and in the name of the sales subsidiary and that all proceeds realized by plaintiff from sales of the Utah product were collected under intercompany contractual arrangements by plaintiff from the sales subsidiary.

The present case now requires decision based upon the facts of record as to what, if any, business of the Utah Division is conducted outside Utah. The facts show that the out-of-state sales activity is the sales subsidiary's business and not the business of plaintiff or its Utah Division and that all out-of-state New York administrative expenses pertaining to the Utah Division have been deducted on the separate accounts of the Utah Division. The question whether the Court's opinion in No. 7298 requires use of the factor of 66.926% as being the proportionate part of the net income of the Utah Division at-

tributable to business done in Utah for the year 1942 is completely without merit but is considered hereafter as a separate point. For present purposes our inquiry is whether the net income of the Utah Division constitutes in its full 100% amount net income attributable to Utah business.

With respect to the general problem of when direct allocation by separate accounting should be used in preference to allocation by statutory formula, we refer the court to the annotation in 167 A.L.R. 943, entitled "What Constitutes Doing Business, Business Done or the Like Outside the State for Purposes of Allocation of Income Under Tax Laws," where at page 981, it is stated:

"Direct Allocation and Separate Accounting.

Attention is directed to certain rules authorizing or requiring direct allocation where possible.

Where the business conducted by the taxpayer outside the taxing state is clearly separable from the business done within the state, the income from the out-of-state business must be allocated to business done outside the state by making a separate account of its income and expenses."

Again in annotation in 130 A.L.R. 1183, entitled "State Income Tax in Respect of Business That Extends into Other States," it is stated at page 1205:

"Circumstances under which allocation is proper:

1. Generally. Allocation to the taxing state of a portion of the total income of a business that

extends into other states, as the basis for computing its state income tax, is proper only when the income is derived partly from within and partly from without the taxing state . . .

2. When business within state is separable. Although the income of a business is derived partly from within and partly from without the taxing state, an allocation to that state of a portion of the total income, as the basis for computing state income tax, is not ordinarily proper where the business transacted within the state is separable from that transacted outside the state. The business within the taxing state has been held to be separable, so as to make an allocation improper, in a number of cases."

The leading article in this field is entitled "Allocation of Income by Corporate Contract" by Roswell Magill, 44 Harvard Law Review 935. With respect to the segregation of income by intercompany contract to the state where the income is actually earned, it is stated as follows at page 950:

"If the contract corresponds with market prices independently quoted, the allocation so adopted should be upheld as against an apportionment ratio, for the contract then effects a proper segregation of the actual income."

Defendant in the administration of the tax laws of this state, and particularly the corporation franchise tax law here involved, makes frequent use of the principle of separate accounting in lieu of the statutory formula in effecting a fair and reasonable apportionment of net

income to the business done within this state. Many concrete examples could be cited. Defendant regularly as a general rule employs separate accounting methods of apportioning net income in the case of banks, finance companies, ranch companies, construction companies and in other similar instances where the books of account kept and maintained by the corporation properly reflect the net income from the operations within this state. The basic command of the law is to include within the tax base only the net income attributable to the business done within Utah. Where the taxpayer's books clearly segregate the income of Utah operations from operations in other states or foreign countries, the use of such separate accounts is the proper statutory tax base from which to compute the franchise tax. The net income earned and realized from business done in Utah thus stands on its own footing unaffected by gains, losses or income earned and derived in other states. For example, if a corporation owned a cattle ranch in Utah and another cattle ranch in Wyoming, the tax should be computed on the basis of the Utah ranch operations separately accounted for and unaffected by the gains, losses or income of the Wyoming ranching operations. Where, as in the present case, the out-of-state function or activity has been separately incorporated the use of separate accounting is, of course, mandatory in the absence of fraud or an intent to evade the Utah tax.

In the case at bar the net income of the Utah Division in its full 100% amount reflects solely and exclu-

sively the net income from business done in Utah and nowhere else. The out-of-state administrative expenses pertaining to the New York Office have been allowed as a deduction. The out-of-state marketing, refining and transportation expenses have been allowed as a deduction. With these deductions the value of the Utah molybdenite and blister copper products has been accurately and fairly valued in terms of actual cash receipts. Such gross value less the local expenses of mining, milling and smelting together with a fair proportion of New York overhead, reflect the net income of Utah business. The gross value of the Utah molybdenite and blister copper product so arrived at has already been judicially determined to constitute the gross proceeds from plaintiff's Utah operations.

The Utah mining occupation tax law imposes an occupation tax on every person engaged in the business of mining equal to 1% of the gross amount received for or the gross value of metaliferous ore sold. Under the provisions of Section 59-5-67 (c) and Section 59-5-68 (4), U.C.A. 1953, plaintiff arrives at its tax base by deducting from the gross proceeds of sales of the molybdenite, copper, gold, silver, platinum and palladium product, the costs of assaying, sampling, smelting, refining, transportation and marketing. Under this law, the mining (including milling) costs are not allowed as a deduction. The deduction from the gross proceeds of the out-of-state marketing, refining and transportation expense

together with the locally incurred expense of smelting constitutes the "gross value" tax base on which this tax is computed.

Arriving at the "net annual proceeds" of the Bingham mine for ad valorem tax purposes under section 59-5-58, U.C.A. 1953, is for present purposes done on much the same basis, except that mining and milling expenses are also allowed as a deduction, and gross proceeds are determined on a production basis by equivalent market values rather than cash proceeds of sales. Under the net proceeds law "gross proceeds realized" are defined to be "from the sale of conversion into money or its equivalent of all ores from such mine."

Both the net proceeds and mining occupation tax laws speak of "ores" but cover the special situation of plaintiff where the ores or minerals themselves are not sold but the metals extracted from such ores or minerals are sold. Such metal extraction profit is added into the tax base. Furthermore, both laws cover the situation where the ores are sold under a bona fide contract of sale. Such contracts determine the gross proceeds or its equivalent for tax purposes. Both laws, by 1949 amendments, now even include a specific provision that sales of ores between affiliated companies shall not carry the price specified in the contract, unless such price is proportionate to the reasonable fair cash value.

The net annual proceeds realized by plaintiff from its Bingham mine to determine the value of that mine,

the gross value of the Utah Division's mineral and metal product used in determining the value of conducting its mining occupation in Utah and the net income of the Utah Division to be used in valuing its privilege of exercising its corporate franchise in Utah all rest on substantially the same conception. The gross proceeds or value of the Utah Division's molybdenite and blister copper product represents and is in fact income earned from business operations in Utah. The out-of-state proceeds of sale, less the out-of-state expenses, is the proper and appropriate starting point in computing the income derived by plaintiff from its Utah business operations. Use of such out-of-state proceeds rests on a secure constitutional footing, as the cases cited heretofore under Point I clearly indicate.

In *Mercur Gold Mining and Milling Co. v. Spry*, 16 Utah 222 (1898), this Court stated, at page 230, that the "gross yield of minerals and metals" and the "value thereof" were the appropriate measuring rods in determining the net annual product of the mine.

In *Salt Lake County v. Utah Copper Company*, 294 F. 199 (1923), the Circuit Court of Appeals for the Eighth Circuit, speaking through Judge Sanborn, quoted from the decision of this court in the *Mercur Co.* case and at page 205 indicated that so far as the product is concerned nothing can be taxed except the net annual product of the mine, and only that which exists and has been ascertained as the annual net proceeds of the mine is to be assessed and taxed.

In *Salt Lake County v. Utah Copper Co.*, 93 F. 2d 127 (1937) (CCA 10), the Court speaking through Judge Phillips, sets forth historically the method which has been used in arriving at the net annual proceeds of the Bingham mine, including the copper, gold and silver product. The court stated at page 131:

“Blister copper has an established and readily ascertainable market value, and when the taxing authorities were apprised of the number of pounds produced it was a simple matter to appraise its value in money.”

The court also stated:

“The trial court concluded that the phrase ‘gross proceeds realized during the preceding calendar year from the sale or conversion into money or its equivalent of all ores from such mine,’ embraced the amount received from sales in such year of blister copper, gold and silver bullion produced in such year, and the amount of the blister copper, gold and silver bullion produced in such year but remaining unsold at the end of the year, the latter amount to be arrived at by appraisal; and that the copper company was entitled to have deducted therefrom the production costs as defined in the statute in determining the net annual proceeds.”

Certiorari was denied by the Supreme Court of the United States in this case, 303 U.S. 652.

In *Salt Lake County v. Kennecott Copper Corporation*, 163 F. 2d 484 (1947), the Circuit Court of Appeals for the Tenth Circuit held that premium or subsidy pay-

ments by the Federal government for certain minerals produced in excess of fixed quotas pursuant to Act of Congress and the O.P.A. should be added to the proceeds received from the sale of ores or metals in computing the base for taxation of mines and mining claims in Utah. The Court ruled that such subsidy or premium payments should be included as elements in the yard stick for measuring the value of mining properties in Utah for purposes of ad valorem taxation, and that such inclusion did not amount to a tax against the United States or any of its instrumentalities.

In *Kennecott Copper Corporation v. State Tax Commission*, 212 P. 2d 187 (1949), this Court held that Federal subsidies paid to plaintiff were properly included in the tax base for the purpose of determining the state net proceeds tax and the mining occupation tax for the years 1944 and 1945. Justice Latimer speaking for the Court, stated at page 190:

“Appellant, Kennecott Copper Corporation, mined and milled its own ores, shipped its mill concentrates to independent smelting and refining companies on a contract or toll basis for refining and marketed its own refined copper after it had been processed and returned. It received premium or subsidy payments for over-quota production, based upon monthly affidavits showing the company's production of ‘returnable’ copper, computed on ninety-seven per cent of the copper contained in the company's mill concentrates as determined from assayed samples of its ores.”

The Court held that the premium prices received by plaintiff had to be included as a part of gross proceeds in computing the net proceeds and mining occupation taxes.

From the foregoing cases, it is clear that the gross proceeds received by plaintiff from the sales subsidiary and A .S. & R. with respect to the Utah Division's molybdenite and blister copper product, which proceeds are fair and based on market prices, constitute the gross income of the Utah Division. Such proceeds less out-of-state expenses constitute the statutory yardstick for determining the value of plaintiff's Utah mine, its Utah occupation and its Utah franchise.

Recalling that the separate books of account of the Utah Division reflect the receipts by plaintiff of the intercompany transfer at fair prices of copper and molybdenite to the sales subsidiary and gold, silver, platinum and palladium to A. S. & R., which companies in turn resell the products in their own name and behalf and in the regular course of their own business, we turn now to those cases which require a state franchise tax to be based upon the net income segregated to the taxing state and which exclude the financial results of business operations in other states. The sales subsidiary and A. S. & R., both separate and distinct corporations from plaintiff, are the selling companies. Plaintiff's Utah Division is merely a producing unit. The selling function and activity is thus clearly separable from the producing function

or activity both corporate-wise and bookkeeping-wise. Plaintiff is entitled to no apportionment of net income outside the state by virtue of sales activities conducted by other companies. Nor obviously does the fact that it maintains an out-of-state administrative office entitle it to apportion sales conducted by other companies outside the state. Moreover, we dispose first of any suggestion that the mere existence of an administrative office outside the state entitles plaintiff to an apportionment of net income outside the state. The Utah Division's fair and proportionate share of the New York administrative expenses has been allowed as a deduction both on the separate books of account of the Utah Division and the Utah tax returns.

We refer again to the decision of the United States Supreme Court in *Shaffer v. Carter*, supra, upholding the right of Oklahoma to tax the income from oil and gas properties derived within the state notwithstanding that such properties were owned by nonresidents and managed from outside the state of Oklahoma. The Court stated:

“The fact that it required the personal skill and management of appellant to bring his income from producing property in Oklahoma to fruition, and that his management was exerted from his place of business in another state, did not deprive Oklahoma of jurisdiction to tax the income which arose from within its own borders . . . *At most, 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; but no such question is raised in the present case, hence, we express no opinion upon it."

In *Cottonwood Coal Company v. Junod*, 236 P. 1080 (1925), the Supreme Court of Montana held that a Minnesota Corporation with its principal place of business in the city of St. Paul, Minnesota, but engaged in the business of mining within the state of Montana was not engaged in business partly within Montana and partly in Minnesota by reason of the fact that its administrative office was located in St. Paul. In this case it appeared that the corporation's plants and mines for the mining of coal were all located within the State of Montana. With respect to the corporation's administrative office in Minnesota, it appeared that a majority of the directors and officers of the corporation resided in Minnesota, that all of the meetings of stockholders and of the board of directors were held in Minnesota, that the corporation had an office in Minnesota, that the business plans and policies of the corporation were formulated at its principal office in Minnesota, that the business of the corporation carried on in Montana at all times was partially supervised and directed through its main office in Minnesota, that some of the financial affairs of the corporation were handled and managed from Minnesota, that some of the proceeds derived from the business of the corporation in Montana were sent to the main office of the corporation in Minnesota and deposited in certain Minnesota

banks to the credit of the corporation from which disbursements were made from time to time for the expenses in operating its business in Montana, that the corporation received in Minnesota certain interest on bonds and bank balances owned by it in Minnesota banks. The Court stated at page 1081:

“From the foregoing statement it is apparent that the only question for determination on this appeal is whether the plaintiff during the year 1920 was ‘engaged in business’ partly within the state of Minnesota, within the contemplation of chapter 79, *supra*.”

The court stated further:

“This statute fixed as the measure of the license fee to be exacted from all corporations for the privilege of carrying on business in this state 1% of their net income derived from the business carried on in this state, whether engaged in business wholly in this state, or partly in this state and partly in another, and the sole purpose of sections 2 and 3 is to point out the method of determining this net income. Beyond that determination, so far as this statute is concerned, the state has no interest in the business of the corporation. If the business is strictly Montana business, the net income is ascertained by deducting the expenses and other statutory allowances from all the gross income, since the gross income of the business or occupation of the corporation is thus necessarily a Montana gross income; and if the gross income is derived from the business done in Montana and from business done in another state, then all of the corporation’s gross income is not used in comput-

ing the license fee, but only the gross income derived from the part of the corporation's business wholly carried on in this state. And as only the Montana gross income is used, so also the Montana expenses will be allowed to be deducted from this gross income, to reach the net income contemplated in the statute.

"From this it appears that, when the statute uses the expression 'engaged in business,' whether in this state or elsewhere, it is speaking in terms of profit and loss, and does not refer to mere corporate action, such as holding meetings of the board of directors, doing clerical work or book-keeping, formulating the plans of policies, or performing other corporate acts, which do not in and of themselves result in the production of income, but does contemplate some kind of business the conduct of which results in an income—some gainful occupation of the corporation. This purpose and intent is manifest all through the various provisions of the statute.

"Necessarily a corporation must do certain acts with reference to its corporate activity at the state in which it is incorporated. Usually it must maintain an office, keep certain records, and hold annual meetings of its stockholders therein. Doing these things implies that it is carrying on business to some extent in such state, but by doing them it is not 'engaged in business' there, within the purview of the statute, which uses the word 'business' solely in connection with its gainful pursuit, and as a means of determining its net income as the basis of fixing a license fee. In the statute under consideration the activity of the corpora-

tion is not made the measure of the license fee, except as such activity manifests itself in the production of income."

This decision of the Supreme Court of Montana involving a mine within the taxing state and with an administrative office outside the state is obviously very closely parallel to the case at bar. The Court held that the entire income from the mining business was attributable in its full 100% amount to Montana where the mine was located and operated. This decision reflects the general principle and approach where the tax is based by separate accounts strictly to the operations within the taxing state. The income and business operations are clearly separable from income and operations in other states and are clearly separable from the operations of the administrative office outside the state. The most that is required under the separate accounting approach is the allowance of a fair share of the out-of-state administrative expenses as an expense deduction against the net income attributable to the business within the taxing state.

Plaintiff's basic contention in the case at bar is that the entire business commencing with mining and through the successive stages of smelting and refining and to and including the sale and distribution of the finished metal product is a unity of operation and ownership. This contention overlooks the fact that the selling function and activity together with the fabricating function and activity have been separately incorporated from the produc-

ing function and activity. In these circumstances, it is clear that the operation is a unity up to but not including the sale or fabrication.

In *Adams Express Co. v. Ohio*, 165 U.S. 194 (1897) involving an early application of the unit rule as applied to common carriers engaged in interstate commerce, the Court stated through Chief Justice Fuller at page 222:

“We repeat that while the unity which exists may not be a physical unity, it is something more than a mere unity of ownership. It is a unity of use, not simply for the convenience or pecuniary profit of the owner, but existing in the very necessities of the case—resulting from the very nature of the business.

“The same party own a manufacturing establishment in one state and a store in another, and may make profit by operating the two, but the work of each is separate. The value of the factory in itself is not conditioned on that of the store or vice versa, nor is the value of the goods manufactured and sold affected thereby. The connection between the two is merely accidental and growing out of the unity of ownership. But the property of an express company distributed to different states is as an essential condition of the business united in a single specific use. It constitutes but a single plan, made so by the very character and necessities of the business.”

All defendant contends in the case at bar is that plaintiff owns a producing establishment in one state and through its sales subsidiary a store in another. It

makes a profit by operating the two but the work of the Utah Division is separate from the sales subsidiary's store.

An excellent case as to what constitutes a unitary business requiring the apportionment method of computing the tax is the decision of the Supreme Court of Oregon in *Edward Hines Lumber Co. v. Galloway*, 154 P 2d 539 (1944). In this case the court held that a Delaware corporation doing business within the State of Oregon did not have to have a net overall income before Oregon could assess a corporation excise tax against it so long as the corporation's Oregon business yielded a net income. The Court also held that part of the plaintiff's business consisting of its ownership of 58,724 shares of the capital stock of the Continental Coal Company, an operating coal company, was not such an integral part of its business that the State of Oregon was required to apply against the corporation's total net income the loss of \$4,093,308.27, which resulted when that stock became worthless, under the apportionment formula contained in the Oregon statute, thus cancelling the profit which the Oregon tax officials found was earned from and attributable to Oregon business. The stock owned of the coal company constituted 93.09% of the total outstanding stock of the coal company. The corporation's excise return included all items of income and deductions from operations both within and without the state of Oregon. The loss on the coal company's stock was taken as a deduction on the return on the ground that such stock had

become worthless within the taxable year. Except for the stock loss the corporation would have had a net income of \$588,178.00. The Oregon tax officials found that \$207,-103.53 of this total was earned in Oregon.

The Court in an opinion by Judge Rossman, after referring to the corporation excise tax as a price exacted for the privilege of doing business in Oregon and of earning a net income in the state, indicated that "the losses or profits resulting from operations in other states are immaterial" to the privilege granted by Oregon of earning a net income in Oregon. The Court also referred to the admonition in the law that "the determination of net income shall be based upon the business done within the state" and also to the provision similar to Subdiv. 8 of the Utah statute which authorized the Commission to permit or require a segregated method of reporting so as fairly and accurately to reflect the net income of the business done within the state. The Court stated at page 544:

"Section 110-1507 does not employ the word 'unitary,' but the duty of the defendant to determine whether a corporation which produces income both within and without Oregon is unitary or multiform is implied. The section, as we have already indicated, uses the term 'segregated method' and 'apportionment method.' Before either of those methods can be employed, the question must first be answered whether the business is unitary or otherwise in character.

“Every definition of the word ‘unitary’ must of necessity be general, and since such must be its nature, a repetition of definition cannot be helpful in the solution of any specific problem. In determining whether a business is unitary or otherwise in character, a knowledge of the facts is essential; in truth, the facts are all important. For instance, in determining whether or not two or more ventures conducted by a corporation are divisible or unitary, one might learn much about their nature by consulting the corporation account books. If the books intermingle the income produced and the expenses incurred by the several ventures, a conclusion would possibly be warranted that the enterprises were a single unit. At any rate, as opposed to the inconvenience of segregating the ventures, one might prefer to deem the business as unitary. *Upon the other hand, if a separate set of books was kept for each venture, and if overhead was apportioned to each, it may be that the corporation’s business would be deemed divisible.* In other words, collateral facts, in addition to the nature of the undertaking, may be entitled to consideration. The determination of the nature of the business enterprise is essentially a practical matter. Much must be left to the sound business sense of the tax commission. Fortunately, the passage of time gains for the commissioners the accession of experience and out of the latter there frequently develops expertness. It is the fact that findings, such as the one which the plaintiff now attacks, were written by men whose judgment was buttressed by experience which entitles such findings to be accorded a high degree of respect when attacked in a judicial proceeding.”

Fisher v. Standard Oil Company, 12 F. 2d 744 (1926) (CCA 8), involved the North Dakota Statute imposing a tax of 3% on the net income of corporations derived annually from business conducted within the state. The corporation was an Indiana company and its business in North Dakota consisted of selling at wholesale and retail petroleum products and by-products which it produced, manufactured and refined wholly outside the state and shipped into the state for sale in North Dakota used in selling and distributing its products after bringing them within the state. It appeared inferentially that as shipments were received they were charged to the North Dakota selling agency at wholesale prices. 2% was added as profit to the cost of producing, manufacturing and refining on receipt of shipments and before sale in the state.

The North Dakota statute provided that the tax should apply to that portion of the total net income of the corporation doing business partly within and partly without the state which the business within the state bore to the total business within and without the state. The statute further provided that where such business within the state is not otherwise 'more easily and certainly separable from such total business' the net income should be apportioned on the basis of the ratio that the property within the state bore to the entire property both within and without the state.

In filing its returns, the corporation computed its tax on the basis of the income separately computed with

respect to the North Dakota selling operations. The state tax commissioner reviewed the returns and made a reassessment of tax. He did not employ, however, the statutory one-factor formula based on property but in lieu thereof and without statutory authority used a factor based on gross sales within the state as compared with total gross sales everywhere. Use of the statutory property factor would have resulted in a smaller tax than that reported on the returns on the basis of treating the North Dakota operations as separable from the business of the corporation conducted elsewhere. The Court speaking through Judge Lewis refused to permit the reassessment as made and stated, page 747 :

“Theories of allocation can have no place in the inquiry, if net income within the state stands on its own footing unmixed with outside business . . . We think it cannot be doubted that the products as brought into the state had an easily ascertainable wholesale market price. We think appellee’s business within the state is easily separable from its other business by charging it with the wholesale price of the products which it sells in North Dakota. That would put it on an equality there with those who sell and do not produce and refine. By strong implication from the language of sections 10 and 27 business without the state is to be disregarded, if that within the state is easily and certainly separable from that without, thus creating an exception to the methods in each of the three sections for the ascertainment of net income.”

Standard Oil Co. v. Thoresen, 29 F. 2d 708 (1928) (CCA 8), again involved the North Dakota tax statute

but in a modified form from that considered by the court in the preceding case. The statute in its modified form provided for the allocation of income under a different statutory apportionment formula. The statute stated that there should be allocated as attributable to business within the state such percentage of the total income of the corporation as the tangible property *and business* within the state bore to the total property and business of the corporation, the percentage of property and business being separately determined and the two percentages averaged. The business factor in turn was measured by payroll and purchases plus receipts from sales. The statute further provided that payroll should be assigned to the office, agency or place of business of the corporation at which the employee chiefly worked or from which he was sent out or with which he was chiefly connected. Purchases were assigned to the office, agency or place of business at or from which such purchases were chiefly handled and attended to with respect to the negotiation and execution. Receipts from sales were assigned to the office, agency or place of business of the corporation at or from which the transaction giving rise to such receipts were chiefly handled and attended to with respect to the negotiation and execution. The statute likewise contained a provision for alternative methods of allocation somewhat similar to subdivision 8 of the Utah statute.

The corporation filed a return under the statute not on the basis of a separate accounting for its North Da-

kota operations, but on the basis of that portion of its total income everywhere derived which the North Dakota statutory formula, as described above, allocated to North Dakota.

Thereafter, the tax commissioner made an additional assessment against the corporation "based upon the allocation to that state of a portion of the income made by the oil company in the business of producing crude oil from the ground, and in the business of manufacturing and refining the crude oil, although it neither produced a barrel of oil in the state of North Dakota nor did it refine any oil in that state." The Court, in an opinion by District Judge Pollock, stated at page 710:

"The question presented for decision in this case is this: Does the law of the state of North Dakota require the plaintiff to pay taxes on its producing and refining oil business done altogether in states other than that state because of the fact it is engaged in the business of marketing refined oil in that state?"

With respect to the contention of the state that the statutory formula should be applied because the "business of plaintiff may and should for the purpose of taxation be regarded as a unit in the production, transportation, refining and marketing of oil," the Court conceded that the unit theory of taxation sought to be applied by the state "is alright and has been upheld by the supreme court" in such cases as Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, and Adams Express

Company v. Ohio, supra. The Court indicated, however, that such cases were inapplicable to the present situation and stated at page 711:

“There is a unity of use of the different appliances and agencies employed by the express company and on this ground the tax of Ohio was upheld; but the right of the plaintiff or any other corporation or citizen to engage in different character of business in different states, or in the same state, must be conceded. The plaintiff in this case is engaged in the production of crude oil in those states wherein crude oil is found. There is no crude oil discovered in the state of North Dakota. The plaintiff has also engaged in the manufacture and refining of crude oils in many states, but has not done so in the state of North Dakota. It has engaged in marketing refined oil alone in that state. On its properties within the state of North Dakota employed in the business of marketing oil, and on the income arising from the doing of that business within the state of North Dakota it may be there taxed by the state and the tax must be paid. *On its business of producing and refining oil it should be taxed only by the state in which this production is found or refining done.* In the manufacture or refining of crude oil in different states it must be taxed and pay its taxes within said states; others, not engaged in the production or refining of oils, engage in the marketing of refined oils in the state of North Dakota. *It is conceded to be a very easy matter for the state to determine the market value of refined oils within its borders at any time and place, and on this, having ascertained the selling price, to determine the tax necessary to be paid.*

“As tending to the view of the case here taken, the recent decision of this court in *Fisher, State Treasurer of North Dakota v. Standard Oil Company*, 12 F. 2d 744, opinion by Judge Lewis.

“It follows the decree should be reversed and case remanded, with directions to enter decree in favor of the plaintiff in accordance with this opinion.”

The problem of allocation by separate accounting versus allocation by statutory formula was again involved, this time before the Supreme Court of Wisconsin, in *Standard Oil Co. of Indiana v. Wisconsin Tax Commission*, 223 N.W. 85 (1929). In this case it appeared that the corporation did business within and without the state of Wisconsin and was engaged in the business of producing, refining, transporting and marketing petroleum products and by-products in eleven midwestern states. Its refining operations were centered in Indiana. Its property within the state of Wisconsin consisted chiefly of tanks and filling stations required to supply the Wisconsin demand. Practically no manufacturing was done within the state of Wisconsin. The Tax Commission, on the theory that the business of the corporation was a unitary business, made an assessment computed under the Wisconsin statutory formula based upon the average of the three factors of tangible property, manufacturing costs and sales. The Wisconsin statute provided that persons engaged in business within and without the state should be taxed only on such income as is

derived from business transacted and property located within the state. The statute likewise included a provision similar to subdivision 8 of the Utah statute permitting an allocation by separate accounting when in the judgment of the tax commission that method would reasonably reflect the income properly assignable to the state.

The court, in an opinion by Judge Rosenberry, stated at page 87:

“The plaintiff contends that its income should be ascertained by the allocation and separate accounting method by which the Wisconsin business is charged at the market price with all products received by it, with the expense of transacting the business, *including a proper allocation of general or overhead expenses and office accounting*; there should be credited to Wisconsin the gross amount received from sales of goods within the state, and that the difference constitutes the taxable income of the plaintiff company.”

The position of the state is set forth in extracts from the argument of the Attorney General of the state contained in a footnote. It was argued that the use of the separate accounting method would lead to the exclusion of income and deductions resulting from business activities and property located within Wisconsin. It was, further argued as follows:

"The appellant's method of accounting does not clearly separate the Wisconsin business and income from the entire business and income of the company. The crude oil is refined by the appellant's refineries and the resultant gasoline, refined oil and by-products, are billed to the sales department at assigned billing prices. Each department of the company which has a part in the making or handling of the product, charges a profit, which profit is treated as a cost to the next department receiving the product. Thus, the departmental books of the appellant show estimated fictitious profits on products not yet sold. It is easy to see that this method of accounting cannot be used for all purposes, and especially not for income tax purposes."

The Court rejected the argument of the state and stated at page 88:

"We regard as unsound the argument submitted to sustain the commission's position in this case. If the manufacturing profits of the plaintiff company are increased by means of sales operations in the state of Wisconsin, the converse is true that the sales operations in Wisconsin benefit by the manufacturing operations of the plaintiff corporation in other states. The argument cannot be applied one way and not the other. If it should appear that the manufacturing operations were conducted at a loss in other states, would it be claimed that some part of that loss might properly be charged to sales operations in the state of Wisconsin to diminish the Wisconsin income? We think not. *There are some operations which from their very nature produce an income which cannot be properly allocated by separate accounting methods*, instances of which are the telegraph,

telephone, and express companies. They stand ready to serve whoever may apply for service and the entire operation constitutes a unit of service. *That is not the case with the manufacturing and sales business, particularly so where the accounts are so kept as to be readily separable.*

“Nor do we find anything in *Underwood Typewriter Co. v. Chamberlain* . . . inconsistent with our conclusion in this case. There was no separation on the basis of market value between the operations of the manufacturing department and the sales department as there is in this case. *We perceive no reason why under the facts in this case, the profits derived from the sales operation should not be ascertained so far as plaintiff is concerned as they would be if the sales operations were conducted by a separate corporate entity.* In either case the profits are earned at the same time and place.”

Piedmont and Northern Railway Co. v. Query, 56 F. 2d 172 (1932), held that the South Carolina Tax Commission could not employ the statutory formula on a mileage basis in computing the railroad company's income taxes with respect to two disconnected lines of railroads, one located entirely in South Carolina and the other entirely in North Carolina.

It appeared that the railway company, a South Carolina corporation, owned one line of railroad entirely in South Carolina, extending from Spartanburg to Greenwood, a distance of 101 miles. The other line located entirely in North Carolina extended from Charlotte to Gastonia, a distance of 26 miles. The two lines of rail-

road were 56 miles apart at the nearest point and were separately operated except as to certain expenses for general management. The railway company had paid taxes to South Carolina on the entire net income of the railroad in South Carolina including its earnings from interstate as well as intrastate commerce. It paid no tax on the income of the railroad in North Carolina. The Tax Commission contended that the railway company should be taxed on the net income of the intrastate traffic of the South Carolina road plus a mileage proportion under the statute of the combined net income of interstate commerce of the two roads and imposed additional income taxes on this basis. The Court in an opinion by Judge Parker rejected the contention of the Tax Commission and stated at page 175:

“The mileage proportion basis as applied to the interstate income of a railroad or a railroad system partly within the state ordinarily measures with reasonable accuracy the value of the property or the income earned within the state . . . It will not be sustained, however, where the circumstances are such that its application results in taxing the railroad on property beyond the jurisdiction of the taxing power . . .”

The foregoing cases, involving as they do judicial insistence on the use of separate accounting methods in lieu of the statutory formula in determining net income attributable to business within the taxing state, have a clear and obvious applicability to the facts of the case at bar. The cases hold that where a product is manu-

factured in one state and transferred by the corporation to its "sales department" in another state at a fair and reasonable price, the state where the selling activity takes place is required to compute its tax, not on the basis of the statutory formula, but on the basis of the difference between the prices so charged or billed and the proceeds of sale within the state taking into account its other expenses within the state and a fair share of the corporation's out-of-state general overhead or administrative expenses. In the case at bar, the Utah Division's molybdenite, copper and other product is not charged to plaintiff's "sales department" but is transferred and charged to the sales subsidiary and A. S. & R., separate and distinct companies, at fair and reasonable prices. Such prices are market prices less fair and reasonable deductions therefrom. Both the sales subsidiary and A. S. & R. earn, receive and are allowed to retain a fair profit for performing the selling activity outside Utah.

A pair of cases both decided by the Supreme Court of Wisconsin on April 15, 1941 are squarely on the point involved in the present appeal. The first case is *Burroughs Adding Machine Co. v. Wisconsin Tax Commission*, 237 Wis. 423, 297 N.W. 574. In this case it appeared that the appellant was a Missouri corporation duly qualified to transact business in Wisconsin. Appellant, a wholly owned subsidiary of Burroughs Adding Machine Co., a Michigan corporation, was engaged in selling throughout the United States, Alaska and Hawaii various adding, calculating and bookkeeping machines manufactured by the parent company. The parent company

transacted no business and owned no property in Wisconsin. In addition to the stock of appellant, the parent corporation owned the stock of 25 other subsidiaries engaged in selling and servicing machines produced by the parent. The officers of appellant and the parent company were the same and there were several directors common to both companies.

In 1921 appellant and the parent entered into a contract under which appellant agreed to purchase from the parent all of the products manufactured by it. For these products appellant agreed to pay to the parent all sums received by it except such sums as would permit appellant to earn annually 24% of the par value of appellant's capital stock. The corporations operated under this contract until 1934, appellant receiving annually a net income of 24% of \$150,000.00 or \$36,000 per year. In 1926 the Tax Commission demanded a consolidated statement from appellant and the parent company. This was refused and a doomsday assessment was proposed and sustained upon hearing. Injunction proceedings instituted in the Federal Court were denied. In 1930 the Commission again demanded consolidated statements but permitted appellant, pending audit, to file returns stating the income as actually received and accounted for on its books with certain adjustments. Such returns were made for 1929 to 1933 inclusive.

On January 1, 1934, a new contract was entered into under which sales were made by the parent to appellant

at a 50% discount from list prices and with the allocation to appellant of 90% of sales and advertising expenses "as well as a proportion of general expenses" (principally incurred for jointly used offices). This contract established on a contractual basis the same discount, costs and expenses appellant used in computing its income for the years 1929 to 1933 inclusive, except that the apportionment of general expenses under the new arrangement was somewhat more favorable to appellant and to that extent increased the latter's income. The Tax Commission refused to accept the returns on the basis of the separate accounting of appellant and approved additional assessments of tax on the basis of consolidating the income of appellant with that of its parent and applying to such consolidated income the statutory Wisconsin formula made up of the average of the three factors of property, sales and manufacturing costs. The parent and subsidiary were treated by the Commission as a unit and a ratio between appellant's property, sales and costs in Wisconsin to those of the parent and all of its subsidiaries everywhere was established. The opinion by Justice Wickhem states at page 575:

"The question here is whether there is any authority in the Tax Commission under the provisions of Section 71.25, stats., to require a consolidated return of the income of the parent and all subsidiaries and then to compute the tax apportionable to Wisconsin in accordance with the factors set up in section 71.02 3d."

On the other hand, appellant asserted that the statute furnished no authority for disregarding the corporate entity and apportioning the tax on the basis of the statute which in terms applied only to single taxpayers doing business within and without the state.

The position of the Tax Commission was thus identical with the position of plaintiff in the case at bar, that is to say, it was argued that the manufacturing operations of the parent company should be consolidated with those of the sales subsidiary and the statutory three-factor formula applied to such consolidated income.

After indicating that the duty of the Tax Commission is to determine the income which the taxpayer would have had had it not been for this income diverting contract, the Court continued, page 576:

“The question, therefore, is whether a percentage of total consolidated income arrived at by taking an arithmetical average of the ratios of appellant’s tangible property, sales and manufacturing costs in Wisconsin to total consolidated property, sales and manufacturing costs everywhere, establishes what appellant would have earned in Wisconsin had it not been for the contract of 1921. It is our conclusion that it does not do so. The fallacy in the method is that it attributes to appellant that portion of the parent’s income which constitutes the latter’s profit from the activities of appellant in Wisconsin.”

As is stated by Judge Cardozo in the *Studebaker* case, *supra* (244 N.Y. 114, 155 N.E. 70):

"The tax has been laid upon the theory that the profit to the agent, in order to be fair and reasonable, must absorb the entire profit to the principal from the business of the agency . . . The privilege for which the appellant has been taxed is the privilege of selling in New York the products of its principal. The business transacted by the principal included the process of manufacture carried on in Michigan and Indiana, a process which was anterior of necessity to any service by the agent. We find no basis for a holding that a fair agreement between the parent which manufactured and the subsidiary which sold would have given the whole profit to the subsidiary and nothing to the parent."

"Judge Cardozo concedes, as did this court in the Curtis case, that if the selling agency is a mere bookkeeping device of the parent, there is power in the taxing state to assess the parent corporation upon its activities there and to use a consolidated return to apportion the proper amount of this tax to the taxing state. *But where a statute, as does Section 71.25, requires that the subsidiary be treated as an entity and its income established, the commission must comply and it may not do this by assigning to the subsidiary profits of the parent corporation from dealings with the subsidiary.* The use of the ratio is based upon the theory that a single taxpayer is involved and that the application to this taxpayer's total income of a percentage which is the average of the ratios gives a fair approximation of the entire income of this taxpayer in this state. Upon this theory, the use of ratios has been sustained. *Hans Rees' Sons v. North Carolina*, 283 U.S. 123 . . . This is what the application of the ratios in this case actually accomplished, and it matters little

whether appellant be considered an entity and hence taxed upon the income of another, or whether the effect is to levy a tax indirectly upon the parent corporation. In neither case does the method answer the calls of section 71.25 . . .

“As Judge Cardozo points out, there should be little difficulty in addressing the inquiry to the question how much would have been made had contracts not artificially controlled the income. A consideration of the usual or customary commissions and the normal and usual expenses of selling and servicing, the profit or loss on trade-ins and other such matters, would bear directly upon the issue prescribed by section 71.25, and lead to an answer to the statutory question. This we hold to be the proper method of approach.”

The other Wisconsin case is that of *Northern States Power Co. v. Tax Commission*, 237 Wis. 433, 297 N.W. 578. This case involved an appeal by Northern States Power Company and four affiliated companies against additional assessments of income taxes made by the Tax Commission. A chart on page 579 (N.W.) shows the common stock ownership of the principal affiliated companies in the Northern States Power group. The chart shows Northern States Power Company (Delaware) owning directly or indirectly the stock of fourteen corporations, including Northern States Power Company (Wisconsin), and Northern States Power Company (Minnesota). All of the companies were in practical effect managed by the same persons as officers and directors. The intercompany business relations and contracts are shown in detail on page 580. Under these intercompany ar-

rangements, gas and electric energy would be sold from one company or division of a company to one of the other affiliated companies. For example, it is stated "Interstate Light and Power Company (Wis.) (Apple River Div.) hydro-electric energy was disposed of by Northern States Power Company (Minn.)." The various subsidiaries were financed directly or indirectly by Northern States Power Co. (Del.) by loans upon which 6% interest compounded monthly was exacted.

Each of the eight Wisconsin subsidiaries of the Delaware corporation reported their income to Wisconsin for the year involved "upon a separate accounting basis." The Tax Commission concluded that the separate accounting method used by the companies did not reflect their true income derived from business transacted in Wisconsin and made separate additional assessments against each of the Wisconsin subsidiary companies for the year 1930 to 1933, inclusive.

In making its assessments the Tax Commission consolidated the total net income of the Delaware company and all of its subsidiaries, direct and indirect, including appellant. Against this total net income so determined, the Tax Commission applied the statutory three-factor formula and of the total net income so apportioned to Wisconsin attributed a portion thereof to each of the appellant taxpayers.

The case involved particularly the production of power by the Wisconsin subsidiaries and the transfer and

sale of such power to the Minnesota subsidiaries for resale to Minnesota customers. In applying the statutory three-factor formula, consisting of property, sales and manufacturing factors, the taxpayers apparently made no objection to use of the property and sales factors, but did object to use of a factor of units manufactured in lieu of the costs of manufacturing. The Tax Commission had decided that cost of manufacturing, if used instead of units manufactured, would have given an inequitable ratio "inasmuch as Wisconsin is predominantly hydro and Minnesota is predominantly steam." Thus the higher cost of production in Minnesota would have the effect of allocating income to that state disproportionate in amount.

In its findings the Commission, among other things, held that it was not bound by the terms of the intercompany arrangement between the companies, that it could consolidate and apportion the income of the companies as a group, that the intercorporate arrangements were not fair and reasonable, that the intercorporate arrangements established an unfair price for the power produced by the Wisconsin affiliates and that the arrangements had the purpose and effect of evasion of the income tax law. It was also concluded that the use of common officers and directors "in effect made of the Wisconsin subsidiaries mere branches of the parent corporation."

On the appeal the taxpayers contended that each appellant should be treated as a single taxable entity,

that the commission had no power to consolidate the net incomes of the companies and apportion the same by formula, and that if the sales between the affiliated companies were at an unfair price, the commission should ascertain the facts and fix a fair price and adjust the corporations' income accordingly.

The Tax Commission, on the other hand, contended that where the separate accounting basis understated true Wisconsin income it was entitled under the statute to consolidate and apportion the income of the affiliated companies.

The Court speaking through Chief Justice Rosenberry stated at page 584:

“Without statutory authority the commission proceeds in this case to consolidate the incomes of the parent and affiliated companies and then to apply the formulas applicable to income taxes within and without the state. It not only does that but having found by formulas the income of all the Wisconsin affiliates, it proceeds to apportion it among the affiliates by formulas. It in effect treats the whole matter as if there was but one taxpayer and that the parent corporation, its Wisconsin income being apportioned among the Wisconsin affiliates. We find no authority in the statute for such procedure.”

Again, at page 585, it is stated:

“As was stated in the Burroughs case, we find no insuperable difficulties in finding, if such be the fact, that a company is selling its products at

less than a fair price, or in finding that it is purchasing products in a manner so as to create a loss or improper income, and after those facts have been determined, it should not be impossible to determine what the reasonable profits would have been but for such arrangement, having due regard to reasonable profit. Certainly the difficulty of solving such a problem falls far short of equaling the difficulty of ascertaining a just and fair rate in a rate case. The result of the application of formulas in these cases, is as in the Burroughs Adding Machine Co. case, to allocate earnings to Wisconsin, which are made outside of the state by subsidiary corporations who have purchased products from Wisconsin corporations. What is to be taxed in Wisconsin under the income tax act is Wisconsin income. *If a Wisconsin company manufactures a product which it sells outside of the state and the buyer thereafter resells it at a profit, Wisconsin can have no claim upon that profit. If the price paid for energy generated in Wisconsin is a fair price, the fact that a subsidiary makes a profit upon a resale in Minnesota gives Wisconsin no right to tax the profit in Minnesota."*

In the case at bar neither plaintiff nor defendant has a right to ignore the intercompany arrangements with and the separate corporate entities of the sales subsidiary and A. S. & R. The price collected by plaintiff from the sales subsidiary and A. S. & R. with respect to the Utah Division product being a fair price, the profit realized by the sales subsidiary and A. S. & R. on the resale in New York or elsewhere outside Utah gives Utah no right whatsoever to tax such sales profit as allocated

by the parties in such contracts. The profit is earned by the sales subsidiary and A. S. & R. outside Utah. At the same time, however, Utah is entitled to a tax on the full profit earned by the Utah Division from its production within Utah as arrived at on the basis of the inter-company contracts and reflected on the separate accounts of the Utah Division's operation.

We refer at this point to several leading and important cases which hold that the taxing officials are not bound by the intercompany prices agreed upon between affiliated companies where such contract prices are not fair or reasonable or arms-length prices but in effect constitute a fraud on the tax laws of the taxing state and represent devices to syphon out of the taxing state income earned from business done within the state. In this connection reference is made to section 80-13-18, U.C.A. 1943, which gives defendant specific statutory authority to distribute, apportion or allocate the gross income or deductions between or among corporations controlled by the same interests in order to prevent evasion of taxes or clearly to reflect the income of any of such corporations. Even in the absence of such specific statutory authority, it is generally held by the Courts that taxing officials may ignore sham transactions whose only purpose and effect is to evade the tax laws of the state.

Chemical v. Wisconsin Tax Commission, 214

Wisconsin Supreme Court upheld

tax on the basis of the value of the charcoal, crude alcohol and acetate of lime produced by the corporation but distributed at cost to its two stockholders, Cleveland Cliffs Iron Company and Goodman Lumber Co. The Court stated at page 449:

"The value of the goods was readily ascertained by the tax commission and the income of appellant was thereby fixed with certainty. The appellant claims that the income found by the tax commission is a theoretical income and not an actual income. In law that is certain which can be made certain. The income of the appellant was made certain by the application of correct principles of accounting and the tax thus ascertained."

To the same effect is *In re Morton Salt Company*, 95 P. 2d 335 (1939), in which the Supreme Court of Kansas permitted the tax commission to treat a parent corporation and its foreign subsidiaries as a unitary business, where it appeared that the parent company made no profit on its manufactured product but sold such product to its sales subsidiaries at cost. The Court, after discussing certain Wisconsin and Massachusetts cases, stated at page 339:

"In the Wisconsin and Massachusetts cases the business transactions between the parent corporation and its subsidiary were conducted on a basis which made a separate fair profit. Because of this the Court held under the similar statute applicable that for the purpose of computing income tax the corporation was treated as a unitary business."

situation here. Appellant makes no profit from the manufactured product sold to its subsidiaries; it sells to them at cost. The result is that it syphons out of this state its own profits for its manufacturing business in this state into its foreign state subsidiaries and collects that profit through the dividends declared to it by such subsidiary. The two opinions in the *Palmolive Co.* case disclosed the formation of numerous corporate entities designed for the purpose of enabling the original corporation to evade income taxes in Wisconsin. So far as these corporations had anything to do with the manufacture, distribution and sale of products, the court treated all of them as a unitary business, disregarding corporate forms. Even agreements between the manufacturing company and the selling companies on the cost of manufacture, plus 3% profit for certain years and plus a 6% profit for certain other years, was disregarded as inadequate. Among the many corporations formed was one that dealt solely with advertising, and because of the nature of its business it was not included within the group of corporations treated as a unitary business."

The decision of the Circuit Court of Appeals for the Seventh Circuit in *Palmolive Co. v. Conway*, is reported in 56 F. 2d 83 (1932). The decision of District Judge Lindley is reported in 43 F. 2d 226 (1930). In this case it appeared that the *Palmolive Co.* of Wisconsin which had manufactured and sold *Palmolive* soap in Milwaukee since 1894 was reorganized in 1923. As a result of the reorganization the parent company became the owner of all the property of the Wisconsin company outside Wisconsin and became the owner of all the capital stock of

plaintiff. Plaintiff on the other hand became the owner of the Milwaukee plant and equipment and all of the stock of the Wisconsin Company. The Wisconsin company remained the owner of the Milwaukee inventory and accounts receivable relating to Wisconsin business. The three corporations were governed by officers and directors substantially identical. The parent company established its chief office in Chicago where it occupied seven floors. Plaintiff had no separate offices and no full time employees. Its transactions were few and its books of records were kept by the office force of the parent company.

The parent company contracted with the Wisconsin company to buy the latter's entire output of Palmolive soap, except that sold in Wisconsin, for the year 1924 at factory cost plus 3%. For 1925 and 1926 the agreed purchase price was fixed at factory cost plus 6%.

District Judge Lindley, after reviewing the operations and profits realized before and after the reorganization and other pertinent facts, stated at page 229:

"These and many other facts of like import and significance lead the Court to conclude that under the undisputed circumstances shown, and the intercorporate relations shown, the contract of factory cost plus percentage manufacture and sale to the parent company constituted a fraud upon the income tax laws of Wisconsin."

He concluded that the reorganization of the old Wisconsin company and the new intercompany arrangements

were designed solely to evade the Wisconsin tax and for the purpose of giving the appearance of removing from the state all income of the Wisconsin company over 6% plus factory cost, whereas in fact there was left within the state the same activities of production which existed prior to the new arrangement. Notwithstanding that the cost of production continued to be much the same after the reorganization as before, its previous average gross profit of 50% was cut down so that 90% of such gross profit was diverted from a Wisconsin source to a new apparent source in Chicago. Although the intercompany sales agreement was set aside the Court refused to set aside the arrangements with the affiliated advertising corporation known as the "Buckingham Agency." In this connection the Court at page 232 stated:

"What has been said has been said with reference to the income of the Wisconsin company and plaintiff company earned in the State of Wisconsin. In the opinion of the court, the situation with regard to the income of the Buckingham Agency is different, and no part of such income should be allocated or charged to the plaintiff or Wisconsin companies. That corporation was organized subsequent to the reorganization hereinbefore discussed. It had only one activity, the placing of advertising. *Its activities were all outside of the state; they had no connection with the manufacture, but consisted of placing advertising of the parent company with advertising houses and collecting commissions thereon.* No part of its income was directly or indirectly earned in the state of Wisconsin; no part of it is taxable

within the state; and, to the extent of the allocation thereof by the tax commission to Wisconsin there should be an injunction as prayed."

In affirming the decree of the District Court, the Circuit Court speaking through Judge Alschuler stated at page 85:

"But, apart from the foregoing, we will give some consideration to the Wisconsin company's profits as undertaken to be fixed by its contract with the parent company. While intercorporate contracts fixing the income or profits of a subsidiary are not per se fraudulent or void as against state taxation of the subsidiary's income, concededly they will not stand in the way of ascribing to the subsidiary a reasonable income from the operation which it carries on within the income taxing state. A stipulated percentage of profit upon manufacturing cost might in many cases be fair enough if all cost factors were included; but with substantial cost items omitted the agreed percentage might prove only a delusion."

The Court also stated page 87:

"Having in mind the magnitude of the business here involved, we believe the commission reached a conclusion which sufficiently approximates justice between this taxpayer and the state as to require approval of the result."

A somewhat similar situation was presented in *Buick Motor Company v. City of Milwaukee, Wisconsin*, 48 F. 2d 801 (1931) (CCA 7). The decision of District Judge Geiger in this case is reported in 43 F. 2d 385 (1930).

The case involved the validity of a reassessment of state income taxes by the Wisconsin Tax Commission for the years 1917 to 1924 of Buick Motor Company, a Michigan corporation, licensed to do business in Wisconsin. The company with a capital stock of \$10,000.00 was a wholly owned subsidiary of General Motors Company, a Delaware corporation. Under contract dated January 2, 1917, General Motors Company, termed the "seller," contracted with Buick Motor Company, termed the "buyer," to sell to the buyer the entire output of automobiles produced at the seller's Buick factory at Flint, Michigan, upon a basis which would result in an annual net profit of \$2500.00 to the buyer on said business. The contract had unlimited duration.

During the years involved appellant's annual sales of cars and parts ranged from a minimum of \$89,000,000 to a maximum of \$231,000,000, the annual sales of the Wisconsin branch ranging from \$2,454,000 to \$6,800,000. The cars and parts sold by the Wisconsin branch were billed to the branch by appellant at about the same price as to independent distributors and were shipped from General Motors factory at Flint, Michigan and remittances were made by customers to the Wisconsin branch which, having no bank account of its own, sent the remittances as received to General Motors. For the year 1917 appellant returned as income to Wisconsin the sum of \$1,018.42, later contending that its income was only \$2,900 which was the amount of income annually returned for the years thereafter. For 1919 the tax commis-

sion added as further income the sum of \$80,051.00 representing in the main Wisconsin's portion of a total amount held by appellant as reserves for dealer's rebate. In 1920 the commission signified its dissatisfaction with appellant's general plan of return of income. Correspondence and discussions ensued, and resulted in 1921 in the inauguration of the general practice of treating appellant's Wisconsin branch as though the branch were an independent jobber or distributor of the Buick products. Amended returns were accordingly filed for 1919 and 1920 but none for prior years under which a portion of the income tax paid for 1919 was refunded to appellant. For subsequent years returns were filed on this basis. However, in 1926 the commission caused an audit to be made of appellants' accounts as well as those of General Motors. The commission concluded from the audit that the returns did not truly reflect the income from Wisconsin business and accordingly made a reassessment of tax. The Court in an opinion by Judge Alschuler stated at page 803:

“But it is insisted that the intercorporate contract relation should be given effect, and that the stipulated \$2500.00 of net profit to appellant should be held to be the maximum of appellant's actual taxable income for each of the years in question. Whether the contract, as between the contracting parties, is upon its face fraudulent, does not concern the state in the matter of its taxes upon income derived from business transacted within its limits. Whatever other purpose such a contract might have, the conclusion quite irresistible that one of its objects

transfer the income arising from the business of such states as then had, or might thereafter enact, an income tax law, so that the income would not be taxable in the state where earned. This motive might not alone warrant the state in ignoring the contract, but if appellant, notwithstanding the contract, continued to earn the income upon business transacted within the state, the contract would not serve to defeat the right of the state to tax the income so earned."

Again

"While appellant carried on this vast business under an arrangement with General Motors whereby the profits realized at once passed to General Motors, the profits constituted taxable income in Wisconsin where they passed to the single beneficial owner of the capital stock. Distribution of corporate profits to or among stockholders, by whatever form, does not relieve the corporation from income tax on what is earned and distributed."

The Court cited the *Cliff's Chemical* and *Shaffer v. Carter* cases, hertofore mentioned.

In the case at bar, running like a thread through plaintiff's argument, is the suggestion that because plaintiff is qualified to do business in New York where the sales subsidiary transacts the business of selling plaintiff's Utah molybdenite and copper product, the operations of the two companies should be scrambled together in one unit. Of some interest on this point is the statement of the Court at page 804:

"It is maintained for appellant that General Motors was also licensed to do business in Wisconsin, and that if this income from the selling of Buick products were taxable in Wisconsin, it should be assessable to General Motors as its income. But appellant is a distinct corporation, which had contracted with General Motors to buy and sell Buick automobiles and parts, and it was this separate entity which transacted this business in Wisconsin, and to this entity the state had a right to look for its tax upon the profit arising in Wisconsin on the transaction of this business there. Judge Geiger's opinion has, in our judgment, well demonstrated that the intercorporate contract does not limit the state to a tax upon the income which the contract assumes to prescribe."

Also running like a thread throughout plaintiff's argument is the suggestion that the sales subsidiary in selling the Utah product is acting for plaintiff *representatively and not individually in the course of its own business*. This matter will be discussed hereafter in more detail under Point 3 of this brief. We take the liberty, however, of referring to Judge Geiger's statement and analysis of this point at page 390:

"This particular contract provides for a 25% profit on a capital of \$10,000.00. If it must be respected, then a contract eliminating all profit retainable by the plaintiff ought to be just as valid. Certainly, on its face, it negatives the purpose of creating an ordinary agency, and the volume of business transacted by the plaintiff does not indicate a good-faith purpose to allow \$10,000 per year as reasonable compensation for the services of a distinct and separate entity which assumes

sponsibility, as such, for the enormous business transacted. In my judgment, it cannot be true, as plaintiff asserts, 'were the contract involved made with General Motors by an individual instead of plaintiff, we may assume that it would pass everywhere unchallenged as determinative of that individual's income.' The assumptions that the contract made by an individual would be analogous and of unquestioned validity when tested out under a tax law would, so it is believed, depend upon the identical consideration urged against the plaintiff, viz. whether the individual professed or insisted that the business transacted was his *individually* or whether it was his *representatively*; what, if any, purpose could be discerned in his willingness to transact a country-wide volume for little or no consideration in either capacity; and what, above all, is to account for the rather anomalous and practically indeterminate manner of fixing a purchase consideration."

Again, it is stated:

"And the record for the Tax Commission, in this case, is not only consistent with, but largely predicated upon, the idea that the income arising on the business transacted *came* to the *motor* company, not on business which *it* transacted in the state, but solely upon devolution *by the plaintiff* to the motors company *under or by virtue of* the contract . . .

"It is my judgment that when the business transacted is found to be plaintiffs, conceding the 'subsidiary' relation to General Motors, the tax authorities of the state were not obliged to respect the contract as an instrumentality relieving

plaintiff, in whole or in part, from the effectiveness of the tax law against the income arising in or on such business."

The *Buick* case is clear authority for the proposition that where by intercompany contract the wholly owned subsidiary undertakes to sell the product produced by its parent the business of selling is the separate and distinct business of the subsidiary and this notwithstanding that the producing parent may be qualified to do business in the state where the sales subsidiary in conducting the selling business. If the intercompany contract does not give the sales subsidiary a fair and reasonable profit for conducting the selling business, the taxing authorities may adjust the terms of the contract and determine the profit which would have been earned if the contract had been negotiated on a fair, reasonable and arms-length basis. In the case at bar, it is the specific fact that the intercompany contracts between plaintiff and its sales subsidiary and A. S. & R. transfer the Utah product to the selling companies at a fair, reasonable and arms-length consideration. In such circumstances, neither defendant nor plaintiff are entitled to have this contract set aside. The contract is binding on both the taxpayer and the tax authorities.

The doctrine of the foregoing cases is again illustrated by the decision of this Court in *Columbia Iron Mining Co. v. Iron County*, 230 P. 2d 324 (1951). In this case the court held that defendant was not bound to accept the price for iron ore contained in the intercompany contract

between Columbia Iron Mining Co. and Geneva Steel Co., both wholly owned subsidiaries of United States Steel Corporation, where it appeared that such prices were below fair market value and thereby avoided the payment of the fair amount of taxes on iron ore. The Court speaking through Mr. Justice McDonough stated at page 327:

“As between subsidiaries, the ore selling subsidiary and the ore buying subsidiary, the operations are controlled by the parent corporation, and the United States Steel Corporation as such parent corporation is the ultimate owner. It was not the intent of the legislature to permit a corporation which operates in this state through wholly owned subsidiaries, to allow one subsidiary to sell to another subsidiary at a price which is below fair market value, and thereby avoid payment of the fair amount of taxes. In such cases, the ultimate owner is the parent corporation, and the state tax commission is not required to adopt the intercompany sales as the basis for the assessment.”

It may be of interest to note that this decision, which was rendered a few months following the denial of plaintiff's petition for rehearing in Case No. 7298, required administrative implementation. In lieu of contract values of approximately \$1.55 per ton of iron ore, a new fair market value of the iron ore had to be ascertained by defendant. The values finally arrived at and determined were the values used by the state of Minnesota taxing authorities in determining the value of iron ore at the mouth of the iron mines in Minnesota. Such values in Minnesota are determined annually by working back from

the published prices of iron ore at the Lower Lake Ports. From such published prices are subtracted the transportation and other expenses incurred in getting the ore from the mouth of the mine to the Lower Lake Ports. Such values when transplanted to Utah have resulted in tax values of iron ore in the neighborhood of \$4.50 to \$6.50 per ton depending upon the grade, character and composition of the ore. Such values are now used by defendant for net proceeds, occupation tax and franchise tax purposes and have not been appealed for judicial review.

We turn now to a pair of decisions of the Supreme Court of Kansas covering, not the reasonableness of intercompany sales prices, but the reasonableness of an intercompany contract between parent and subsidiary company covering management and administrative services rendered by the parent to and for the subsidiary company. These cases are pertinent to the case at bar when it is recalled that for the period 1931 to 1936 the Utah Division was not a division of plaintiff but an affiliated company, Utah Copper Company. The record shows that both from an accounting and operating standpoint, the Utah Division is a separate *unit* of plaintiff, separable from plaintiff's other divisions and subsidiaries. In other words, the mandate of this court in No. 7298 requiring defendant to compute the tax on the basis of the separate accounts of the Utah Division is in certain respects equivalent to requiring the Utah Division to be treated as a separate and distinct entity or unit

from plaintiff's other operating divisions or subsidiaries.

The question, heretofore mentioned, arises as to the extent to which the New York management and administrative expenses should be allowed as a deduction on the separate books and tax returns of the Utah Division. In computing the net income of the Utah Division arising from business done in Utah, the Utah Division's fair and proportionate share of the New York administrative expenses as reflected on its books has been allowed as a deduction by defendant on the Utah tax returns. It will be remembered that the *Cottonwood Coal Co.* case, heretofore cited, holds specifically that the maintenance of an out-of-state administrative office by a mining company conducting mining operations within the taxing state does not require an apportionment of income outside the state in which the mining operations are conducted.

Nutrena Mills Inc. v. Kansas State Tax Commission, 91 P. 2d 15 (1939), involved a corporation organized under the laws of Missouri engaged principally in the business of manufacturing and selling feed for livestock and having its principal manufacturing plant in Kansas where it was duly authorized to do business. All of its stock owned by Miller Management Corporation, a Missouri corporation, not qualified to do business in Kansas. The court states that "the evidence is that it performs its services for Nutrena Mills, Inc., in the territory."

On June 23, 1934, the subsidiary entered into a written contract with its parent under which the parent agreed to furnish to the subsidiary "complete managerial superintendence and executive control for the proper, efficient and economical operation of the business and affairs" of the subsidiary. For such services the subsidiary agreed to pay \$4.50 to the parent for each ton of feed manufactured by the subsidiary. For the year 1935 this amount was reduced to \$3.25 per ton. In filing its tax returns for the years 1934 and 1935 in Kansas the subsidiary deducted \$47,308.85 for 1934 and \$129,001.67 for 1935 because of the management and financial charges. The Tax Commission readjusted these amounts, allowing \$7,000 for 1934 and \$33,580 for 1935, these being the sums actually paid by the parent for salaries of the officers of the subsidiary. The balance was treated as dividends from the subsidiary to the parent and accordingly taxable to the subsidiary. The Kansas law and regulations permitted the deduction of all 'ordinary and necessary' expenses paid in carrying on a business and permitted the deduction of a reasonable allowance for salaries or other compensation paid for personal services actually rendered.

The subsidiary taxpayer argued that the per ton agreed upon were fair and reasonable. It appeared, however, that the subsidiary's commission for 1933 showed that its net r

to have been 46c plus for 1933, to have been \$1.85 for 1934 (up to June 1) and had never approached anything like \$4.50 per ton. The Court stated page 18:

“Hence, the agreement is open to the interpretation that the price per ton which by its contract of June 1934, the Nutrena Mills, Inc., agreed to pay the Miller Management Corporation for its management and financial services was fixed so high that it would take all of the profits of the Nutrena Mills, Inc., even though they might be greatly in excess of the previous profit of the company.”

Again,

“The Nutrena Mills, Inc., had its manufacturing plant in Kansas and transacted its business in this state and is liable for income taxes here. If, as argued by appellee, it was to syphon out of this state and into another state the profits made by Nutrena Mills, Inc., in Kansas by a contract to pay the out-of-state corporation a sum grossly in excess of the reasonable value of its services to Nutrena Mills, Inc., that fact should not defeat the collection of the income tax from the Nutrena Mills, Inc., by this state.”

The other Kansas case is *Wyandotte County Gas Company v. State Commission of Revenue and Taxation*, 127 P. 2d 481 (1941). In this case it appeared that the appellant Wyandotte County Gas Company was the operating gas company of the Cities Service organization in the Kansas City area. In filing its Kansas income tax return for 1937 the company claimed a deduction of \$30,120.20

from gross income which amount represented a management fee paid to its parent, Cities Service Company. Such fee had been computed under an intercompany contract dated September 1, 1929 on the basis of $1\frac{3}{4}\%$ of its gross revenue.

The commission disallowed the deduction in its entirety finding as follows:

“The commission further finds that the New York management fees paid to the Cities Service Company were based upon a percentage of gross income and were computed without regard to actual services rendered. Such fees, therefore, do not constitute an ordinary and necessary business expense . . .”

No attempt was made before the commission or in the District Court to show the value of any services rendered the taxpayer by the Cities Service Co. or in fact that any services had been rendered. The Court cited the Nutrena Mills, Inc. case and sustained the commission.

Under these cases and the separate accounting cases cited heretofore, the most that plaintiff should be entitled to charge and deduct against the net income from its Utah operations is a fair distributive share of the New York administrative expenses to the extent that such expenses are reasonable in amount and cover services actually rendered by the New York administrative personnel to the activities of the Utah operation. There is not the slightest showing or contention in the present proceeding that the amount of New York administrative

expenses allowed by defendant is unfair, unreasonable or in an amount less than the fair value which such services contributed to the net income earned by the Utah Division. In fact Mr. Henry B. Fernald testified as follows (See F. page 157) :

“Q. And the general and administrative overhead of the New York Office has been properly allocated in part to the Utah Division?

A. I think I can say it has been properly allocated, but understanding that there are some of the general expenses of the corporation on which there has been no attempt to distribute, division by division; but they are left as general expenses of the corporation, which in the aggregate are quite minor in total amount.”

The Cottonwood Coal Company case, the Standard Oil Company cases, and the other cases heretofore referred to show clearly and conclusively that the Utah tax may and should be assessed on the basis of the net income of the Utah Division separately computed on plaintiff's books of account where the segregation of income on such books of account is based upon market values which on a fair basis allocate some of the profits to the state of production and some of the profits to the state where the selling business is transacted, providing that a fair share of out-of-state administrative overhead is charged back against the operation in the state of production. Such segregation of income on a separate accounting basis is required in such circumstances even though

the taxpayer corporation itself in its own name and in the regular course of its own business conducts both the manufacturing and selling operations. The selling activities of Standard Oil in North Dakota, for example, were not conducted by a separate subsidiary of the taxpayer corporation, but were conducted by its own "selling department."

In the case at bar, the selling activity has been separately incorporated and all sales are handled by and in the name of the separate and distinct subsidiary corporation. Computation of the tax on the company engaging in the production operations must be computed on the segregated books of account if such accounts reflect fair and reasonable intercompany arrangements between the affiliated companies. The net income which plaintiff derives in New York from the selling operations separately conducted by its wholly owned sales subsidiary is derived from the dividends which plaintiff receives annually from such subsidiary. During the period here involved, plaintiff received dividends from the sales subsidiary aggregating \$1,240,000. Such dividends together with all of plaintiff's other investment income has been allocated to New York and excluded from the Utah tax base. All of the net income from the molybdenite and blister copper produced by the Utah Division in Utah is attributable to Utah and is earned from Utah business solely and exclusively. All of the Utah products being transferred to the sales subsidiary and A. S. & R. at fair prices for resale, plaintiff on a separate account-

ing basis is entitled to no apportionment of income within and without the state of Utah merely by virtue of the maintenance of an out-of-state administrative office.

Where allocation to the taxing state is made by separate accounting methods the only thing required with respect to the out-of-state administrative office is that a fair share of such general out-of-state overhead be charged against the separable local operation. Were this not so, there would be no such thing as allocation by direct separate accounting methods. The statutory formula would be applicable to all cases, the only difference being the question whether such statutory formula should be applied to the total net income of the corporation from all sources or whether it should as a matter of right entitle the taxpayer to apply it against the separate net income shown and calculated on his separate set of books as attributable to the operations conducted within the producing state. The mere existence of an out-of-state administrative office would thus require the state of production to allocate income within and without the state by formula in every and all cases. This is clearly not the law as the foregoing cases cited under this point show. A different case would be presented, of course, where the taxpayer corporation comes forth and shows that the existence of the out-of-state administrative office has subjected him to an income or franchise tax in the state in which the administrative office is located. In such a case a question of double taxation of the same net income might be involved.

In the case at bar, plaintiff has not shown nor does it now claim that any question of double taxation is involved. It makes no claim that any portion of the net income of the Utah Division is taxable or has been subjected to tax by the New York taxing authorities. This feature of the case is particularly important because a computation of tax under Subdivision 8 of the Utah Statute under the mandate of this Court in Case No. 7298 requires defendant in computing the tax to take into account whether or not the assessment will result in double taxation. This failure of plaintiff to make any claim of double taxation is particularly significant also when we look at plaintiff's Utah operations from the standpoint of New York's similar franchise tax law. New York's claim for tax against net income arising from plaintiff's Utah Division is negligible, if any. In the first place, New York sees a corporation which by separate accounts has attributed all of the net income of the Utah operations to the Utah separate division of the company. If New York accepts and recognizes such separate and segregated accounting methods it sees on such books no net income of the Utah Division allocated or apportioned to New York. In the second place, if New York sought to apply its statutory formula based upon property, payroll and gross receipts against plaintiff, it is faced with the fact that all of the property of the Utah Division is located outside New York, all of the payroll of the division is located outside New York and all gross receipts from sales of the Utah product are negotiated and effected by a separate and distinct corporate entity, to wit,

the sales subsidiary or A. S. & R. as the case may be. In these circumstances and on the present record it may, therefore, be fairly concluded that not \$1.00 of net income which plaintiff in the case at bar is seeking to exclude from the Utah tax base has been taxed or is legally subject to tax by any jurisdiction as arising from or attributable to the doing of business outside the state of Utah.

Plaintiff's net income from the Utah molybdenite and blister copper product is in its full 100% amount net income earned from its land and mines and other operations in Utah. The market values determined under the intercompany contracts between plaintiff and its sales subsidiary and A. S. & R. constitute the separate gross proceeds or their equivalent for the purpose of net proceeds, occupation tax and corporation franchise tax of plaintiff's Utah Division. Deduction of the out-of-state administrative, selling, refining, transportation and marketing expenses from gross proceeds actually realized represents Utah gross income which arises from the privilege of engaging in a local business which has been granted to plaintiff by the State of Utah. No other state or foreign country has or in the nature of the case could have any claim for tax against this income or the privilege for which it is exacted. As a further illustration of principle, see *State v. Hampel*, 178 N.W. 244 (1920), which held that income from out-of-state land and mines in Michigan was not taxable in Wisconsin when the owners were residents in Wisconsin and distributed

buted to Wisconsin beneficiaries, such beneficiaries being stockholders of the corporation previously owning such land and mines.

To summarize, defendant urges here under point 2 that the full 100% net income of the Utah Division constitutes plaintiff's Utah corporation franchise tax base. This follows for the reason that plaintiff by fair and reasonable intercompany contracts with the sales subsidiary and A. S. & R. has allocated by corporate contract the profits attributable to Utah business and earned from the Utah molybdenite and blister copper product. Defendant also urges that the profit on the sale of the products is earned by the sales subsidiary and A. S. & R. outside Utah, that such selling profit based on intercompany contract is fair and reasonable, that in the absence of fraud or an intent to evade the Utah tax neither plaintiff nor defendant in this proceeding may set aside the intercompany contracts with or the separate corporate entities of the sales subsidiary and A. S. & R., that the out-of-state expense incurred by plaintiff with respect to the Utah product does not constitute out-of-state business by plaintiff or its Utah Division, that a tax required to be computed on the basis of a direct allocation by separate accounting methods must be based on such separate accounts and not on the basis of the statutory formula applied to such separate accounts, and that the fair value of the Utah molybdenite and blister copper product on the intercompany contracts with the sales subsidiary and A. S. & R. less the out-of-state expense

statutory allowances have already been judicially determined to constitute the proper tax base with respect to plaintiff's Utah operations for net proceeds and occupation tax purposes.

It would appear that plaintiff's case on this appeal will turn mainly on the question whether the separate corporate entity of the sales subsidiary may be set aside and ignored. Both before the defendant below and here on appeal, plaintiff seeks to ignore the separate corporate entity of the sales subsidiary either on the ground of "agency" or on the ground that being a wholly owned and dominated subsidiary of plaintiff, defendant and this court should look through the corporate form and treat the sales subsidiary as a mere department or adjunct of plaintiff in carrying on and conducting plaintiff's business. In other words, plaintiff is arguing that the sales subsidiary is the *alter ego* of plaintiff because dominated by its sole stockholder. On the other hand, if regarded as a separate entity, it is urged that it is acting "representatively" and not "individually," conducting plaintiff's business but not its own business.

The cases and authorities to be discussed under Point 3, together with the authorities discussed here under this Point 2, all show clearly and conclusively that in the absence of fraud or evasion the separate corporate entity must be recognized and accepted for tax purposes. By definition the word "taxpayer" means one corporation, not two or more corporations, except where

in pursuance of the law in such cases provided, affiliated companies are permitted to file a consolidated tax return covering the operations of the companies as if they were a single entity. Unless affiliated companies join in a consolidated tax return the tax liability of each company must be separately computed providing the intercompany contracts and arrangements are fair and reasonable and have been negotiated upon an arms-length basis.

It should be recalled at this point that plaintiff's sales subsidiary, a New York corporation, has never qualified to transact nor has it in fact transacted business within the state of Utah. The consolidated return provisions of the Utah franchise tax law and defendant's regulations issued thereunder manifest a clear intent that only affiliated companies subject to taxation in Utah may file a consolidated tax return. Where such consolidated returns are filed, intercompany transactions are ignored and one tax computed with respect to the entire group of affiliated companies as if they were one legal taxable entity. The action of plaintiff in filing its Utah tax returns of adding back into the Utah Division's net income the full commissions paid to its sales subsidiary and deducting in lieu of such commissions an estimated amount representing the actual expenses incurred by the selling subsidiary with respect to the sale of the Utah copper and molybdenite appears to be clearly in error. Such action appears directly contrary to the regular and systematic treatment of such commissions on the books of account of the Utah Division. It seems to fly

directly in the teeth of the fair and reasonable intercompany arrangements between plaintiff and its sales subsidiary. Furthermore, it appears to do violence to the provisions of the Utah statute relating to the filing of consolidated returns.

As stated by this Court in *First Security Corporation of Ogden v. State Tax Commission*, 91 Ut. 101 (1936) at page 113:

“The statute requires only Utah corporations or corporations qualified to do business in Utah to make returns. The state of Utah has no power nor authority to require a Wyoming corporation which has not accepted the constitutional provisions of Utah nor qualified to do business in the state, to make returns under the income tax law.”

In *A. C. Lawrence Leather Co. v. Commonwealth*, 151 N.E. 851 (1926) the Supreme Judicial Court of Massachusetts stated the same principle as follows at page 852:

“The clear meaning of the paragraph in its entirety is that taxation upon combined net income of foreign corporations can be levied only when such corporations doing business in this commonwealth constitute the entire group filing a consolidated return of income to the federal government, and that such corporations which have joined with one or more corporations ‘not subject to this section,’ in filing a consolidated return to the federal government must each file with the commissioner a statement of its net income as there described.”

Again the same court in *J. G. McCrory Co. v. Commissioner of Corporations*, 182 N.E. 481 (1932) at page 484 stated:

“The taxpayer was a domestic corporation. Neither its parent corporation nor any one of the other subsidiaries of that parent corporation carried on a business in this Commonwealth. The taxpayer conducted a local retail business in two cities within the Commonwealth. It was not engaged in business elsewhere. There is no warrant in G. L. c. 63 for basing the excise tax on the domestic corporation upon the capital or income of foreign corporations carrying on no business within the Commonwealth. It is elementary that no tax can be valid unless authorized by statute and assessed in conformance to its terms . . . There is nothing in this record to show that the relation between the taxpayer and its parent corporation was fictitious or a mere cloak for something not appearing on the face of the transaction. The method followed by the commissioner upon the facts disclosed was in conflict with the principle stated in *Hoeper v. Tax Commission*, 284 U.S. 206, at page 215, . . . in these words: ‘. . . because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person’s property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment.’ While the tax in the case at bar is an excise and not a property tax, this principle is equally applicable when the excise is measured by property or income not belonging to the corporation sought to be taxed.”

The Supreme Court of Minnesota in *State v. Oliver Iron Mining Co.* 292, N.W. 407 (1939) in discussing the mandatory consolidation provisions of the Minnesota statute, stated at page 411:

“Nor does it offend our tax law or any provision of c. 405 that the affiliated or related corporations which have no tax status in this state are not joined in the consolidated returns. As we regard it, if all of the affiliated corporations which are taxable in this state join in the consolidated return it is a sufficient compliance with our law although there may be other affiliated corporations having no tax status here.”

See also Annotation contained in 117 A.L.R. 508 entitled “Franchise tax of corporation as affected by creation of affiliated corporation.”

Under the foregoing authorities it is quite clear that plaintiff's returns in consolidating the operations of the Utah Division with the operations of the sales subsidiary, which latter corporation is not subject to taxation in Utah, is wholly unwarranted and in conflict with the clear wording of our Utah statute. Furthermore, it should be remembered at this point that even if the separate corporate entity of the sales subsidiary is completely disregarded, plaintiff makes no claim in this proceeding that the separate corporate entity of the fabricating subsidiaries, Chase Brass and Copper Co. and Kennecott Wire and Cable Co., should be disregarded. The transfer of 25% of the total production of copper of the Utah Division to these fabricating subsidiaries in

any event would have to be attributed to Utah business for the reason that such intercompany sales are on fair and reasonable terms and thus covered by the separate accounting cases heretofore mentioned. The statutory formula could in no event be applicable to such transfers of the Utah copper product to the affiliated fabricating subsidiaries. Furthermore, it should be pointed out that A. S. & R. which disposes of the gold, silver, platinum and paladium product of the Utah Division cannot under any circumstances consolidate for tax purposes its operations with those of plaintiff for the reason that plaintiff and A. S. & R. are not affiliated companies.

With respect to defendant's position under this point that the Utah tax must be computed upon the full 100% net income shown and reflected on the separate accounts of plaintiff's Utah Division, which position assumes that the separate corporate entity of the sales subsidiary must be recognized and respected both by defendant and plaintiff, we invite the court's particular attention to the case of *Curtis Companies, Inc. v. Wisconsin Tax Commission*, 251 N.W. 497 (1933), which case is also reported in 92 A.L.R. 1065.

Bearing in mind plaintiff's basic position in this proceeding that plaintiff's producing operations in Utah must be combined with the selling operations in New York of its sales subsidiary and tax computed on the basis of the statutory formula as applied to such combined op-

erations, we quote from the summary of appellant's argument appearing at page 1067 of the A.L.R. Report:

“Plaintiffs and affiliated corporations cannot on the record here be treated as a single corporation doing business both within and without the state, in order to justify an apportionment of income as the income of Curtis Companies, Inc.”

In the case at bar plaintiff seeks to combine the operations of its sales subsidiary with the Utah Division in its attempt by use of the statutory formula to exclude $\frac{1}{3}$ of the net income of the Utah Division as attributable to the selling activities conducted in New York. In the Curtis Companies case, it was the tax commission which attempted to combine the operations of the affiliated corporations and compute the tax as if such combined operations were being conducted by a single corporation. We quote first from the headnote contained in the A.L.R. Report.

“Authority to require a consolidated state income tax return from a manufacturing corporation and the company of which it is a subsidiary, and to treat such return as the return of a single corporation in ascertaining, according to the method prescribed by the income tax statute, the portion properly subject to state income tax, on the ground that the allocation of corporate income of the manufacturing corporation to the state as arrived at by the separate accounting method is controlled by arbitrary factors, to-wit, the margin allowed to the manufacturing corporation on sales, at a price not claimed to be unfair, to the distributing subsidiaries of the parent company, the

distribution of advertising charges, the distribution of general administrative charges, and the factory rental charge made by the parent company to the manufacturing company,—is not conferred by a statutory provision relating to cases where a corporation so conducts its business as directly or indirectly to benefit the members or stockholders by selling its products at less than a fair price, and to cases where a corporation a substantial portion of whose capital stock is owned either directly or indirectly by another corporation acquires and disposes of the products of the parent company in such a manner as to create a loss or improper net income.”

Again on page 1066 (ALR) the headnote states:

“So long as the corporate form or intercorporate agreements between a manufacturing subsidiary and the company by whom all the stock of such subsidiary is owned do not constitute devices having the purpose or effect of covering up income actually received by the corporation whose affairs are under examination, the State Tax Commission is without power, in assessing the subsidiary for state income tax, to disregard corporate agreements as to price, expenses, and other factors essential to the establishment of a net income, and to proceed to determine the income upon the basis of its judgment as to providence or business wisdom of such arrangement.”

The headnote continues:

“Power to disregard the corporate entity, or intercorporate contracts, in assessing the state income tax of a manufacturing corporation, stock in which is owned by a parent company but which

has its own officers who actually transact its affairs and which sells its products at a fair price to the distributing subsidiaries of the parent company, by which charges are made for rental, advertising and general administrative charges, is not conferred upon the state tax commission by a statute empowering it to require, in the case of affiliated corporations, 'such consolidated statements as in its opinion are necessary in order to determine the taxable income received by anyone of the affiliated or related corporations.' "

The opinion of the Wisconsin Supreme Court by Justice Wickhem gives the specific facts involved in the case as follows:

The Curtis Companies, Inc. was a holding company owning all the capital stock except director's qualifying shares of the Curtis & Yale Company and of several companies engaged in a similar business. The Curtis & Yale Company was a producing company manufacturing and jobbing sash, doors and miscellaneous mill work. Its plant was located at Wausau, was owned by Curtis Companies, Inc. and was leased by that corporation to the Curtis & Yale Company. Both the Curtis & Yale Company and Curtis Brothers & Company, another subsidiary with a plant at Clinton, Iowa, did extensive manufacturing and sold their products to outside dealers as well as to the distributing subsidiaries of Curtis Companies, Inc.

It appeared that since 1920 Curtis Companies, Inc. and Curtis & Yale Company had filed returns of income

with Wisconsin reporting Wisconsin income upon a separate accounting basis. In 1929 a field audit of both companies for the years 1925 to 1928 inclusive was made. On the basis of this audit it was determined that Curtis & Yale Company owed additional income taxes of \$6,319.90 and that Curtis Companies, Inc. was entitled to a refund of \$491.55. In making these assessments the separate accounting method of reporting Wisconsin's income was not changed. Due notice of the additional assessment was given and on objection by the taxpayers, a hearing was held before the commission. On the hearing it was conceded that Curtis Companies, Inc. was entitled to a greater refund, that is, in the amount of \$547.58. Curtis & Yale Company conceded liability for an additional tax of \$2,611.72, but objected to the balance.

Objection of Curtis & Yale Company to the assessment centered principally about the disallowance of a total of \$66,640.47 for advertising expenses in the returns of the company for 1925 to 1928 inclusive. These sums represented charges made to Curtis & Yale Company by Curtis Companies, Inc. as its proper share of national advertising authorized by it.

As a result of the hearing the commission concluded that the separate accounting method did not reasonably reflect Wisconsin income and that the "proper basis for reporting in this case is, therefore, a consolidation of the incomes of the inter-related corporations and an apportionment thereof in the manner described by the statute."

The assessment ultimately made was entered against Curtis Companies, Inc., the parent company. The plaintiffs contended that the action of the commission in consolidating the income of the affiliated companies and assessing a tax on the combined income to the parent company by application of the Wisconsin statutory formula was improper and invalid.

The Court refused to permit the statutory apportionment of the combined income of the affiliated companies and ruled that the tax should be computed on the basis of the separate accounts regularly maintained by each company.

The opinion states at page 1070 (A.L.R.):

“Having determined that the allocation of corporate income to Wisconsin, as arrived at by the separate accounting method, is controlled by four arbitrary factors, to-wit: (1) The 11½% margin allowed to the factories on sales to the distributing subsidiaries; (2) The distribution of advertising charges; (3) The distribution of general administrative charges; and (4) The rental charged Curtis & Yale Company for the Wausau factory, it is first contended that the commission had a right to require consolidated returns under the authority given by section 71.25(2). It is further contended that the domination of the Curtis and Yale Company by Curtis Companies, Inc. combined with the arbitrary character of the items which determine the Curtis & Yale income, justify the commission in disregarding the separate identity of the corporations and imposing a tax in accordance with the consolidated return.

It is conceded that this tax probably should have been entered against the Curtis & Yale Company, but it is contended that this is an error that can be readily corrected. It will be noticed that the commission does not conclude that the inter-corporate transactions under examination here were unfair during the years under audit, nor is it contended that either the form of corporate organization adopted or the contracts between the parent and subsidiary had for their purpose the evasion of the income tax law by diverting a portion of the Curtis & Yale Co. income properly attributable to its Wisconsin activities through subsidiaries doing business in the state not having an income tax law.

“At the outset it seems clear that section 71.02(3)(d) relates to the situation presented by a single taxpayer who does business within and without the state. He is permitted separately to account when that method reasonably reflects the income properly attributable to activities in this state, and, if it does not, the statute contains a precise and detailed description of the manner in which the Wisconsin income is to be determined. This method involves the application to the total income of such a taxpayer, of the average of certain ratios described in the section. Assuming that Curtis and Yale Company was a wholly independent corporation and not a subsidiary, it is clear that this section sets forth in detail the method of ascertaining its Wisconsin income. It is claimed, however, that the commission, for any purposes of the income tax law, may require a consolidated return in cases of affiliated corporations, and that having exacted this return, the corporations may be treated as a single corporation in applying the ratios described in section

71.02(3)(d). Certainly section 71.25 gives no such authority to the tax commission. This section is entitled 'Corporate Tax Evasion Prevented.' Its first subdivision deals with two situations: 1st, a corporation which so conducts its business as to directly or indirectly benefit the members or stockholders by selling its products at less than a fair price; 2nd, where a corporation, a substantial portion of whose capital stock is owned either directly or indirectly by another corporation, acquires and disposes of the products of the parent company in such a manner as to create a loss or improper net income. It is not seriously contended that Curtis & Yale Company sold its products at less than a fair price, nor was this fact found by the commission. The second provision of the section obviously has no application to the Curtis & Yale Company since it was the producing company and had no contract whatever to dispose of the products of Curtis Companies, Inc. In the two situations above described, neither one of which, as it seems to us, applies to this case, the commission may determine the income of the corporations found to engaged in an effort to evade taxes by disregarding these arrangements and estimating the reasonable profits which might have been made but for their existence."

The Court further stated:

"If it once be admitted that the intercorporate contract or arrangement does not establish an unfair price for the goods, and in addition that it is not a device adopted for the purpose of avoiding the provisions of the income tax law, section 71.25 has no application, and, if the position of the commission is sound it must be because the commission, from some source or by some process, has acquired the right to disregard all intercor-

porate contracts for income tax purposes whenever it appears that the taxpayer corporation, the income of which is under investigation, is wholly owned by another corporation. This question we shall consider hereafter. It is, of course, clear enough that except for this question, presently reserved, the commission has no visitorial or supervisory control over the affairs of a corporation; that it cannot question the wisdom of its contracts or practices, being limited to a decision as to whether or not the contracts or business practices are colorable devices adopted to conceal income and avoid the tax."

With respect to whether the commission may combine the operations and income of parent and wholly owned subsidiary merely because "a wholly owned subsidiary is involved" the Court stated:

"We find no authority in the statutes to sustain the conclusion that the commission has such powers. The only basis for a claim to such powers rests in the undoubted right of the commission to exact reports that accurately reflect income, and to tax upon the basis of the true income. So long as the corporate form or the intercorporate agreement do not constitute devices having the purpose or effect of covering up income actually received the corporation whose affairs are under examination, they do reflect the true income of the corporation. The corporation reports, for example, in this case the aggregate income actually received from sale of products. It reports its actual expenditures for advertising and for rent. Its gross income, minus legitimate deductions, constitutes its net income upon which a tax may be levied. The situation is quite different

from that in the Palmolive, Buick, and Cliffs Chemical Company cases, where profits actually earned by the subsidiary were routed to the parent corporation by special contract designed to prevent a showing of profit by the subsidiary."

The judgment of the court below was reversed, the assessment set aside and the cause remanded to the tax commission with direction to reassess the tax as indicated in the opinion based upon the separate accounts of parent and subsidiary and not on the basis of an apportionment of income under the statutory formula based upon the combined net income of parent and subsidiary.

The Curtis Companies case is again clear authority that the action of plaintiff in the case at bar in combining the net income and operations of plaintiff's Utah Division and its sales subsidiary and apportioning the net income of both parent and subsidiary under the Utah statutory formula was improper and erroneous. Particularly is this so where the subsidiary was not even qualified to do or doing business in Utah and consequently not subject to taxation upon its selling profit in Utah. The testimony, evidence and findings of defendant show that the intercompany arrangement between plaintiff and sales subsidiary covering the sale of the Utah product is a fair, reasonable and arms-length arrangement. The transfers by plaintiff of a portion of the Utah product to A. S. & R. under fair, reasonable and arms-length intercompany arrangements must likewise be

recognized and accepted by both plaintiff and defendant in this case. The Curtis Companies case is likewise of interest in that it shows once again that where the tax is to be computed on the basis of separate accounting methods only a fair and reasonable proportion of general administrative charges need be charged against the local operation. Not an apportionment of income within and without the state is required or permissible, merely a fair distribution of the general overhead or administrative expense.

The foregoing authorities under this Point 2 clearly establishing that the Utah corporation franchise tax should be based upon the full 100 per cent net income of the Utah Division of plaintiff, as separately kept and maintained, we turn next to the question whether this court has jurisdiction to increase by a modification of defendant's decision or a remand of the case, the deficiencies in tax as determined by defendant.

The jurisdiction of defendant to increase the amount of deficiencies over the amount of deficiencies shown in the initial notice by letter to the taxpayer, required under the provisions of Section 80-13-36, U.C.A. 1943, appears not to have been judicially considered in this state. Furthermore, the question seems not to have been considered of the extent to which this court has jurisdiction in modifying a decision of defendant or in remanding a case to defendant for rehearing, to make a determination or to direct a determination by defendant which will

result in deficiencies in tax greater than the amounts previously asserted against the taxpayer by defendant.

The general procedure contained in the statute with respect to the determination and assessment of tax deficiencies by defendant with respect to corporation franchise taxes is as follows.

Under Section 80-13-36, U.C.A. 1943, after determining that there is a deficiency in tax, defendant mails notice of such deficiency to the taxpayer which notice contains the details of the deficiency and the manner of computing the tax. Within sixty days after the mailing of such notice, the taxpayer may file a petition with defendant for a re-determination of the deficiency. Except with the taxpayer's consent, the deficiency cannot be assessed or collection proceedings instituted until a mailing of such notice and the expiration of sixty days thereafter, or if a petition has been filed with the defendant until defendant's decision has become final. The statutory provisions suspend the running of the statutes of limitations on the making of assessments and the institution of collection proceedings until the expiration of 30 days after notice to the taxpayer of defendant's decision. Such decision, however, does not become final upon the expiration of such thirty day period if proceedings for review of the decision are taken to this Court. In the event of appeal, Section 80-13-46 provides that the decision "shall become final, (1) when affirmed or modified by the judgment of the Supreme Court; (2)

if the Supreme Court remands the case to the tax commission for rehearing, when it is thereafter determined as hereinabove provided with respect to the initial proceedings.”

Upon the filing of the taxpayer’s petition for a redetermination of a deficiency, notice of which has been mailed to the taxpayer, the statute requires defendant to give the taxpayer notice and an opportunity to be heard. It is also provided that after hearing a decision shall be made as quickly as practicable. Of particular importance to the question here presented is Section 80-13-39 entitled “Jurisdiction to Redetermine Deficiency.” This section reads as follows:

“The Tax Commission shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed; provided, that at the hearing or prior thereto claim therefor is asserted.”

In addition to the power of this Court under Section 80-13-46, referred to above, of affirming or modifying defendant’s decision or remanding the case to defendant for rehearing, Section 80-13-47, entitled “Review by Supreme Court,” provides for application to this Court for a writ of certiorari or review for the purpose of having “the lawfulness of such decision inquired into and determined.” This latter section also provides “upon the

hearing no new or additional evidence may be introduced, but the cause shall be heard on the record before the Tax Commission as certified to by it. The decision of the tax commission may be reviewed both upon the law and the facts, and the provisions of the code of civil procedure relating to proceedings in the supreme court shall, so far as is applicable and not in conflict with this chapter, apply to the proceedings in the supreme court under the provisions of this section." Of interest also is Section 80-13-48 entitled "Exclusive Jurisdiction of Supreme Court." This section provides "no court of this state, except the supreme court, shall have jurisdiction to review, reverse or annul any decision of the tax commission, or to suspend or delay the operation or execution thereof." Although Section 80-13-47 permits "any party affected thereby" to apply for a writ to review a decision of defendant this apparently means and has been construed to mean a party other than the Tax Commission itself. The requirement of the deposit or bond covering the taxes, interest and other charges in Section 80-13-49 would indicate that defendant, unlike the Federal government, has no right to appeal on behalf of the State a decision not appealed by the taxpayer. In the Federal law, the Commissioner of Internal Revenue is specifically given the right of appeal from decisions of the Tax Court.

It appears that the problem of the validity of an increase in the deficiency beyond that set forth in the initial deficiency letter to the taxpayer may arise either before defendant or before this Court on appeal. Let us

assume the mailing by defendant of a notice of deficiency and the filing by the taxpayer of a petition for redetermination of the taxes set forth in such deficiency letter. At any time *before* the hearing is actually held or at any time *during* the hearing, defendant has the statutory right to assert its claim to the increase. At the same time, if no such claim were asserted, Section 80-13-39 would prevent defendant by its decision from redetermining the deficiency in an amount greater than the amount contained in the original deficiency letter. Again, if the decision were appealed to this Court, the Court has jurisdiction under the statute to "affirm," "modify" or "re-mand" the decision to defendant for "rehearing." If the Court, after a review of the matter, decides that the tax deficiency appealed by the taxpayer is too small, may the Court "modify" the decision to increase the deficiency where claim therefor has been asserted at the hearing below by defendant, and, further, where a case on appeal has been remanded by this Court to defendant for rehearing, may defendant at the "rehearing" assert a claim for an increased deficiency as a result of the decision and opinion of this Court. These two questions, involving the occupational hazards of tax litigation, are presented here.

The authorities hereafter discussed show that the same rule applicable to the initial hearing is applicable to the "rehearing" following a remand of the case by this Court. The reason for this is the provision in Section 80-13-46 that upon remand of a case to the Tax Commis-

sion for rehearing, the same statutory rules with respect to a decision by defendant are applicable on the rehearing as are applicable with respect to initial proceedings except that defendant's decision on rehearing cannot be inconsistent with this Court's decision and opinion. The discussion here with respect to the year 1942 and the effect of the court's mandate and remittitur in Case No. 7298 on defendant's authority to increase the deficiencies on the rehearing over and above the deficiencies originally asserted and appealed to this court is tied directly into plaintiff's argument that under the mandate of this court in Case No. 7298 the allocation factor of 66.926% is res judicata and binding on defendant. This point is hereafter discussed under defendant's Point 5 with respect to whether defendant's decision is inconsistent with the Court's mandate in No. 7298 but discussed here with respect to whether defendant may assert a claim for an increase on the "rehearing" under the statute assuming such claim to be entirely consistent with the Court's mandate.

In view of the fact that the questions here being considered are novel ones so far as this Court is concerned, we must turn primarily to the applicable Federal authorities for assistance on the problem.

It will be remembered that the Utah corporation franchise tax law in its general framework is largely based upon the Federal 1928 income tax law. Section 272 (e) of the Internal Revenue Code provides as follows:

“Increase of deficiency after notice mailed.—The tax court shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefore is asserted by the commissioner at or before the hearing or a rehearing.”

The above provision has been in the federal tax law since the 1926 act.

For a general discussion of the problem see Prentice-Hall 1954 Federal Tax Service, Volume 3, Para. 21,504—9, and 1954 CCH Fed. Tax Reporter, Vol. 4, para. 1354.10-.155.

The Utah statute, unlike the Federal law, confers no authority on defendant to grant a rehearing. Thus, following a hearing, when defendant's decision is rendered and mailed to the taxpayer, its jurisdiction in the matter is then completely exhausted and terminated. The only authority for a rehearing in the Utah statute is one directed by this Court upon a remand of the case. In other words, the authority of defendant is the same as that of the State Tax Commission of Arizona considered in *Magma Copper Co. v. Arizona State Tax Commission*, 191 P. 2d 169 (1948). In this case it appeared that the taxpayer following a hearing before the commission and an adverse decision by the commission, instead of appealing to the court filed a petition for rehearing with the

commission which was granted. A further hearing was held and the commission's original assessment was confirmed. The taxpayer within the statutory period measured from the second decision appealed to the court. On behalf of the state it was argued that the commission had exhausted its jurisdiction when it entered its first decision and that all action taken thereafter was null and void, and that the court therefore was without jurisdiction in the matter. The Supreme Court of Arizona stated at page 175:

"Nowhere in the income tax law is there any authority for a rehearing by the commission upon rendering its decision after the hearing provided for in Sec. 73-1539, *supra*. The only remedy provided for is by appeal to the Superior Court. No appeal was taken from the order of the commission of December 29, 1942. Instead the appellant, for some reason, moved for a rehearing. The commission was wholly without authority to grant a rehearing or to take further action of any kind in the matter. All actions thereafter taken by it, including its order of October 11, 1945 were null and void."

When we turn to the provisions of the Federal law pertaining to the jurisdiction of the Federal Circuit Courts of Appeals to review decisions of the Tax Court of the United States (formerly Board of Tax Appeals) we see a substantial similarity of these provisions with the Utah statutory provisions governing the jurisdiction of this Court over decisions of defendant.

Section 1141 of the Federal Internal Revenue Code provides

“(a) Jurisdiction.—The Courts of Appeal shall have exclusive jurisdiction to review the decisions of the tax court, . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari in the manner provided in Section 1254 of Title 28 of the United States Code.”

This section also provides

“(c) Powers.—(1) To affirm, modify or reverse.—Upon such review, such courts shall have power to affirm or, if the decision of the board is not in accordance with law, to modify or to reverse the decision of the board, with or without remanding the case for a rehearing, as justice may require.”

The provisions of Section 80-13-39 U.C.A. 1943 and Section 272 (e) of the Internal Revenue Code, with respect to increases of deficiencies, appear to be almost identical with the exception that under Federal practice the Commissioner of Internal Revenue may assert the claim not only “at or before the hearing” but also at “a rehearing.” The phrase “or a rehearing” is omitted in the Utah law. This rehearing provision in the Federal law appears to be applicable to both rehearings granted by the Tax Court itself and those directed by the Federal Courts of Appeal. In other words, the Commissioner

may assert his claim for increase before the hearing, at the hearing or at any rehearing before the Tax Court.

In the case at bar the question of the validity of a claim asserted by defendant at a rehearing granted by itself is not involved. With respect to the year 1942, there is involved the validity of defendant's claim asserted at a rehearing directed by this Court by the mandate and remittitur in No. 7298. With respect to the years subsequent to 1942, that is, 1943 to 1950 inclusive, there is involved the validity of defendant's claim asserted at the initial hearing, which hearing had been consolidated with the rehearing relating to 1942.

In *Cement Gun Co. v. Commissioner*, 36 F. 2d 107 (1929) (CCA DC), the Court after referring to the pertinent provisions of the Federal revenue code, stated at page 108:

"The Commissioner, in his amended answer to the Board, set forth the error in his determination of the deficiency for the year 1920, and requested that the deficiencies be increased by the amount of the partial allowance he had made for that year. This correction was made by the Board. The Board in its redetermination of the deficiency was acting clearly within its jurisdiction and authority."

Again in *Davison v. Commissioner*, 60 F. 2d 50 (1932) (CCA 2), the Court stated, page 51:

"The petitioner challenges the jurisdiction of the Board to assess a deficiency greater than the deficiency set out in the 1925 notice because he

asserts that the statute of limitations had run before the commissioner's amended answer was filed. This contention is without merit. Section 274(e) of the Revenue Act of 1926 . . . , permits the Board to redetermine the correct amount of the deficiency, even if it be greater than the deficiency stated in the commissioner's notice to the taxpayer, 'if claim therefor is asserted by the commissioner at or before the hearing or a rehearing.' . . . The provisions of section 277 (b), . . . , and Section 274 (a) of the act . . . cause the running of the statute of limitations to be suspended while proceedings are pending before the Board."

However, in the same case covering the year 1926, the Court refused to permit an increase of deficiency where no claim therefore had been asserted at the hearing, the Court stating, page 52:

"The 1926 deficiency was also increased by the Board, although the commissioner had failed to assert any claim for an additional deficiency as required by Section 274 (e) of the Revenue Act of 1926. This was clearly an error, and cannot be justified under Rule 50 of the Board's Rules of Practice. Rule 50 requires the computation of deficiency to be in accordance with the decision on the issues presented at the hearing of the proceeding on the merits. New issues, other than those relating to computation, cannot be raised upon computation of the tax under Rule 50."

Again in *Weiller v. Commissioner*, 64 F. 2d 480 (1933) (CCA 2), the Court stated the general rules to be as above, citing the *Davison* and *Cement Gun* cases. It then stated, page 482:

"The only difference between the two decisions last mentioned and the case at bar is that here new property upon which an additional deficiency has been found was first introduced in the answer of the commissioner before the Board of Tax Appeals and had never been considered by the commissioner or included in his deficiency notice. The taxpayer's theory seems to be that a deficiency can only be increased by the Board when it concludes that the commissioner adopted a wrong rule of law in dealing with the facts shown by the return, or where the particular credits or debits upon which the commissioner had based his determination of the deficiency were valued improperly. But we see no reason for supposing that Section 308(a) is so limited and we hold that it enables the Board of Tax Appeals to make a full audit and do complete justice between the parties whenever the taxpayer seeks to review the assessment and the commissioner asserts a claim that an additional amount should be assessed. It seems clear from the foregoing that the Board proceeded properly and rightly determined an additional deficiency. It can make no difference that in arriving at this determination it dealt with matters extraneous to the original assessment."

In *Helvering v. Edison Securities Corp.*, 78 F. 2d 85 (1935) (CCA4), the Court stated at page 90:

"The Board refused to entertain the claim for increased deficiency seemingly on the ground that the power given it by Section 274 (e) is to be exercised only if the claim is asserted by the commissioner at or before the hearing or a rehearing of the case, and because in the opinion of the

Board this stage had been passed when the commissioner set up the claim in this case. We think that the power still persisted, for there seems to be no reason why the word 'hearing' should not be given a significance broad enough to include the whole proceeding down to the final decision. Ordinarily a hearing in equity embraces the decision also. (Citing Cases) But here the purpose is manifest to give the taxpayer an opportunity to answer and resist the claim before it is made effective by the action of the Board. If this is done, a claim of increase may be made and considered with propriety, whether it is presented during the taking of the evidence or in the period allowed for oral arguments, or written briefs, or even subsequently during the hearing under Rule 50; in short, at any time before or after the filing of the board's findings of fact until the decision and judgment of the board has been entered; or even later in the event of a re-hearing.

"This statement, however, must be taken with the qualification that the power to receive the claim should not be exercised unless a reasonable opportunity to oppose it is given to the taxpayer, and unless it is presented in accordance with reasonable rules laid down by the Board. If the question involved in the increase has been actually raised during the trial and the taxpayer has presented his evidence and his views on the point or has been given a chance to do so, the claim may be received at any time before the decision and allowed therein if found to be correct; but the taxpayer ought not to be taken by surprise."

Again the Court stated

"Even after a full trial below, an appellate court has the power to remand a case for further

proceedings if it has been tried on a wrong theory, *Underwood v. Commissioner CCA* (56) (F2d) 67, 73; and it cannot be doubted, in view of the purpose for which the Board was established and of the statute governing its procedure, that it has equal power to do full justice to the parties while they are still before it. . . .”

A footnote on page 91 discussing this problem and the jurisdiction of the Board under the 1926 act goes on to state

“And from an adverse decision by the Board, either party was given a right to appeal to the Circuit Courts of Appeals, and these Courts were given power to modify or reverse a decision of the Board if not in accordance with the law, with or without remanding the case for a rehearing, as justice may require.”

With respect to the situation where a remand of the case from the Appellate Court was involved we invite the Court's attention first to the case of *Underwood v. Commissioner*, 56 F. 2d 67 (1932) (CCA 4), in which the Court stated at page 73:

“The Board had ample power under the statute to require the production of additional evidence when it became clear that it could not do justice to the taxpayer by reason of the deficiencies in the record before it. It was unquestionably encumbant upon the taxpayer to offer the testimony in the first instance, and cases arise where the moving party must suffer the consequences of his own neglect. Here, however, the Board's own opinion showed that the commissioner's action

was wrong in a material respect. The information to correct the mistake was readily obtainable from the same source as that from which the gross receipts of the taxpayer were ascertained. Under these circumstances, the Board should have deferred its decision until testimony showing the amount of the deductions to which the taxpayer was entitled was introduced, and then have redetermined the deficiency. The decision of the Board will therefore be reversed and the case remanded in order that the course indicated may be followed. This action, we think, is authorized by the powers vested in this court by the Revenue Act of 1926, . . . where it is provided that the Circuit Court of Appeals shall have power to modify or reverse a decision of the Board, if not in accordance with the law, with or without remanding the case for a rehearing, as justice may require. In a number of instances, Circuit Courts of Appeal have remanded cases for rehearing when it seemed necessary in order to do justice to the parties. It does not appear in these cases that new evidence was available; but in the instant case the evidence is known to exist and it would be an abuse of discretion to decline to receive it. . . . In addition, there is the well established rule that an appellate court has the power, without determining and disposing of the case, to remand it to the lower court for further proceedings if the case has been tried on a wrong theory, or the record is not in condition for the appellate court to decide the question presented with justice to all parties concerned. . . .”

A case of particular pertinence to the case at bar is *Hall v. Helvering*, 68 F. 2d 399 (1933) (CCA DC). This case involved two appeals to the Circuit Court in the

same controversy. The taxpayer had assigned to his second wife certain life insurance commissions to which he was entitled from Lincoln National Life Insurance Company. The question arose whether the assignment constituted a transfer of future income on which the husband should be taxed or whether it was an assignment of property the income from which would be taxable to the wife.

In the first proceeding before the Board of Tax Appeals, the Board decided that the assignment was merely an assignment of future income. The taxpayer appealed to the Circuit Court which reversed the Board's decision and held that the assignment was an assignment of property. The case was remanded to the Board for further proceedings.

In the further proceedings before the board, following the remand, the Commissioner contended that even if the amounts paid by the life insurance company to the wife did not constitute income taxable to the husband, nevertheless the amount that the wife had paid out of such sums to discharge debts of the husband was taxable to the husband. The Board sustained the Commissioner's contention and the taxpayer again appealed to the Circuit Court. The Circuit Court affirmed the decision of the Board and stated at page 400:

"When the question arose as to whether there was a deficiency in petitioner's taxes, he appealed to the Board, and thereby stopped the running of the statute of limitations until final determination

of that question, but when the case was here before, this court did not decide, nor was it asked to decide, whether there was a deficiency in petitioner's income tax.

"We decided only that what passed from the husband to the wife under their contract was property, not income; and remanded the case for further proceedings.

"Such further proceedings could only mean to fix the taxpayer's liability, if any, on that basis; which in turn could only mean that the consideration for the assignment should be taken into account; and the laws determining what is gain or loss from the sale of property should be applied to arrive at the tax due."

Judge Groner dissented from the opinion not on the ground that the Commissioner lacked the authority to raise the issue on the remand, but on the ground that the Board on the remand had reached its decision without giving the parties an opportunity of introducing additional evidence on the new issue. Judge Groner's dissenting opinion states:

"When our mandate went down, the commissioner revived an alternative claim which he had originally urged on the Board but had elected to abandon, or at least not to urge, on the first petition for review. On this formerly unconsidered issue, the Board, without any new evidence, entered its order of redetermination, under which petitioner was required to pay, not only the full amount of the tax originally demanded by the commissioner, but some \$4,000 or \$5,000 more. Assuming as I do, that it was permissible

for the commissioner to revive the issue unpassed on by the Board at the first hearing, I think the decision should nevertheless and for another reason be reversed. . . .

“The case on this new and previously unconsidered issue was, I think, decided by the Board prematurely and without affording either of the parties opportunity to introduce evidence.”

Another case of a special significance to the case at bar is that of *Swenson v. Commissioner*, 69 F. 2d 280 (1934) (CCA 5). In this case the court stated at page 281:

“An effect of the remandment of the cause to the Board of Tax Appeals ‘for further proceedings not inconsistent with this opinion’ was to enable that Board to act on the petition for redetermination which by the remandment again was submitted to it, and to direct it in doing so to avoid the errors which had vitiated its former decision. The ruling of this court plainly contemplated a resubmission of the case to the Board of Tax Appeals and a reconsideration by that tribunal of evidence before it. Nothing contained in the opinion or the mandate indicated that the Board of Tax Appeals was to refrain from passing on the evidence submitted to it, or was bound by the finding of the Commissioner of Internal Revenue on the subject of the fair market value of the corporate stock mentioned at the time it was received for the oil and gas lease. This court did not direct the Board of Tax Appeals to adopt or accept a computation based on findings made by the Commissioner of Internal Revenue, and did not intimate that that Board was at liberty

to refrain from considering evidence submitted to it and reaching its own conclusion therefrom. After the reversal of the decision of the Board of Tax Appeals which formerly was reviewed by this Court and the remandment of the cause for further proceedings not inconsistent with this Court's opinion, the duty of the Board to act on the petition for redetermination was not different from what it was before the former erroneous decision was rendered; *the mandate of this court having the effect of restoring to that board the power it had when the case was first before it, except that its further proceedings were forbidden to be inconsistent with this Court's opinion.*"

A case in line with the above authorities and squarely in point with the case at bar is that of *William E. Boeing v. Commissioner*, 47 BTA 5 (1942). The decision is also reported in CCH Board of Tax Appeals Dec. 12,543.

In this case it appeared that the taxpayer filed gift tax returns for the years 1936 and 1937 claiming thereon two \$5,000 exclusions on the ground that although the gifts were to a trust there were two beneficiaries of the trust and he was entitled to one \$5,000 exclusion for each beneficiary. The Commissioner mailed the taxpayer notices of deficiencies in the amount of \$1,312.51 for 1936 and \$1,312.50 for 1937, on the ground stated in the deficiency notice that the taxpayer was entitled to only one exclusion in view of certain court holdings to the effect that a trust represents one beneficiary. The taxpayer filed a petition for redetermination of the defi-

ciency with the Board. Following a hearing on the merits the Board decided in petitioner's favor and held that there was no deficiency. The Board's decision was placed on the ground that the two beneficiaries of the trust were the donees of the gift and not the trust itself, as the Commissioner had determined. The Commissioner appealed the Board's decision to the Circuit Court of Appeals for the Ninth Circuit. The decision of the Circuit Court is reported in *Commissioner v. Boeing*, 123 F. 2d 86 (1941).

When the case was heard first before the Board, the only issue presented or considered by the Board was the question whether the trust or the beneficiaries constituted the "donee", that is, whether the taxpayer was entitled one or two exclusions. On appeal the Commissioner raised before the Circuit Court for the first time the question whether the taxpayer was entitled to any exclusion by reason of the fact that the gifts were gifts of a future interest in which case under the statute the \$5,000 exclusion would not be applicable.

The Circuit Court in its opinion reversed the decision of the Board, holding that the gifts were of future interests and in its opinion indicated that the Board was right in rejecting the proposition of law advanced by the petitioner that the trust was the donee "person" but further held that "on the basis of the record before it, it was wrong in holding that there were no deficiencies in taxes for the two years." The Court stated:

"Accordingly, the decision must be reversed and the cause remanded to redetermine or compute the deficiency. Since the applicability of the future interests provision of the statute was not considered and no issue was made in respect of it, opportunity should be given the taxpayer to present evidence on the issue if he so desires.

"As the matter stands the Commissioner has assessed deficiencies based on an exclusion of \$5,000 for each of the two years, although the taxpayer appears to be entitled to none. The Board of Tax Appeals is a body authorized by statute to operate under rules of its own adoption. Whether, in the light of its rules and of Sec. 272(e), (f) of the 1932 Act . . . , the Board may or should redetermine a greater deficiency than the amount of which notice has been given the taxpayer is a question which we have not considered and do not undertake now to decide. The question is not before us since no assertion of an additional deficiency has yet been made by the Commissioner in conformity with the statute."

Following its opinion the Circuit Court issued the following mandate:

"On Consideration Whereof, it is now here ordered and adjudged by this Court, that the decision of the said Board of Tax Appeals in this cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Board of Tax Appeals for further proceedings in harmony with the opinion of this Court.

"You, Therefore, Are Hereby Commanded that such further proceedings be had in the said cause in accordance with the opinion and judgment of this court. . . ."

Following the filing of the above mandate, the Commissioner filed a motion with the Board to permit the Commissioner to file a claim for increases in the deficiencies as proposed in the original deficiency notices and to permit the petitioner to introduce evidence on the question of future interests if he so desired.

The taxpayer on the other hand filed a motion stating that he had no desire to present additional evidence on the future interest issue and opposed the Commissioner's motion to file a claim for the increased deficiencies.

Member Sternhagen first ruled on March 9, 1942 that the Commissioner's assertion of the claim for additional deficiencies was not timely in that the claim had not been originally asserted at or before the original hearing or a rehearing thereof stating as follows: "No claim was asserted by the respondent at or before the hearing. No motion was made for a rehearing and therefore no rehearing was had, so no claim was asserted at or before a rehearing. By rule 19 a motion for rehearing must, except by special leave, be filed within thirty days, so the time for such a motion has expired. If the present motion of respondent be considered as a motion for rehearing, although it is not couched in those terms, it is plainly not a timely motion." This ruling reported in 46 BTA and in CCH Dec. 12,460, was pursuant to order of March 27, 1942, ordered to be reviewed by the full

Board of Tax Appeals. Upon review, member Sternhagen's ruling was reversed by the Board. After a careful analysis and consideration of the problem, the Board's opinion states:

"As we have already stated, it seems plain to us that the Court, in reversing and remanding these proceedings, has directed a rehearing at which the issue of 'future interests' is to receive consideration. That is the very occasion and purpose of the reversal and remand of the Board's prior decision.

"It is of course perfectly true that the Commissioner will get no increase in the deficiencies which he has already determined unless he asserts them in a proper pleading 'at or before the rehearing.' *Moise vs. Burnet*, 52 F. 2d 1071. . . The *Moise* decision clearly prohibits an increase in the deficiency under the pleadings now on file....

"The Commissioner, however, by motion duly filed, seeks to file an amended answer in which by affirmative allegations he raises the issue of 'future interests' and in which he clearly and succinctly sets forth his grounds for an increased deficiency and, after setting forth the grounds, concludes as follows:

"Wherefore, respondent respectfully prays that the deficiency claimed in his notice of deficiency be increased in accordance with the foregoing computation and now asserts a claim for such increase of deficiency as the statute in such a case provides.

"We think respondent's motion to file his amended answer raising the new issue of 'future

interest' and asking for an increased deficiency is, under the circumstances existing in these proceedings, a timely motion."

The opinion also states

"The present opinion replaces and supersedes the opinion herein entered March 9, 1942, . . . , which was, by order of the Chairman dated March 27, 1942 referred to the Board for review."

The Moise Case referred to in the Board's opinion had held that the claim for an increased deficiency should be actually and definitely made and not left to conjecture, inference or interpretation. The opinion of the Court in the Moise Case stated at page 1073:

"No words of claim, request, or demand were used by the Commissioner. He must be bound by his pleadings and cannot be assumed to have intended to present a claim that he did not actually assert."

Copy of this Court's remittitur issued January 12, 1951 in case No. 7298 covering the year 1942 is in evidence as Tax Commission Exhibit PP (2). The Court's mandate reads:

"This cause having been heretofore argued and submitted on the return made to the Writ of Review heretofore issued herein, and the court being sufficiently advised in the premises, it is now ordered, adjudged and decreed that the order of the State Tax Commission be and the same is affirmed and the cause remanded with

instructions to determine and enter a deficiency judgment in accordance with the views expressed in the opinion filed herein."

The case thus came back to defendant by remand under the authority conferred upon this Court by Section 80-13-46, U.C.A. 1943, which provides that a decision of the Tax Commission shall become final "if the Supreme Court remands the case to the Tax Commission for rehearing, when it is thereafter determined as hereinabove provided with respect to the initial proceedings." Upon resumption of its jurisdiction over the case following the remand, defendant's authority and jurisdiction was the same as it had been before on the initial proceedings or hearing, the only qualification being that it could take no further action or make any redetermination or assert any claim for increased deficiencies at the rehearing which would be in conflict or in any way inconsistent with the decision and opinion of this Court.

The first hearing followed the remand in No. 7298 which hearing covered not only the year 1942 but the subsequent years to and including 1950, was held on December 4, 1951. At this hearing (Tr. 3) it was stated:

"The purpose of the hearing is to finally determine the corporation franchise tax deficiency of Kennecott for 1942 and the years subsequent thereto, under and in accordance with the decision and mandate of the Supreme Court of the State of Utah in the case of Kennecott Copper Corporation and Bingham and Garfield Railway Company, Plaintiff, v. State Tax Commission, Defendant, Case No. 7298."

It was also stated (Tr. 5) :

“ . . . The serious question has arisen whether the method adopted by the commission has gone as far as the Supreme Court's decision requires. In other words, the present deficiencies in tax, excluding interest totalling \$2,712,915.47, may be too low. We are thus placed in the dilemma of having Kennecott here contesting proposed deficiencies which instead of being too high, may legally be too low.

“Under the Supreme Court's mandate we are required to compute Kennecott's tax liability on the basis of the separate accounts of receipts and expenses which the company maintains for its Utah Division. This is clearly a sensible and proper basis because it relates Kennecott's tax liability to the net income it derives from each pound of copper, each pound of molybdenite concentrate, each ounce of gold, and each ounce of silver extracted from the ore actually mined from the Bingham pit in Utah.”

Defendant's claim at the hearing for an increase of deficiencies based upon the full 100% net income shown and reflected on the separate accounts of defendant's Utah Division was as follows (Tr. 8) :

“ . . . I must, as counsel and as a matter of precaution, to protect the interest of the State, here and at this time reserve the right to this Commission and to the Supreme Court if this case again reaches the Supreme Court, to amend the deficiencies by asserting tax based on 100% of the Utah Division's net income. Accordingly, under and pursuant to the provisions of Sec. 80-13-39, Utah Code Annotated, 1943, jurisdic-

tion of the Tax Commission is hereby reserved to assert, and claim therefor is hereby in fact asserted at this hearing to redetermine the present deficiencies in an amount or amounts greater than the amount or amounts, notice of which has previously been mailed to the taxpayer, by computing such deficiencies on the entire net income of the Utah Division and not on some lesser proportion or fraction thereof."

Defendant's assertion of claim to compute plaintiff's Utah corporation franchise tax based upon the full 100% net income of the Utah Division has thus been clearly and specifically made at the rehearing on 1942 and at the hearing on the subsequent years. The claim has in no way been left to conjecture, inference or interpretation. It should also be pointed out and perhaps emphasized that the reserved right to increase the deficiencies is not related to a different "issue" from that previously considered by the Court in No. 7298. It is thus unlike the Boeing case where the increase of deficiencies was due to a separate and distinct issue of "future interests" which had not been raised in the Board below. In the case at bar the issue is "allocation." That was the issue before defendant originally in the case covering the year 1942. It was the issue before this Court in No. 7298. It was the issue before defendant on the hearing covering the year 1942 and subsequent years. It is the issue here on appeal again. Defendant has reserved its jurisdiction and the jurisdiction of the Court to allocate 100% of the Utah Division's net income to Utah if the facts and authorities so require and notwithstanding that by its

decision here on appeal the actual amount allocated to Utah is about 93%. Plaintiff's contention for 1942 is that the correct figure is 66.926%, which figure has been used by defendant in the original notice of deficiency. For the subsequent years plaintiff contends that the allocation to Utah should average about 64%.

Under the circumstances here presented and the pertinent authorities heretofore cited, it appears to be quite clear that this court has jurisdiction to modify defendant's decision here on appeal or to remand the case to defendant for further proceedings to permit the computation of tax based upon the full 100% net income of plaintiff's Utah Division. The basic reason for the Federal and Utah statutory provisions relating to claims for increased deficiencies over and beyond those contained in the original deficiency notices, rests essentially on a conception of fairness to the taxpayer in giving him adequate notice of the nature of the claim and an opportunity to present evidence thereon and to have such evidence considered before any redetermination is made. In the case at bar plaintiff cannot claim that it was surprised or prevented in any respect from giving evidence on the issue of the extent to which the net income of its Utah Division should be allocated to Utah. It was properly apprised of defendant's claim for a full 100% allocation on the first day of the hearing and the record is voluminous with plaintiff's testimony showing that the

amount of the Utah Division's net income to be allocated to Utah should be not 100% nor 93% nor 80%, but a percent which will average about 64% for all of the years involved.

With respect to the proposition that this Court has full and complete jurisdiction under the circumstances here existing to modify the decision of defendant or to remand the proceedings with directions to redetermine the deficiencies in tax either by way of a decrease or by way of an increase in such deficiencies we refer the Court to the following cases.

In *Olds and Whipple v. United States*, 22 F. Sup. 809 (1938) (Court of Claims), the court stated at page 818:

“A third reason for denying this contention is that when a case decided by the Board is appealed to and reversed by the Circuit Court of Appeals such court is not limited by the provisions of Sec. 274 (e) and 272 (e) of the Revenue Acts of 1926 and 1928 in the decision of the issues raised on appeal by the taxpayer. Section 1003 (b), 26 USCA Sec. 641 (c) (1), provides that upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require. If justice requires that issues raised by the taxpayer on appeal be decided and if such a decision results, as it did in this case, in deficiencies in excess of those determined by the Board, the tax-

payer is in no position to complain. The provisions of the statute with reference to the determination of increased deficiencies were obviously intended to protect the taxpayer against the assertion of the increased deficiencies by the commissioner in excess of those determined by him in the statutory deficiency notice and against a determination by the Board of increased deficiencies by reason of a decision on matters of which the taxpayer has not been advised and not raised by either party before the Board. It would be a strained construction of the section to hold that it was intended to protect the taxpayer against his own deliberate acts or the natural and necessary consequences of a correct decision of the issues raised by him.

“The fourth and final reason which requires a decision against plaintiff on its contention made in support of the third alleged cause of action is that if it be assumed that the Board upon the opinion and mandate of the Circuit Court of Appeals did not have authority or jurisdiction to enter the decision of Nov. 20, 1935, or the increased deficiencies for 1927 and 1929, unless claim therefor was made by the commissioner at or before the final hearing, a proper claim by the commissioner for the increased deficiencies of \$15,234.67 for 1927 and \$330.01 for 1929 was made by the commissioner in sufficient compliance with the provisions of Sections 274(e) and 272(e) of the Revenue Acts of 1926 and 1928, respectively. . . . The filing of the recomputation pursuant to the order of the Board of Feb. 27, 1935, and the submission of the cases thereon to the Board for final decision was a rehearing within the meaning of Sections 274(e) and 272(e) of the Revenue Acts of 1926 and 1928. *The commissioner*

was therefore enabled at such time to make claim for the first time for increased deficiencies, and if his recomputation carried out the opinion and mandate of the Circuit Court of Appeals, which we assume it did and which is not denied by the petition in this case, he made a valid and legal claim for the increased deficiencies within the meaning of the sections in question."

Again in *Insular Sugar Refining Corp. v. Commissioner*, 157 F. 2d 673, (1946) (CCA 2), the Court stated at page 673:

"When this case was before us last year . . . , a majority of the court held that the Tax Court had been right except that it had mistakenly reversed the assessments, levying the deficiency properly assessable for the year 1935 in the year 1936; and vice versa. Since the deficiencies were not the same, this required a refund of part of the deficiency paid for the year 1935 and an increased deficiency for 1936. The taxpayer had sought to amend its petition before the Tax Court to conform to the facts; but apparently that court became confused and denied the application. In any case we held that its refusal was 'an abuse of discretion' and concluded our opinion as follows: 'the cause is remanded to the Tax Court with direction to amend its order to conform to the ruling here made.' Our mandate affirmed the order below; but remanded the cause to the Tax Court 'with direction to amend its order to conform to the ruling made in the opinion of this court.' This the Tax Court did by an order awarding a refund for 1935, and increasing the deficiency of 1936. *The taxpayer has appealed upon the ground that Section 272 (e) of the Internal*

Revenue Code, . . . , gives jurisdiction to the Tax Court to increase a deficiency only in case 'claim therefor is asserted by the commissioner at or before the hearing or a rehearing'; and, although the commissioner did assert a 'claim' by amending his answer to increase the deficiency for 1936, at the hearing held upon remittitur of our mandates, that was not a 'rehearing,' so that the court had no jurisdiction to execute our mandate.

"We cannot now see why we found it necessary to remand the case at all; Section 1141 (c) (1) of the Internal Revenue Code . . . , gives us power to 'modify . . . the decision of the tax court, with or without remanding the case for a rehearing, as justice may require.' It is true that the error was not of the kind which appeared upon the face of the record, and which may be corrected at the time; but plainly the section does not limit our powers to correcting such errors without a rehearing. *However, whether we had the power to correct this error without remand, we did remand it, and section 1141 (c) (1) certainly gave us power to remand the case for a 'rehearing' and perhaps only for a 'rehearing'. By what legerdemain the Tax Court became incapable of obeying our mandate "to amend its order to conform to the ruling made," escapes us. The theory appears to be that the merits have somehow become so enmeshed in a web of verbiage, that the taxpayer is to be relieved of paying what he concededly owes.*"

The Court's attention is likewise invited to the provisions of Section 80-13-47, U.C.A. 1943, which indicates that a decision of defendant may be reviewed by this Court both upon the law and the facts and that the

provisions of the Code of Civil Procedure relating to proceedings in the Supreme Court shall so far as applicable and not in conflict with the tax law be applicable to proceedings before this Court.

Rule 72(a) providing for appeals to be taken to this Court from all final judgments states:

“In equity cases the appeal may be on questions of both law and fact. In cases at law the appeal shall be on questions of law only.”

Rule 76(a) provides as follows:

“The Supreme Court may reverse, affirm or modify any order of judgment appealed from, and may, in case the findings in any case are incomplete in any respect, order the court from which the appeal was taken to add to, modify or complete the findings so as to make the same conform to the issues presented and the facts as the same may be found to be by the trial court from the evidence, and may direct the trial court to enter judgment in accordance with the findings when corrected as aforesaid, or may direct a new trial in any case, or further proceedings to be had. If a new trial is granted, the court shall 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.”

It would thus appear that the jurisdiction of this Court is fully as great and in fact substantially the same as that of a Federal Circuit Court of Appeal and the Supreme Court of the United States over decisions of the

Tax Court of the United States. It might even be urged, although the point is not here material, that the jurisdiction of this Court over defendant is somewhat broader than the jurisdiction of the Federal Court of Appeal over the Tax Court for the reason that our statute makes it quite clear that a decision of defendant may be reviewed both upon the "law and the facts." By the Dobson decision, 320 U. S. 489, the Supreme Court of the United States severely restricted the jurisdiction of the Circuit Courts of Appeal over the Tax Court with respect to both law questions and questions of fact. Congress repealed this decision by legislation effective Sept. 1, 1948, and the Federal statute referred to above now provides that the United States Courts of Appeals are authorized to review decisions of the Tax Court "in the same manner and to the same extent as decisions of the district courts in civil actions without a jury." This language might perhaps be construed as being a little narrower than the language of the Utah provision which states that the "decision of the Tax Commission may be reviewed both upon the law and the facts . . ."

Under this Point 2 we undertook initially to show and have shown that the Utah franchise tax must under the mandate of this court in No. 7298 and the pertinent statutes and authorities be based on the full net income shown and reflected on the separate books of account of plaintiff's Utah Division, that use of the method of direct allocation by separate accounting methods precludes and prevents application and use of the three-factor statutory

formula, that the out-of-state administrative, refining, transportation and marketing expenses should be and have been deducted and charged against the operations in Utah, that the intercompany arrangements between plaintiff and the sales subsidiary and A. S. & R. being fair, reasonable and arms-length must be recognized and respected by both plaintiff and defendant in this proceeding, that the separate corporate entity of the sales subsidiary cannot be set aside and ignored, that the operations of plaintiff's Utah Division and the operation of the sales subsidiary and A. S. & R. cannot be combined and consolidated under the consolidated return provisions of the Utah statute, that within the issue of "allocation" defendant has properly and in accordance with the statute and the mandate of this court in No. 7298 reserved the jurisdiction of defendant and this Court to compute the tax on the full 100% net income of the Utah Division of plaintiff and that on this appeal this Court should modify defendant's decision or alternatively remand the case to defendant with directions that none of the net income of plaintiff's Utah Division as shown and reflected on its separate books of account be apportioned outside the State of Utah. The tax based upon the law and the facts should be in an amount equal to 3% of the adjusted total net income for the years here involved shown on line 1 of tax computation schedule, page 193 of defendant's decision here on appeal.

POINT NO. III.

IF PLAINTIFF IS ENTITLED TO APPORTION SOME OF THE NET INCOME OF ITS UTAH DIVISION OUTSIDE UTAH, THE DECISION OF DEFENDANT IS MORE THAN FAIR AND SHOULD BE AFFIRMED.

Under this branch of the case we will undertake to show that if plaintiff is entitled to apportion some of the net income of the Utah Division outside Utah by virtue of the existence of an administrative office outside Utah, defendant's decision being fair and reasonable and not arbitrary should be affirmed. Plaintiff's argument under its Point 1 is an excellent presentation of its position in the matter. In assessing the validity and the soundness of this argument, however, some preliminary remarks appear desirable.

It will be remembered that plaintiff's argument is addressed to a construction of the Utah statute which will result in the apportionment outside Utah of 36% of the net income of the Utah Division to its New York administrative office, notwithstanding it is not shown or even claimed that any portion of this income has been taxed or is taxable in New York and notwithstanding that the selling business was conducted by separate companies. In its decision defendant as a discretionary matter applied the statutory formula to the separate accounts of plaintiff's Utah Division in computing the tax. The decision allocates about 6% of the property of the Utah Division outside Utah, 3% of the payroll of the Utah Division outside Utah, and 13% of the gross receipts

of the Utah Division outside Utah. The average of the 3 fractions thus allocates outside Utah about 7% of the net income of the Utah Division, 93% being allocated to Utah business. Plaintiff on this appeal raises no objection to the apportionment of 6% of the property, 3% of the payroll and 13% of the gross receipts of the Utah Division outside Utah. The contention is that in addition to the apportionment of the gold and silver receipts outside Utah, constituting 13% of total receipts, all receipts from copper, molybdenite, platinum and palladium as well should be apportioned outside Utah.

It is argued that the gross receipts from *all* sales must be allocated outside Utah and thus excluded from the gross receipts numerator because generally speaking (see page 29 of brief) none of the sales were negotiated or made within Utah, none of the persons concerned with sales worked out of offices in Utah, none of the products were delivered to customers within Utah, no sales activities of any character were carried on within Utah, and that to apportion any gross receipts from sales to Utah patently violates the intent of the apportionment statute when viewed in relation to the very substantial activities occurring outside of Utah in connecting with the production of net income from the Utah Division. Notwithstanding that the fair and proportionate share of the New York administrative expense has been deducted and charged against the Utah operation, and notwithstanding that the Utah molybdenite and commingled blister copper products are transferred at fair value to and for

resale by the sales subsidiary and A. S. & R., it is said that the Utah statute requires the sales business conducted and carried on by the sales subsidiary and A. S. & R. to be assimilated with and attributed to plaintiff's outside administrative office. Furthermore, even though the sales subsidiary and A. S. & R. by intercompany contract have been allocated and given a fair profit for conducting the selling business, it is felt that the Utah statute decrees that 36% of the net income of the Utah Division be attributed to the administrative work performed outside Utah by plaintiff's New York office.

The mandate of this court in No. 7298, requiring a computation of tax on the basis of the separate accounts of plaintiff's Utah Division under the provisions of subdivision 8 of the Utah statute, and the applicable authorities heretofore considered under defendant's Point 2 have shown that the tax properly should be computed on the basis of the full 100% net income of the Utah Division. An apportionment of 93% of net income to Utah is not arbitrary or error where the authorities and statutory provisions show that the proper apportionment should have been 100%. Without in any way conceding or admitting that the apportionment should be in any amount less than 100%, we take up the argument here to show that even if plaintiff is entitled to application of the statutory formula to its Utah Division's separate

accounts, defendant's decision is proper and in every respect fully complies with the statutory formula provisions of the Utah statute.

It might be helpful to the Court in the ascertainment of the meaning and intent of the Utah apportionment formula to consider for a moment the underlying theory of apportionment formulas generally. On page 32 of its brief plaintiff cites Altman and Keesling, *Allocation of Income in State Taxation* (2d Ed. 1950) for the proposition that the sales factor serves the purpose of balancing the property and payroll factor by giving weight to the elements which are not reflected by the property and payroll factors. We further invite the Court's attention to Chapter VI of the above cited treatise which is entitled "Theory of the Apportionment Formula." This chapter, page 107, first states:

"As discussed in the preceding chapter, even though a taxpayer may be doing business in two or more states, where the business in any state is separate and distinct from the business in the other state, the income attributable to such state may properly be determined by the so-called separate accounting method."

Thereafter follows a general discussion of the appropriate use on the other hand of the statutory formula where the business within the taxing state is integrated with the taxpayer's business in other states to such an extent that the net income from operations within the taxing state cannot by separate accounting methods be

properly segregated from outside operations. In such a case net income arising from operations in the several states may be apportioned to the taxing state by formula.

At page 110 the property factor is discussed and it is pointed out that under our business system capital is generally considered an income producing factor which to the extent at least of the taxpayer's actual capital investment should be taken into consideration in an apportionment formula. A discussion of the payroll factor commences at page 122, where it is stated that the use of the payroll factor is the easiest of all factors to justify on theoretical as well as practical grounds. It is stated: "There can be little question that without the services of human beings it would be utterly impossible to conduct business or to earn income." A discussion of the sales factor commences at page 124, where it is stated:

"In direct contrast with the payroll factor the use of the sales factor is one of the most difficult of all to sustain. The principal objection to the use of the sales factor is the difficulty of determining how sales should be allocated. There are any number of possibilities of which the following are a few: *The place where title passes; the place where the products sold are manufactured or produced; the place where orders are solicited; the place from which the goods are shipped; the place where orders are received; the place where orders are approved; the place from which the order is sent; and the place to which the goods are shipped.* There are still other possibilities. Thus, in the case of companies engaged in the transportation

of passengers or freight, it is common to apportion receipts on a mileage basis. A similar rule is often followed in the case of companies engaged in the operation of telephone and telegraph lines. Still another possibility is to apportion sales to the office *where the transaction is "principally" consummated*. Another possibility would be to divide certain classes of sales and apportion them *in part to one state and in part to another*. In any given case, which of these or other methods should be used?

"As will be seen later, there is a wide discrepancy between the practices of the different states using the sales factor in the apportionment formula."

After discussing the various conflicting considerations and the difficulties involved in the application of a sales factor, the authors state: "In view of the foregoing difficulties, it may well be asked, why use the sales factor?" It is then suggested that its use, as indicated by plaintiff, is justified to serve as a balance of the property and payroll factors.

Chapter VII is entitled "Allocation Formulae in Practice" and shows the wide variation among the various states in their statutory provisions and practices with respect to allocation formulas. Also set forth are brief summaries of the apportionment formulas used by each of the several states.

The attention of the Court is likewise directed to annotation entitled "What constitutes business, business

done, or the like, outside the state for purposes of allocation of income under tax laws, 167 ALR 943. This article discusses the matter of sales outside the state or to out-of-state buyers and shows again the wide variation of practice among the states, particularly with respect to the sales factor under statutory formulas of apportionment. A study of the formulas used by the various states would reveal quite clearly, it is suggested, that the apportionment formula adopted by any particular state seems to have been adopted by reference to the specific economic situation of that state. This is particularly true with respect to the sales factor. A consuming state has a tendency to adopt a sales factor which would allocate the sale to the point of delivery or consumption. A producing state would have a tendency to allocate the sale to the point of shipment or manufacture. A mercantile state would have a tendency to allocate the sales to the place where the orders are accepted or where other work connected with the sale is done. The result of the various conflicting formulae and the variation of practice among the states is that sales may be allocated to more than one state. This raises, however, no constitutional objection providing the state has a formula of apportionment in the statute, "crude approximation" being sufficient. The evil consequences of overlapping statutory formulas are to a considerable extent in most of the states alleviated by provisions similar to subdivision 8 of the Utah statute, which permit a modification of the statutory formula where the taxpayer is able to show that application of the formula results in double taxation

or does not properly reflect net income from business done within the state. Use of the method of direct allocation by separate accounting is likewise designed to avoid problems of double taxation and the taxation of business attributable to activities outside the taxing state.

Of the various types of sales factors which it might have chosen, Utah saw fit to select the same sales factor which is used by the states of Massachusetts and Pennsylvania. Massachusetts and Pennsylvania, as is well known, economically are primarily states of production and manufacture. The goods produced within those states are marketed throughout the entire country and elsewhere. Both states as a matter of revenue protection to themselves adopted a rather strict but fair sales factor. All receipts of a taxpayer from sales are allocated to the state unless the taxpayer shows not only that he is "doing business" outside the state but also that the sales business is being conducted outside the state in an office of the taxpayer actually maintained outside the state and from which office the sales are negotiated and effected in behalf of the taxpayer. It is not enough as it is in several states, that the sales are negotiated and effected outside the state by a roaming sales force of the taxpayer. It is also a statutory prerequisite that this sales force be negotiating and effecting the sales in behalf of the taxpayer from an out-of-state office maintained by the taxpayer with which the force is connected, situated or dispatched.

Is the position of plaintiff on this appeal that the phrase "in behalf of the corporation" should not be construed as requiring the sales to be negotiated and effected by an agent in the name of his principal, the taxpayer, and in the regular course of the taxpayer's business. It is deemed to be a sufficient compliance with the law that the agent although an independent broker, factor, commission merchant or distributor is selling and marketing the goods out-of-state. Defendant, on the other hand, construes the phrase "negotiated or effected in behalf of the corporation by agents" as clearly meaning that the agent must be acting and operating *representatively and in the name and behalf of the taxpayer corporation*. It is defendant's position that if the agent as broker, factor or commission merchant sells in his own name and behalf and in the regular course of his own business and calling, the statute does not permit the exclusion of such sales from the gross receipts numerator. We will undertake hereafter to answer the specific objections of plaintiff to defendant's construction of this statute. We emphasize at this time, however, that defendant's construction rests upon the very basic common-sense business conception that sales business outside the state under the statute means sales business conducted by the taxpayer corporation outside the state. The whole idea of the Utah statute is to tax net income attributable to business done within the state. If the selling business outside the state is conducted by another corporation, the selling activity outside Utah is not business done by the taxpayer outside Utah.

Plaintiff seeks to distinguish the large group of cases holding that a corporation producing goods within the taxing state is not entitled to an apportionment of income within and without the state where the goods are marketed outside the state through independent brokers, factors or commission merchants. Such cases hold specifically and uniformly that the marketing of goods through independent brokers, factors or commission merchants does not constitute the doing of business outside the producing state. The attempt to distinguish these cases is based on the fact that plaintiff happens to maintain an administrative office in the state in which the selling business is transacted and conducted by other companies. The business of the selling companies thus becomes, it is felt, combined, assimilated and consolidated with the business activities of the administrative office. On this theory the sales business thus becomes conducted and transacted *by the administrative office* outside Utah with the same force and effect as if the broker, factor or commission merchant did not exist.

Any disinterested look at the tax computation (F. page 193) of defendant here appealed from shows on its face a clear and obvious liberality to plaintiff. No question has been raised as to the specific assignment to Utah of the loss of \$950,877.67 before arriving at the net income subject to apportionment, nor to the assignment of 6 per cent of the property outside consisting primarily of inventory in transit to market, nor to assignment of 3 per cent of the payroll outside consisting of New York

administrative expense and the further allowance of such expenses as a deduction, nor to the assignment outside of 13 per cent of gross receipts from sales of gold and silver, nor to the allowance in full as a deduction of all payments to A. S. & R. as expense. In allocating 7 per cent of the net income of plaintiff's Utah Division to the New York administrative office, as applied to about \$230,000,000 of total net income, defendant has thus allocated to the New York office and treated as non-taxable in Utah over \$16,000,000 of net income.

Plaintiff feels, however, that the existence of the administrative office in the same state as that in which the selling companies sell the Utah Division product requires the exclusion from Utah of 36% or over \$82,000,000 of the net income of the Utah Division. 36% of the Utah Division's net income on plaintiff's theory is supposed to have been earned by the relatively small administrative staff located in plaintiff's New York office. Under the pertinent authorities, such a result appears to constitute a gross if not incredible distortion of the Utah statute. From a practical business standpoint, it is difficult to see how to the administrative payroll of 3% in New York is possibly attributable 36% of the profit of the marketable molybdenite and blister copper product of the Utah Division which moves out of Utah each day for sale by other companies. If plaintiff itself conducted the selling business in New York in its own name and from its own premises by means of a sales department within its own organization, negotiating and

executing the contracts of sale of copper and molybdenite in its own name, dealing with the customers and collecting receipts from sales in its own name and in the regular course of its own business, a different question would obviously be here presented. The administrative office of plaintiff in New York, however, has not and never has negotiated or effected the sale of a single pound of copper or molybdenite in behalf of the plaintiff corporation. The selling business conducted by separate and distinct corporations cannot be attributed to the administrative work conducted by plaintiff in its New York administrative office. It is here in Utah that plaintiff has its large capital investment, where the mine is located, where the activities of 5,000 employees convert a raw crude ore into marketable molybdenite and blister copper. The income is earned from the industrial operation of producing metal, not from New York administrative services.

The statutory test for the assignment of payroll within and without the state is essentially the same as the statutory test for the assignment of gross receipts from sales within and without the state. The statute says that there shall be assigned to the state wages, salaries, commissions or other compensation to its "employees" as represents the compensation of employees not chiefly situated at, connected with, or sent out from, premises for the transaction of business owned or rented by the corporation outside the state. Plaintiff makes no claim or suggestion here that the "commissions" to the

sales subsidiary constitute a part of out-of-state payroll. In fact, it will be recalled, for tax purposes plaintiff added such commissions back into income deducting estimated expenses of the subsidiary instead.

The statute under the gross receipts fraction assigns to Utah the amount of the corporation's 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, and sales otherwise determined by the tax commission to be attributable to the business conducted on such premises." Thus, under the payroll fraction, the statute speaks of "commissions" to "employees." Under the gross receipts fraction the statute speaks of sales "negotiated or effected in behalf of the corporation by agents." Although the word "employees" is not used in the gross receipts fraction, it is suggested that "agents" although a broader term for some purposes is here used in much the same context and with the same meaning as "employees" under the payroll fraction to the extent that the agents as described must be acting "in behalf of the corporation." The phrase "in behalf of" means, as we shall hereafter see, "in the name of" and covers the situation where the agent is acting not individually in the regular course of his own business, but representatively on behalf of the corporation. The dis-

tion in the statute is thus essentially dependent upon whether the "agent" is conducting his own business individually or conducting the taxpayer's business representatively.

In other words, the question under the statute is essentially this—whose business is it? Is it the taxpayer corporation's business or is it the separate business of the agent? Pertinent judicial decisions in construing the statute plainly hold that sales of a corporation outside the state of production by independent brokers, factors or commission merchants is not business done by the corporation outside the state so as to require an apportionment of income within and without the state. This construction, illustrated in the decisions, rests on the obvious practical view that a corporation is only entitled to allocate a part of its net income to its sale activities outside the state if, but only if, the selling activities outside the state are performed by the corporation itself.

Although we will hereafter take up plaintiff's argument point by point in detail with respect to the gross receipts factor, it is apparent that the basic framework of plaintiff's case rests upon the argument (page 35 of brief) that the sales of the Utah product are made entirely outside Utah, to buyers located outside Utah, through persons operating at or from offices permanently located outside Utah, and that no selling activities of any character took place in Utah or were carried on by persons within or operating from or under the supervision or direction of plaintiff's offices within Utah.

The short answer, of course, to this argument is contained in the numerous constitutional cases cited under defendant's Point 1. These cases made it abundantly clear that the state of production or manufacture has a very special and unique claim for a tax laid on the privilege of conducting a local manufacturing or production business, even though a tax on such privilege be measured by the gross receipts from out-of-state sales. Moreover, our statute is perfectly plain in its intent to apportion gross receipts from sales outside Utah only where the taxpayer engages itself in a selling business outside the state from which such gross receipts are held by the statute to be in part earned and realized. The statute only permits $\frac{1}{3}$ of the net income by the gross receipts factor to be allocated outside the state where the taxpayer engages in the business of selling outside the state from premises maintained outside the state.

It is, therefore, not enough under our statute for plaintiff to show that the sales of the Utah product are made outside the state. The goods originate in Utah, commence their interstate journey in Utah and the selling activity is conducted and transacted by a separate and distinct corporation, the sales subsidiary. The statute does not permit defendant to assign sales receipts to Utah only where it establishes that the taxpayer is conducting the sales activities in Utah. The statute says that the sales receipts are assignable to Utah unless the taxpayer establishes that the sales are negotiated and effected in its behalf from its out-of-state premises, i.e., that it is doing a sales business outside the state.

We turn now to the consideration, here very important, of the legal and tax status of independent brokers, factors and commission merchants. Are they, under the authorities and within the meaning of our statute, carrying on their own business or are they carrying on as plaintiff contends the business of their principal?

As a preliminary matter, we again invite the Court's attention to the standard form of contract covering all sales of copper by the sales subsidiary (F. page 71) which reads: "Kennecott Sales Corporation, hereby agrees to sell and deliver and Triangle Conduit and Cable Company, Inc., New Brunswick, N. J. agrees to purchase and receive the products on terms and subject to conditions specified below."

We also refer to defendant's findings with respect to the status, function and activity of Kennecott Sales Corporation. (Page 140 of Findings, et seq.) Among these findings, at page 147, is the following:

"g. The Sales Corporation was employed by Kennecott as a commercial agent and vested and entrusted under appropriate instructions and arrangements with the right of possession, disposal and control of all copper and molybdenite produced by Kennecott for the purpose of selling such property, at an agreed commission or compensation, in the name and pursuant to and in the usual course of trade or business of the Sales Corporation and authorized to receive payment for such sales from the purchaser thereof. We hold

and find that the Sales Corporation was in fact and functioned as a factor or commission merchant with respect to all sales of copper and molybdenite during the period here involved."

Prentice-Hall, State and Local Tax Service, Vol. 1, All States Unit, Para. 7500, states:

"Another method is to consign goods to a factor in the state whose business is to sell the goods to his customer and account to his principal according to the terms of his contract . . ."

Paragraph 7501 reads as follows:

"Consigning goods to a factor in another state is interstate commerce. — A contract of factorage is one whereunder one party, called the consignor, places in the hands of the other party, the consignee or factor, goods which, while they are still in the latter's hand, remain the property of the consignor. The factor is to sell such goods to his customer in the state, paying to the consignor for the goods so sold a price fixed by the 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. *The business done in the state is entirely that of the factor.* When he makes a sale of the consignor's goods in the state, what really takes place is this: The factor purchases the goods from the consignor and resells them to his customers. In *Mitchell Wagon Co. v. Poole*, the court said: 'The contract here provided for the bankrupt becoming purchaser in several contingencies. One, was when he sold the wagons. This follows from the fact that he had a right to sell on such terms as to price and time of payment as he liked, but was bound, if he sold, to pay appellant for them at a fixed

price at a fixed time, and the proceeds of the sale were to be his. *A sale by him was, in effect, a purchase and a resale.* . . . In *Cooper Rubber Co. v. Johnson* the Court said: "The terms "factor" and "commission merchant" are said to be nearly or quite synonymous; the former expression being more common in the language of the law, and the latter in the language of commerce. A "factor" is one whose business is to receive and sell goods for a commission, being entrusted with the possession of the goods to be sold, and usually selling in his own name. 1 Mechem on Agency, Secs. 74, 2497, et seq. While in one sense a factor or commission merchant is the agent of the consigning dealer or manufacturer, he does not conduct an agency for business for the latter at the place of business of the former, where the sales of the consigned merchandise are made to customers chosen by the local dealer, at his own risk, and the proceeds of the sale do not become the exclusive property of the consigning company. And business so conducted is truly said to be that of the factor or commission merchant." Where the consignor is a foreign corporation sending goods on consignment to the factor from without the state, such corporation is engaged in interstate commerce."

Although the sales subsidiary is here not a "del credere" factor in that it did not guarantee accounts for collection, it was in every respect under and by virtue of its contractual arrangements with plaintiff a usual and normal type of commission merchant, as the findings of defendant at page 60 et seq. clearly show.

We quote the findings, page 64:

“p. The American Smelting and Refining Company or anyone holding any copper of Kennecott for delivery is authorized, upon demand made by the Sales Corporation to make deliveries to the Sales Corporation or its order of such copper.”

Again at page 33 is the following:

“By arrangements entered into between Kennecott and the Sales Corporation which have been accepted, recognized and followed by A. S. & R., Kennecott has entrusted the Sales Corporation with authority to sell all of the refined copper produced at the Baltimore refinery of A. S. & R. or other refinery, and with the right to possess and control such copper for the purpose of sale and to issue instructions to A. S. & R. or others pertaining to the casting, storage, handling and shipment, sale or other disposition of such copper and with the right to receive payment from the customer of the purchase price thereof.”

The status of brokers, factors and commission merchants is well recognized both in the law, in business and in the administration of state tax laws. Much of the agricultural and livestock production in Utah is marketed outside the state through this medium. For example, cattle, sheep, wool and fruit are to a large extent so marketed. Conversely, many of the products consumed in Utah and produced in other states are marketed here in Utah by means of brokers, produce merchants, factors and commission merchants. Although selling the goods

of their principal, the business done is not the business of the principal, but their own business. They are the ones who sell to the customer in the market. For example, Reg. 45 under the Sales Tax Law provides:

“Every auctioneer, consignee, bailee, factor, etc., entrusted with possession of any bill-of-lading, customhouse permit, warehouseman’s receipt, or other document of title for delivery of any tangible personal property, or entrusted with possession of any such personal property for the purpose of sale, is deemed to be the retailer thereof, and upon the sale of such property is required to file a return on the selling price and pay a tax thereon. . . .”

Again Regulation No. 6 under the Corporation Franchise Tax Law provides in part as follows:

“Application of corporation franchise tax act to foreign corporations selling merchandise to customers in Utah.

“In general, foreign corporations which have neither agents nor stocks of goods in Utah, and which engage in no other activities here, are not doing business in this state and are, accordingly, not taxable under the Corporation Franchise Tax Act, even though goods are shipped to customers in this state pursuant to order received by mail, telephone or telegraph. *Such corporations are likewise not subject to the tax, even though sales are made to customers in this state pursuant to orders taken by independent dealers (factors) or by brokers,* 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.

“(a) Whether or not orders taken for sales are made by an agent, or by an independent dealer, or by a broker must depend upon the facts of each particular case. *In general, if a person acts only for one company and takes orders and makes sales in the name of that company or otherwise purports to represent that company, he is acting as an agent and his acts are the acts of the company. Conversely, if a person purports to be doing business on his own account and not as a representative of some other party, the person is generally acting as an independent dealer.* Finally, if a person is acting as a representative and not in his own behalf but purports to be representing several other parties, his activities are generally those of a broker. . . .

“(d) Foreign corporations do not become subject to the tax imposed by the corporation Franchise Tax Act, because they send goods to independent dealers or brokers on consignment, or because they maintain stocks of goods here from which deliveries are made pursuant to orders taken by independent dealers or brokers.”

Thus the sales subsidiary in selling the Utah product of plaintiff is conducting its own business and not that of plaintiff even though in a sense every broker, factor or commission merchant is an “agent.” The point here, however, is that the factor is not an agent acting in his principal’s behalf and in the name of his principal — he is acting in his own name and behalf and in the regular course of his own business. See: *Gwin, White & Prince v. Henneford*, 305 U.S. 434. The activities of the sales subsidiary either in New York or in any other state in which

it might qualify to do business would not constitute the conduct by plaintiff in such states of a selling business. The selling business would be attributable solely and exclusively to the activities of the sales subsidiary. The selling business would in no wise be attributable to plaintiff. Plaintiff as a result of the sales subsidiary's activities in either New York or elsewhere runs no risk of having the sales subsidiary's activities imputed to it for tax or other purposes.

We refer the Court to the discussion under the heading "Sales to Broker or Factor" contained at page 956 of annotation in 167 A.L.R. 943. It is there stated:

"A taxpayer cannot be deemed to be doing business outside the state so as to require an allocation of income where it merely sells its product outside the state through cooperative marketing associations and independent produce brokers or factors, even assuming that the association or brokers are agents of the taxpayer."

The California case of *Irvine Company v. McColgan*, 167 ALR 934, 157 P. 2d 847 (1945), is referred to.

The above annotation refers to the decisions of this Court with respect to the question whether out-of-state broker sales constitute out-of-state business and states the ruling of the Supreme Court of Utah to be that such sales do not constitute out-of-state business for franchise tax purposes. The annotation reads, page 957:

“The decision in *American Invest. Corp. v. State Tax Commission* (1941) 101 Utah 189, 120 P. 2d 331, that a sale, by a foreign investment corporation doing business within the state, of shares of stock in two other foreign corporations through an out of state broker was out-of-state business was over-ruled in a case involving ordinary income of an investment company in *J. M. and M. S. Browning Co. v. State Tax Commission* (1945) 107 Utah 457, 154 P. 2d 993 . . . wherein it is also said that buying and selling stocks and bonds does not constitute doing business.”

Of significance here is the following statement at page 954 of the above annotation:

“In the absence of a statute allocating to out-of-state business sales negotiated or effected through *a sales office maintained out of the state*, there is little logical basis for making a differentiation based solely on whether the taxpayer maintains *a sales office* out of the state or merely sends a salesman out of the state to do the same work that might be done through *a branch sales office*.”

The above quotation it will be noted interprets the Utah type of statute as requiring the maintenance of a “sales office” outside the state from which the out-of-state sales are negotiated or effected by the corporation’s salesmen. This is precisely defendant’s point here, namely, that plaintiff although maintaining administrative offices, does not maintain in New York a sales office.

In the following discussion we ask the Court to assume, contrary to the Cottonwood Coal Co. Case and the numerous cases cited under defendant's Point 2 with reference to direct allocation by separate accounting methods, that plaintiff by virtue of its New York administrative office is thereby doing business in New York so as to require an apportionment of net income outside Utah. This was the assumption made in defendant's decision by its computations of the payroll, property and gross receipts fractions. With respect to the sales factor we refer the Court to the discussion in the A.L.R. Annotation, 167 at page 958 under the sub-heading "Express Statutory Provisions as to Sales." The statutory provisions as to sales allocation are substantially the same in the states of Utah, Massachusetts and Pennsylvania. Although the problem of the sales factor was before this Court in the case of California Packing Corporation v. Commission, 97 Utah 367 (1939), the matter has been considered more frequently by the appellate courts of Pennsylvania and Massachusetts.

We quote from the above annotation at page 960:

"Where an out-of-state sales office made sales within the state which were filled from a branch within the state, and the state appellate tax board found as a fact that such sales constituted sales negotiated through the out-of-state office so as to be excluded from taxation under such a statute, the decision was affirmed in Commissioner of Corporations and Taxation v. Ford Motor Company (1941) 308 Mass. 558, 33 NE 2d 318, in view of another statute making the board's findings of

fact final. Conversely, where orders negotiated by the local branch of the corporation with local buyers were filled by an out-of-state branch, it was held that the sales were properly classified as sales made within the state.

“And it was held under such a statute, in *Com. v. Electric Storage Battery Co.* (1941) 51 Dauph Co. Rep. (PA) 90, that a sale is to be assigned to the out-of-state office which negotiated and concluded it, even though the goods were manufactured within the state and orders therefor were filled from several warehouses within and without the state.

“But in *California Packing Corp. v. State Tax Commission* (1939) 97 Utah 367, 93 P. 2d 463, a three to two decision, the majority of the court practically rewrote the portion of the statute quoted, *supra* this sub-division, saying that it should read: ‘Negotiated or effected in behalf of the corporation by agents or agencies chiefly situated at, connected with or sent out from premises owned or rented by the corporation, for the transaction of business outside of this state.’ And the majority construed the statute, as thus rewritten, saying: ‘It excepts from sales the income of which is used in computing the tax those which may be handled from offices or premises within the state to a purchaser without the state for shipment out of the state, if made by an agent of the company chiefly engaged in out-of-state sales and business. Sales otherwise made of goods within the state for shipment out of the state are deemed to be sales made and business done within the state, and enter into the income from which the tax is computed. This construction makes the question of the exception of proceeds of a sale of goods

within the state depend upon where the sale is made rather than upon the home office of salesman. This more directly covers business done within the state.' But the minority thought that the legislature had clearly indicated its intention to make the locus of the sale depend upon the location of the office out of which the salesmen work, and pointed out that ordinarily such a formula did rough justice. It might be added that the construction adopted by the minority has the virtue of being practical from an administrative point of view, for the state has only to add up total sales of the local office and that is the end of it; but under the view of the majority the state must first determine whether each salesman is engaged chiefly in work within or without the state and, if most of his work is without the state, whether each sale was made within or without the state, and the cost of such an administrative investigation may often exceed the tax to be collected. The Pennsylvania Tax Court disapproves the majority opinion in this case in *Com. v. Bayuk Cigars* (1941) 50 Dauph Co. Rep. (Pa.) 243 (Rehearing denied (1941) 51 Dauph Co. Rep. 140, affirmed in (1942) 345 Pa. 348 28 A. 2d 134, affirmed in (1943) 318 US 746, . . .; and in *Com. v. Charles S. Walton & Co.* (1942) 53 Dauph Co. Rep. (Pa.) 279."

A brief discussion of the California Packing Corp. Case appears unavoidable. It is cited by this Court in its opinion in No. 7298, and by plaintiff in its brief (pages 26-27, 36 and 53) generally for the proposition that the Utah law seeks to avoid double taxation and to levy a tax with respect to business done only within the state, and that under neither the majority or minority opinions

should any sales be assigned to Utah which are not negotiated by personnel operating from offices in Utah.

We feel it necessary to point out that plaintiff relied primarily upon the California Packing Corporation case before this Court in No. 7298 in support of its claim to a calculation of tax on the basis of the statutory formula as applied to its total operations. This Court held, however, that this plaintiff's tax should be computed not on the basis of the statutory formula but on the basis of the separate accounts of plaintiff's Utah Division. This Court in its opinion in No. 7298 cited both the majority and minority opinions in the California Packing case as establishing the right of defendant to depart from the statutory formula and assess the tax under subdivision 8 of the Utah statute on the separate business done by plaintiff's Utah Division.

To see what, if any, relevance the California Packing case has to the allocation problem in the case at bar, it is necessary to turn to the facts of the case. It appeared that the Packing Company in filing its franchise tax returns used the three factor formula in the statute and allocated to Utah some property and some payroll. In the sales fraction, however, it showed \$55,511,789.30 of total sales none of which were assigned to Utah. The sales fraction was thus zero as plaintiff contends it should be here in the case at bar. The Packing Company allocated no sales to Utah "since none of the goods were sold by salesmen or agents sent out from premises within the

state of Utah." In auditing the return the Tax Commission allocated to Utah sales in the amount of \$2,122,110.26 which represented "the sales of goods which were stored in Utah at the time of sale although such sales were made by agents sent out from the California offices of the company." The Tax Commission, before the Court, sought to justify this adjustment of the gross receipts fraction under subdivision 8 of the statute. The majority opinion states at page 372:

"The amount shown as No. 3, total gross receipts in Utah, includes sales of goods which were stored in Utah at the time of sale regardless of whether the sales were made to Utah concerns or to concerns in other states.

"Should the income from sales of produce manufactured or stored within this state be allocated to income attributable to business carried on within this state when such sales are made for the company by an agent sent out from the California office?"

After construing the statute as indicated above in the A.L.R. annotation, the Court went on to state at page 374 as follows:

"This construction also puts into the income of business done within the state the proceeds of sales of goods manufactured or stored within the state but sold for shipment out of the state, where the sale is made through a broker or jobber within the state rather than through an out-of-state agent or employee of the company. We repeat, the exception goes only to sales to an out-of-state party when the agent of the company making

the sale is chiefly connected with out-of-state business and such others made from premises maintained for out-of-state business as the Tax Commission may determine to be attributable to business done out of the state."

Again at page 375, with the exception of an order by a St. George merchant on a Salt Lake warehouse filled by a delivery from a Las Vegas, Nevada, warehouse, the Court states:

"The section thus provides that the receipts from business assignable to the state shall be determined from three factors: (a) Sales of goods manufactured or stored within the state, less the exception noted above . . ."

The result of the majority opinion was to yield "in the main results closely akin to those which the commission sought to accomplish by departing from the statutory formula." (page 379)

The dissent in the minority opinion was placed on the ground that the statute "means just what it says" (page 390), and the Supreme Courts of Pennsylvania and Massachusetts have followed the construction of the statute as set forth in the dissenting opinion.

In a strict sense the California Packing Corporation case is completely distinguishable from and has no application to the case at bar whatsoever for the reason that the sales employees operating out of the California "offices of the company" were selling the goods manu-

factured or stored in Utah "to Utah concerns or to concerns in other states" in the name and in behalf of the company itself. In other words, the goods were not being sold by an affiliated sales subsidiary or by A. S. & R. or by some other separate and distinct company or by independent brokers, factors or commission merchants. The Packing Company was thus *manufacturing and selling* its own goods in the regular course of its own business.

Although the majority opinion seemed to indicate that the test under the statute should be, not the home office of the salesman, but whether the agent was "chiefly engaged in out-of-state sales and business," the opinion goes on to state that "*this construction makes the question of the exception of proceeds of a sale of goods within the state depend upon where the sale is made rather than upon the home office of the salesman.*"

Furthermore, the dissenting opinion in discussing this "drastic" revision of the statute, stated at page 386:

"Before transposition the test of accepted sales was whether they could be credited to agencies outside of Utah, i.e., agencies or agents accredited to premises outside of Utah. *After the transposition the test is whether the sales which are accepted were made out of the state.*"

Although the minority raises certain constitutional doubts about certain possible applications of the gross receipts factor as contained in the law, the cases cited heretofore under defendant's Point 1 and the several

decisions in Massachusetts and Pennsylvania and particularly the Bayuk Cigars case which was affirmed by the Supreme Court of the United States clearly and definitely sustain the constitutionality of the Utah statute both as it stands in the books and as applied here to plaintiff.

If we assume that the California Packing Corporation case is still law in this state, under neither the majority nor the minority opinion would selling activities outside the state by independent brokers, factors or commission merchants appear to require an apportionment of income outside Utah. However, to the extent that the California Packing case is interpreted as discarding the statutory test in the law and adopting in lieu thereof the sole test of whether *the sale was made outside Utah*, the decision has subsequently been clearly if not expressly over-ruled by this court in the J. M. and M. S. Browning Co. case.

The opinion in *American Investment Corporation v. State Tax Commission*, 101 Ut. 189 (1941) points up clearly the conflict of view on this question within the Court. The majority opinion, page 201, states:

“Do the proceeds from the sale of the oil stocks represent receipts from business done in Utah? It does not appear that anything with respect to the sale of this stock was done in Utah. *These stocks were sold on the New York stock exchange by a member of that exchange in New York.* They were not sold in Utah nor under any

right of the plaintiff to do business in Utah. A sale made within the state is business done within the state. *A sale is made without the state to another person without the state and by an agent chiefly engaged in out-of-state business is not business done within the state.*"

The opinion relies upon the California Packing case for the above and then continues:

"The legislature adopted a method of taxation which meant to reach only the profits earned within this state. *The general criteria for determining the place of sale in cases of executed contracts of sale is the place where the title to the property passes to the buyer as between himself and the seller.*"

The dissenting opinion at page 207 with respect to the point here involved states:

"Further, by the prevailing opinion, if a local broker with New York connections sells stock for plaintiff, in N. Y., the income is not taxable, but if such broker consummated the deal in Utah, the income would be taxable. It is clear that the opinion fails to understand that the business of the Idaho corporation or the oil companies in earning a surplus and declaring dividends is an entirely different business from plaintiff's business of owning stock and receiving dividends, and that in this case the franchise covers the latter type of business. Equally clear is it that the opinion fails to distinguish the business done by the broker in New York and that done by plaintiff here in placing the stock with the broker for sale, and receiving the returns therefrom."

Except for its well substantiated position under Point 2 requiring the franchise tax to be based upon the income shown by a direct allocation of separate accounting which position is in accord with the mandate of this Court in No. 7298, defendant would here be having obvious difficulties if the majority decision in the American Investment Corp. case in its interpretation of the California Packing case and the statute were still law. If stock sent from Utah to a New York broker for sale by the broker in New York is not business done within Utah solely because "title to the property passes to the buyer" in New York, plaintiff's argument here that sending its copper and molybdenite to New York for sale in New York by the sales subsidiary is not business done within Utah would have considerable merit.

However, in *J. M. & M. S. Browning v. State Tax Commission*, 107 U. 457 (1945), the previous minority view became the law and insofar as defendant's position here or generally in administering the statute is concerned, the statute "means what it says." On page 466 of the opinion it is stated:

"The only thing that can be noted as having been done in another state is the holding of rental properties and possibly the buying and selling in other states of stocks and bonds."

Again,

“It follows that all of the income from conducting its investment business was derived from business done in Utah. The holding of the Tax Commission in this regard must be affirmed. Insofar as the American Investment Co. v. Tax Comm. case, *supra*, is to the contrary, it is hereby expressly over-ruled.”

Also of significance here is the statement of the court at page 463:

“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 is almost totally destroyed.”

Again at page 465:

“The test as to whether a corporation is doing business in states other than Utah under particular fact situations would therefore be: Would such conduct if carried on in Utah be held to constitute doing business so as to subject the corporation to the Utah corporate franchise tax.”

Just as the Court in the Browning case felt the question to be whether the plaintiff there was conducting an “investment” business in a state other than Utah, so here in the case at bar is the question whether plaintiff is conducting a “sales” business in a state other than Utah. We emphasize particularly the fact that some of the consolidated companies in the Browning case “did business in

Utah and Missouri, and had employees chiefly situated at, and carried on business from premises which were rented outside the state of Utah." Such business done outside Utah from premises outside Utah did not, however, require the apportionment outside Utah of any of the income from the investment business. The investment business was all done in Utah and all of the investment income thus became apportionable to Utah. The office outside Utah did not engage in any investment business. In the case at bar the office of plaintiff outside Utah is an administrative office and does not engage in any sales business whatsoever. That business is conducted in New York by separate and distinct companies.

We invite the Court's attention to the following quotations from the annotation in 167 A.L.R. and cases cited therein:

"The fact that the purchaser is located outside the state does not require that the income from a sale to him be allocated to business done outside the state." (947)

" 'Doing business' cannot be so identified with 'receipt of income' that the business of the taxpayer in making sales must be deemed to have been done at the place where the purchase price was received." (947)

"It has been held that the fact that title to goods passes outside the state does not necessarily establish that the income from a sale of such goods arises from business done outside the state." (948)

The Court's particular attention is likewise invited to the case of *Maxwell v. Kent-Coffey Mfg. Co.*, 204 NC 365, 168 SE 397; affirmed 291 U.S. 642 (1934). In this case it appeared that the taxpayer was a Delaware Corporation carrying on a manufacturing business in North Carolina. 99.8% of the goods manufactured within North Carolina were sold outside the state, in the amount of \$1,545,485.95. Sales within the state were \$3,021.13 or 00.2% of the total sales. In filing its tax return the taxpayer allocated 58.538% of its net income to North Carolina. The Commissioner of Revenue, however, allocated 99.2% of the taxpayer's net income to North Carolina and assessed an additional tax on this basis. The Supreme Court of North Carolina sustained the assessment and stated:

"The bare fact of sale produces no income. It is merely the act by which the income is captured; the capital, the organization, or efforts which produce the sale, are the things to be considered in ascertaining the amount of income to be credited to the sale. Again 'no effort was made in the evidence to break up the business of appellee into the separate or component elements of buying, manufacturing and selling, as was done in the Hans Rees' Sons Case ..."

We come now to a specific analysis and answer of plaintiff's argument as set forth in its brief that receipts from sales of products produced by the Utah Division were not gross receipts from business done in Utah and

cannot be attributed to business carried on within Utah. The discussion assumes, without conceding, that plaintiff is entitled to apply the statutory formula against its Utah Division's separate books of account.

Plaintiff's main point that sales of the Utah products do not constitute gross receipts from business done in Utah appears at page 19 of its brief. The discussion from pages 19 to 23 is general and reference is made to the provisions of the Utah statute relating to the statutory formula basis of allocation. At page 21 it is pointed out that the gross receipts from all sales of copper, molybdenite, platinum and palladium of the Utah Division have been attributed to Utah business "although all of such sales were made outside of Utah to buyers located outside of this state by agents operating from offices outside of this state." Plaintiff's contention is stated on page 22 to be that "such gross receipts are the result of business carried on in a state other than Utah." It is stated that the gross receipts factor "should be substantially zero and that the net income to be allocated to Utah should range from 63 to 65%." Plaintiff indicates its agreement with defendant's decision to the extent that the decision allocated the gross receipts from gold and silver outside Utah. The sales of platinum and palladium are indicated to be "but an infinitesimal part" of the total and therefore the subsequent argument is addressed primarily to the sales of copper and molybdenite.

It is urged that the subsequent argument demonstrates the error in defendant's application of the statute and if so applied the resulting tax is unconstitutional.

The only point necessary to discuss here is the reference to the sales of platinum and palladium. True it is that these receipts may be infinitesimal when considering a total adjusted net income, before apportionment, of the Utah Division in the amount of \$232,570,086.66. Such receipts are nevertheless in a substantial amount. Plaintiff has raised the propriety of assigning such receipts to Utah business and we suggest that such receipts should not be assigned outside the state merely because such receipts constitute a small proportion of total receipts. This is not a very good reason. The evidence clearly shows and establishes that the sales of platinum and palladium were negotiated and effected by and in the name of A. S. & R. from A. S. & R.'s own separate premises and in the regular course of its own business. Plaintiff has established no basis whatsoever for the assignment of such receipts to business done by plaintiff outside Utah.

Plaintiff urges on page 23 that the Utah tax statute is designed to tax net income attributable to Utah business and that the decision of defendant is at variance with this purpose.

Plaintiff's discussion from pages 23 to 29 is again general and to the effect that the so-called Massachusetts formula is only designed to impose a tax on the

corporation's net income fairly and reasonably attributable to business done within the taxing state. It is pointed out that Massachusetts in adopting its three-factor formula of property, payroll and gross receipts from sales first recognized that no single factor could be generally applied to give a fair allocation of income within and without the state. It is pointed out that the Massachusetts formula has been adopted by several states "with some differences in its specifications in one state or another." It is urged that the statute, its legislative history and the opinions of this Court show that the statute only taxes such income as is reasonably attributable to business done in Utah. It is suggested that defendant has by a tortured construction of the statute violated its fundamental purpose and has manifested no concern as to whether the result reached was fair or not. It is further suggested that the three factors must be applied "since each factor operates as a check and balance to the others" and that application of the formula is necessary in the case of a "single or unitary business conducted across state lines." At page 29, plaintiff indicates its acquiescence in the assignment of 6% of the property outside Utah, 3% of the payroll outside Utah, but objects that the assignment to Utah of receipts of sales of products, other than gold and silver, constitutes a patent violation of the statute because none of the sales were negotiated in Utah, none of the persons concerned with sales worked out of offices in Utah, none of the products were delivered to customers in Utah and no sales activities occurred within Utah.

As heretofore indicated, the several states in adopting the Massachusetts formula have modified the statutory test on the sales factor. The Massachusetts, Pennsylvania and Utah laws do not however, arbitrarily allocate sales receipts to the state of production or manufacture or to a state in which the corporation is otherwise doing business if it appears that the sales are negotiated by the company in out-of-state premises. The statute pertaining to the sales factor simply assigns gross receipts to the state from sales unless the taxpayer corporation itself conducts outside the state the selling business and activity from the corporation's own premises. The statute neither requires nor permits the apportionment of net income to business conducted or the corporate franchise exercised outside the state by some other company. Furthermore, even on plaintiff's theory of the case, the formula is clearly and definitely inapplicable to the intercompany transfers of 25% of the copper produced by the Utah Division to the fabricating subsidiaries, Chase Brass and Copper Co. and Kennecott Wire & Cable Co., separately accounted for.

After pointing out on page 29 that no sales activities are conducted in Utah, plaintiff begins to move toward the heart of the problem on page 30 by referring to various administrative duties performed in the New York office as "evidence" of out-of-Utah activity and

then concludes on page 31 that the administrative activities of plaintiff in New York were so "necessary and substantial" that but for them "the operation of the Utah Copper Division would not have been carried on successfully over the years involved." It is further concluded that the error of defendant lies in the fact that it has "inequitably attributed to Utah sales in no way related thereto." The answer of course to this contention is that defendant has not attributed to Utah sales in no way related to Utah. The only gross receipts from sales assigned to Utah are sales of the Utah molybdenite and blister copper products. These products are related to Utah because they were produced in Utah. These products were loaded on cars in Utah for shipment outside Utah in interstate commerce. The Utah Division started the product on its way for out-of-state sale by the sales subsidiary. This subsidiary did the selling, not plaintiff's New York administrative office. Administrative liason with or even some supervision over the independent sales subsidiary's activities does not make the business of the subsidiary business done by the New York administrative office any more than supervision over Utah production constitute production of molybdenite and copper in the New York administrative office. The discussion on pages 32 to 35 relates generally to the propriety of the statutory formula to a company which manufactures in one state and sells in another, but overlooks the fact that in plaintiff's case plaintiff conducts outside Utah no selling business.

On page 35 the point is made that defendant erred by assigning to Utah business carried on its entirety in other states. Pages 35 to 38 again emphasize that no selling activities are supposed to have occurred in Utah and that because the sales were out-of-state sales the defendant has violated the statute and the construction of the statute by this Court in the California Packing Case. It is urged that the "except" clause in the Utah statute has been erroneously and too narrowly construed and further that such construction disregards the clause in the statute which also excepts from assignment to Utah "sales otherwise determined by the tax commission to be attributable to the business conducted on such premises." It is urged that however technical the interpretation of the initial language of the "except" clause, the aforesaid concluding language clearly assigns outside Utah that business which is not fairly attributable to Utah. Plaintiff concludes at 38:

"It thus becomes apparent that the real and substantive question under the statute is, in each case, whether the sales in question resulted from sales activity within or otherwise related to Utah or whether, on the contrary, they are in fact attributable to sales activity permanently carried on outside of this state. It is entirely inconsistent with the purpose of the statute to attribute to Utah gross receipts from sales which had no relation to any sales activity conducted in that state."

Here seemingly is the outright contention that permanent sales activity outside Utah automatically excludes sales receipts from Utah business, irrespective of

whether the sales activity outside the state is conducted by the taxpayer or some independent marketing instrumentality. This construction is clearly incorrect and does violence to the statute. Most certainly, to begin with, the business of producing and manufacturing molybdenite and blister copper in Utah is business assignable to Utah. The statute then by clear command assigns the receipts from *its* business to Utah unless and until the taxpayer can demonstrate that the sales fall within the "except" clause. This "except" clause under any reasonable construction only excepts those sales negotiated "in behalf of the corporation" by agents in out-of-state premises owned or rented "by the corporation." The sales are not those of some other corporation but "of the corporation." The corporation concerned is the taxpayer. Furthermore, plaintiff can place no reliance on the concluding portion of the language under consideration for the reason that defendant in its decision did not otherwise determine that the sales herein involved were attributable to the business of plaintiff conducted at plaintiff's administrative office in New York. In fact, the evidence showed and defendant specifically found that the selling business of the sales subsidiary was the separate business of the subsidiary conducted on and attributable to the subsidiary's premises.

Plaintiff carries the main burden of its argument from pages 39 to 59 of the brief. By the point on page 39 it first undertakes to show that the sales by

the sales subsidiary in New York were sales "in behalf of the corporation by agents." It then undertakes by the point on page 54 to show that the sales subsidiary as agent was "chiefly situated at, connected with, or sent out from premises" of plaintiff outside Utah.

There is thus presented the basic position of plaintiff that the sales were negotiated by an agent in behalf of plaintiff from plaintiff's premises as contrasted with defendant's position that the sales were negotiated by the sales subsidiary in its own behalf and from its own premises. The two points, namely, first, whether the sales were negotiated in behalf of the corporation and, second, from the corporation's out-of-state premises, although to some extent intermingled, are separate and distinct points and to justify exclusion of sales receipts from Utah under the Utah statute it is necessary for the taxpayer corporation to establish both points.

We turn first to the question whether the sales of copper and molybdenite negotiated and effected by the sales subsidiary were sales made by an agent "in behalf of" plaintiff. Pages 39 to 46 of plaintiff's brief are devoted, first, to showing that the sales subsidiary was an "agent" even though it be a factor or commission merchant; second, that plaintiff's control over its wholly owned sales subsidiary precludes a finding that the sales subsidiary was a factor or commission merchant; third, that the separate corporate entity of the

sales subsidiary should be ignored and "rather its activities as they affect the Utah Copper Division should be taken into account to the same extent as though it were simply a division of Kennecott"; fourth, plaintiff's production activities and the sales subsidiary's sales activities "constitute a single unitary enterprise" and a separation of the two activities would "disregard the essential economic facts of the case." The pages following from 46 to 54 are then devoted to the attempt to distinguish the *Buyuk Cigars* and *Minds Coal Mining* cases which involved the similar Pennsylvania statute.

True it is to begin with that a broker, factor or commission merchant is an "agent" but also equally true, as plaintiff's quotation from the Restatement of the Law on page 42 shows, the "attorney at law, the broker, the factor, the auctioneer," are "independent contractors." When the broker, the factor, the commission merchant functions, he functions not representatively but individually in his own name and behalf and in the regular course of his own business. As hitherto pointed out in the quotation from paragraph 7501 Prentice-Hall All States Unit, while in one sense a factor or commission merchant is the "agent" of the consigning dealer or manufacturer, he nevertheless conducts his own separate business of selling the goods to which he has been entrusted with the power of sale. The factor sells the goods to his own customers. He pays to the consignor a price fixed by the contract and

retains for himself the amount by which the price his customer pays him exceeds that which he is required to pay to the consignor. As the Prentice-Hall quotation points out "the business done in the state is entirely that of the factor. When he makes a sale of the consignor's goods in the state, what really takes place is this: The factor purchases the goods from the consignor and resells them to his customer." For sales tax purposes the factor is in the business of reselling the goods of the consignor. Doing business in Utah through a factor, broker or commission merchant is not doing business in the state. The business done here is that of the broker, factor, or commission merchant. The sales negotiated and effected by a factor or commission merchant are not sales made "in behalf of" his consignor principal. The sales are negotiated and effected "in his own behalf." This phrase "in behalf of" in the Utah statute means and can only mean *in whose name* and pursuant to whose business are the sales made. To use the language of the *Buick* case, *supra*, the factor acts "individually" and not "representatively". The business of selling being thus the separate business of the factor or commission merchant, it would, where the question is whose business is it, make no difference whether the manufacturer and the factor were doing business in the same state. Business conducted by one person is not business conducted by another person, unless it is done *representatively*. An overwhelming line of cases has established the rule contained in the Utah Regulations

heretofore quoted, that where the manufacturer is in one state but sells his product outside the state through a factor or commission merchant, he is not doing a sales business outside the state of production.

Taxwise no net income is assignable outside to the state in which the sales business is conducted independently by a factor or commission merchant. Administrative control or supervision may be exercised by the consigning principal over his out-of-state broker, factor or commission merchant. The Utah sheep ranch with respect to its Boston wool broker, the Utah cattle ranch with respect to its Denver or Omaha livestock agent, the Utah investment company with respect to its New York broker, the Utah fruit grower with respect to its Chicago produce broker may exercise an administrative supervision over sales in the sense of outlining the basis and terms within which the agent may sell but the Utah product is sold out-of-state by these independent agents in their own name and in the regular course of their own business. Moving an administrative office outside Utah, the state of production, to another state or even to the state in which the broker, factor or commission merchant is selling the goods can make no difference to the fundamental question raised by the Utah statute as to whether the sales business conducted outside the state is business conducted by the corporation outside the state. To apportion sales receipts outside the state the statute requires a corporation to exercise *its* corporate franchise of sell-

ing and negotiating and effecting contracts of sale outside the state. Although the legal authorities pertinent to the questions are considered here, the question whether a sale is negotiated "in behalf of the corporation" is largely a question of fact. Let us turn then to the record and to defendants findings of fact.

Defendant has specifically found as a fact in this proceeding that the sales negotiated by the sales subsidiary covering the Utah product were not sales negotiated on behalf of plaintiff, but in the subsidiary's own behalf. For example, the standard form of contract of sale (F p. 71) shows that all contracts were negotiated and executed by and in the name of the sales subsidiary as seller. Nowhere in this standard contract is plaintiff's name even mentioned. All casting, shipping and delivery instructions to A. S. & R. were given by and in the name of the sales subsidiary. The sales subsidiary dealt exclusively with the customers. The cash proceeds from sales were collected by and in the name of the sales subsidiary, such sums being deposited in its own name, in its own bank accounts. The subsidiary periodically remitted the proceeds of sale to plaintiff after deducting its agreed commission of \$1.00 per net ton of copper and \$3.50 per net ton of molybdenite together with certain other miscellaneous expenses connected with the sale.

As Mr. Lenz testified (Tr. 609) (F p. 143) "It, of course, is the duty and obligation of Kennecott Sales Corporation to make proper contracts for the

protection of Kennecott Copper Corporation in making the sales of Kennecott's products. It also has, as I previously testified, to given directions to the refineries with regard to the casting of shapes, the shipping of the copper as well as the shipment of molybdenite, and Kennecott Sales Corporation in its own name issues the bills or statements on the basis of which payment for the copper or molybdenite is made. Kennecott Sales also collects the money and pays over the net thereof to Kennecott Copper Corporation."

Mr. Lenz further testified (Tr. 616) (F p. 142) that "The general business and the sales arrangements, however, are carried out by the Sales Corporation."

Defendant found from this and other voluminous testimony that all of the details of the selling activity and the determination of the time, the place, the manner and the price of sales were solely and exclusively all handled and determined by the sales subsidiary. Plaintiff's New York administrative office coordinated production with sales and determined or outlined the general policy to be followed and was consulted by officials of the sales subsidiary if "anything unusual" occurred in regard to sales matters (F. p. 142), but clearly and without doubt the business of selling was the separate and distinct business of the subsidiary. Plaintiff was held out to the trade as the producer and the sales subsidiary was held out as the seller.

The evidence made it abundantly clear and perfectly apparent that the sales of copper and molybdenite negotiated and effected from day to day during the period here involved were negotiated and effected by officials of the sales subsidiary in behalf of the sales subsidiary. Of some interest in this connection are the minutes of the special meeting of the Board of Directors of *the sales subsidiary* held on April 15, 1942 (F P. 49-50) which state:

“The Chairman then stated that it was advisable to continue the authorization of certain officers of *the corporation* to enter into and execute contracts covering the routine, day to day sale of copper and molybdenite.

“Thereupon, after discussion and upon motion duly made, seconded and carried, it was

“RESOLVED, that the president or any vice-president or any assistant sales manager be and each of them hereby is authorized to enter into and execute *in behalf of this corporation, when acting either as principal or agent*, routine day to day contracts covering the sale of copper and molybdenite.”

This resolution under which the officials of the sales subsidiary were legally authorized to negotiate and effect sales of copper and molybdenite merely confirms again that the sales were entered into and executed “in behalf of this corporation (the sales subsidiary), when acting either as principal or agent.” The authority conferred was not to negotiate and exe-

cute in behalf of plaintiff or some other corporation contracts covering the sale of copper and molybdenite, but only authority to negotiate and execute contracts "in behalf of" the sales subsidiary.

Plaintiff argues here that the separate corporate entity of the sales subsidiary be ignored and its operation treated as a mere "department" of plaintiff. This argument is particularly interesting in the light of Mr. Lenz's testimony (Tr. 618) (F p. 52) to the effect that the very reason for incorporating and organizing the sales subsidiary was to prevent the sales activities from being a department of plaintiff. He testified:

"Q. Can you explain to me why Kennecott Sales Corporation was created and why it exists?

A. There are number of reasons. In this way a somewhat sharper distinction is made between operations and sales than if the sales department were merely a department of the operating company."

The attention of the court is likewise invited to the historical statement (F. pages 66-68 and 105-109) which shows that the producing function has always been legally separated from the separate business of selling the product. In the year prior to 1920 A. S. & R. acted as sales agent. During the period from 1920 to 1934 Guggenheim Brothers acted as sales agent, and since January 1, 1934 the sales subsidiary has conducted the selling function, first, under the Guggenheim agree-

ment for the period from January 1, 1934, to midnight August 31, 1935, and thereafter under substantially the same arrangements as are set forth in the agreement dated September 3, 1935, between the sales subsidiary and plaintiff, Utah Copper Company and Mother Lode Coalition Mines Company. A copy of this agreement and the Guggenheim agreement are attached to defendant's findings.

It likewise appeared that the sales subsidiary acts not only in selling the Utah product but also the product of the other three western mining divisions and Braden Copper Company (Chile). Likewise, (F. pages 34-36), the sales subsidiary conducted a world-wide business of selling with branch offices or agencies in various parts of the world, even having a wholly owned subsidiary itself in Great Britain.

In the face of all these facts and many others, plaintiff's argument (See page 43) that the sales subsidiary sold as "agent" in plaintiff's behalf appears quite tenuous indeed. The subsidiary's sales were its own sales in its own name and in the regular course of its own world-wide business. When the sales subsidiary collected and deposited from customers the cash receipts from sales it was conducting its own business in the same way and manner that a factor or commission merchant regularly functions. The subsidiary's subsequent remittance of the funds to plaintiff less the agreed commission and other expenses was exactly the same

method of doing business as that conducted by any independent factor or commission merchant. Plaintiff insists, however, that this cannot be true for the reason (Page 43) that "the Sales Corporation never obtained possession of the products sold, possession remaining either in Kennecott or A. S. & R. on Kennecott's behalf."

The above statement appears contrary to the evidence and the specific findings of defendant. The exact facts on this point are as follows, the Finding at page 32-33 stating:

"30. The intent of the contract between Kennecott and A. S. & R. dated November 29, 1940, as heretofore noted as regards the Baltimore Refinery, is that refined copper shall be returned to Kennecott as it is produced. (Ex. III (2) P. 13). The contract provides that final return of copper shall be made by delivery thereof 'to Kennecott or its order,' at specified points in the refinery area. (Ex. III (2) (2), page 13). Also, as heretofore noted, A. S. & R. is obligated to store the refined copper without additional charge. When requested, A. S. & R. is obligated to issue transferable storage certificates for such copper of Kennecott as A. S. & R. shall store or arrange to store. (Ex. III (2) page 30). Physical possession of the copper at the refinery is thus by contract in A. S. & R. subject to Kennecott's order.

"31. By arrangements entered into between Kennecott and the Sales Corporation which have been accepted, recognized and followed by A. S. & R., Kennecott has entrusted the Sales Corporation

with authority to sell all of the refined copper produced at the Baltimore Refinery of A. S. & R., or other refinery, and with the right to possess and control such copper for the purpose of sale and to issue instructions to A. S. & R. or others pertaining to the casting, storage, handling and shipment, sale or other disposition of such copper and with the right to receive payment from the customer of the purchase price thereof. (Tr. 168-181)."

The contractual arrangements in effect between plaintiff and the sales subsidiary are set forth from pages 59 to 66 of the Findings. Under these arrangements plaintiff has appointed the sales subsidiary its exclusive agent for the sale on commission of the entire production of copper of each of plaintiff's producing units and this appointment has been accepted by the subsidiary which has agreed to use its best endeavors to procure the highest market price for the copper produced by plaintiff. Plaintiff has agreed to deliver to the sales subsidiary copper of standard grade and quality. More particularly (F. p. 64), it is stated:

"The American Smelting and Refining Company or anyone holding any copper of Kennecott for delivery is authorized, upon demand made by the Sales Corporation to make deliveries to the Sales Corporation or its order of such copper." (Tr. 663-4).

Again (F. p. 65):

"All premiums for special and unusual shapes as are currently charged by A. S. & R. or other refinery and as are paid to the Sales Corporation

by the buyers of special shapes are paid by the Sales Corporation directly to A. S. & R. or other refinery which has supplied such shapes. Allowances made by the refinery for cathodes are received by the Sales Corporation and duly credited to the buyers." (Tr. 667).

Further, at page 74 of the Findings are shown typical specimens, following the execution of a contract of sale between the sales subsidiary and customer, of the shipping instructions from the sales subsidiary to A. S. & R. The shipping and casting instructions issued to A. S. & R. are issued by and in the name of the sales subsidiary.

On the basis of the above facts and others, defendant found (F. pages 143-4) that:

"By appropriate directions to and arrangements with the refinery or others, all control and the right to issue instructions as to the casting of shapes of copper and the storage or shipment of both copper and molybdenite to the persons having the actual possession or custody thereof, was vested by Kennecott exclusively in the Sales Corporation."

Defendant further found (F. 147-8):

"The Sales Corporation was employed by Kennecott as a commercial agent and vested and entrusted under appropriate instructions and arrangements with the right of possession, disposal and control of all copper and molybdenite produced by Kennecott for the purpose of selling such property, at an agreed commission or compensa-

tion, in the name of and pursuant to and in the usual course of trade or business of the Sales Corporation and authorized to receive payment for such sales from the purchaser thereof. We hold and find that the Sales Corporation was in fact and functioned as a factor or commission merchant with respect to all sales of copper and molybdenite during the period here involved."

There can be no doubt that these findings of defendant rest on the facts. Nor does plaintiff point to any evidence in the record to show this Court any error in such findings. The authorities do not require a factor or commission merchant to have actual physical possession of the goods entrusted to him for the purpose of sale. It is sufficient and in fact the normal situation for the goods to be held in storage under warehouse receipt or otherwise providing that the person in actual physical possession of the goods holds the goods for and subject to the order of the factor or commission merchant. Upon production of the refined copper in the Baltimore Refinery, A. S. & R. held the copper in its yard for the account and subject to the order of the sales subsidiary. A. S. & R. took no action whatsoever with respect thereto except as specifically directed and instructed to do so by the sales subsidiary. Upon shipment to the sales subsidiary's customer, the sales subsidiary would be shown as shipper. Similarly in the case of molybdenite upon production in Utah plaintiff held this product for the account and subject to the order of the sales subsidiary. Officials of plaintiff here in Utah took no action with respect thereto what-

soever except as specifically instructed and directed to do so by the sales subsidiary with the sales subsidiary being shown as shipper when the molybdenite product was moved out of the state to market.

We move on then to plaintiff's next argument, pages 44-46 of its brief, that the separate corporate entity of the sales subsidiary should be set aside and its activities "taken into account to the same extent as though it were simply a division of Kennecott."

It is now far too late in the day to ignore the separate entity of corporations in taxation as the numerous cases cited heretofore under Point 2 clearly establish. All of the cases cited by plaintiff at pages 44-5 of its brief in support of its plea to ignore the corporate entity are not pertinent precedent in a *tax* case. All these cases show is the old equity rule that the corporate form cannot be employed as a device to commit a fraud. A wholly owned subsidiary organized and employed to defraud creditors or improperly conceal assets can of course be set aside. In the case at bar, however, the sales subsidiary has been organized and operated for no fraudulent purpose but for valid business reasons and under fair and reasonable contractual arrangements with its parent.

Plaintiff's suggestion that the corporate entity of the sales subsidiary be ignored for the reason that plaintiff's business of production and the subsidiary's busi-

ness of selling constitute from the economic point of view but a single unitary enterprise has been more than sufficiently disposed of by the authorities heretofore cited under Point 2. These cases clearly show that in the absence of fraud or an intent to syphon income out of the taxing state to evade tax that a taxpayer is perfectly free to separately incorporate the manufacturing function from the selling function, and that the separate corporate entities of each function must be recognized and respected where the intercompany arrangements are fair and reasonable.

Plaintiff refers to and quotes from the decision of the California Supreme Court in *Edison California Stores v. McColgan*, which held that the taxing authorities could consolidate the business of parent and all of the subsidiaries owned and managed under one centralized system, where the separate accounts of the operations within California did not reflect the net income from the business done within California. The Court thus applied the same rule to the parent subsidiary relationship as had been applied in the earlier California case of *Butler Brothers v. McColgan*, 315 U.S. 501 (1942), affirming 111 Pac. 2d 334 (1941), which had permitted the California tax authorities to apply the statutory formula to country-wide operations carried out not through subsidiaries but through various branch offices, where again the separate branch office accounts of operations carried on within California did not properly reflect the net income from

business done in California. In the case at bar the evidence is that the separate accounting basis of the Utah Division clearly reflects net income from business done in Utah. If this were not the fact, then the Butler Brothers and Edison California Stores decisions, among others, might permit or furnish defendant with some authority for rejecting a tax return based on the separate accounts of the Utah Division and insisting instead of a return based upon the formula as applied to country-wide operations. The various difficulties, however, of attempting to consolidate under the circumstances of the case at bar the incomes of the sales and fabricating subsidiaries not qualified to do business in Utah, are apparent from the cases heretofore fully considered under Point 2.

We turn now to additional authorities showing clearly that the operations of plaintiff and its sales subsidiary cannot be combined and consolidated together either on the ground of agency or ignoring the corporate entity.

On the general problem we refer the Court to an article entitled "Income Tax Status of the Wholly Owned Subsidiary Corporation" contained in the Monthly Digest of Tax Articles, April 1951, published by Mathew Bender & Co. This article is a condensation of an article in 29 Texas Law Review 88 (1950). The article considers the question whether the "one man" corporation and the wholly owned subsidiary may be ignored for tax purposes and at whose behest—the commissioner's or the

taxpayer's. After referring to the early income tax laws of the Civil War period under which corporations were treated much as partnerships are today, the article moves on to modern Federal legislation and discusses the various decisions of the Supreme Court of the United States dealing with corporate entity under tax laws. Reference is made to *Lynch v. Turrish*, 247 U. S. 221 (1918), *Lynch v. Hornby*, 247 U.S. 339 (1918), *Southern Pacific Co. v. Lowe*, 247 U.S. (1918), *Gulf Oil Corp. v. Lewellyn*, 247 U.S. 71 (1918), *Gregory v. Helvering*, 293 U.S. 465, (1935), *Higgins v. Smith*, 308 U.S. 473 (1940), *Moline Properties, Inc., v. Commissioner*, 319 U.S. 436 (1943), *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943), and finally the recent leading decision of the Supreme Court in *National Carbide Corporation v. Commissioner*, 336 U.S. 422 (1949). The article states:

“It is interesting to note that the Southern Pacific and Gulf Oil cases and *Lynch v. Turrish* are seemingly the only Supreme Court decisions where a taxpayer has succeeded in an effort to disregard his corporation so as to gain a tax benefit. Since these early holdings, any effort by a taxpayer to employ the corporate form for business convenience and then to abandon it tax wise has met with notable failure before the court.”

Reference is made to the statement of Mr. Justice Reed in the Higgins case as follows:

“A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages. On the other

hand, the government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The government may look at actualities and upon determination that the form employed for doing business . . . is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute."

Of significance to the case at bar is the reference to the Moline Properties case which held that the corporation was not the agent of its sole stockholder where the corporation held title to certain mortgaged realty. The Court held the gain taxable to the corporation but excepted the situation where a corporation was in fact serving as an agent. In the Interstate Transit Lines case the Court considered the agency argument to be the same as the argument of substantial identity in a different form and refused to treat the parent and subsidiary as one.

The article after referring to the National Carbide decision summarizes the law as follows:

"The express words of the Court's opinion leave no doubt but that a parent corporation which organizes a subsidiary for the conduct of business on its own account will find the earnings of the subsidiary taxed to such subsidiary and not to the parent."

Turning to the facts of the National Carbide case we find three taxpayers, wholly owned subsidiary corporations of Air Reduction Corporation (Airco), operating under an agreement to act as "agent" for Airco in the

manufacture, distribution and sale of various products. Airco agreed to supply working capital, executive management and office facilities for its subsidiaries, who in turn agreed to maintain and operate the plants acquired by them, to manufacture and sell the products and to turn over all profits to Airco therefrom in excess of 6% of their outstanding capital stock. Title to all assets remained in Airco, cost of assets acquired by the subsidiaries was carried as an account payable to Airco. Such accounts were interest free and realizable only on dissolution. Transfers of assets between subsidiaries were reflected on intercompany accounts at cost without the transfer of cash. Officers of Airco served the subsidiaries in similar capacities. The subsidiaries were under the complete domination, control and ownership of the parent corporation, Airco.

The three subsidiaries, although showing sizable profits, reported as income only 6% of their capital stock, the balance being reported by Airco against which was offset a loss sustained by a fourth subsidiary. The commissioner asserted deficiencies against the three subsidiaries, contending that the amounts paid to the parent constituted the income of the subsidiaries. The Supreme Court by an unanimous decision, opinion by Chief Justice Vinson, refused to set aside the separate entity of the subsidiaries either on the ground of agency or substantial identity and held that the income having been earned by the subsidiaries should be taxable to the subsidiaries.

The Court stated:

“‘Agency’ and ‘practical identity’, as those words are used in the Southern Pacific case are unquestionably opposite sides of the same coin.”

Again,

“Ownership of a corporation . . . can have no different tax consequences when clothed in the garb of agency than when worn as a removable corporate veil.”

Again,

“So far as control is concerned, we can see no difference in principle between Airco’s control of petitioners and that exercised over Moline Properties, Inc. by its sole stockholder. Undoubtedly the great majority of corporations owned by sole stockholders are ‘dummies’ in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually.”

We come now to that portion of the National Carbide decision which deals with the specific issue of the case at bar, namely, whether the sales subsidiary of plaintiff negotiated and effected the sales of copper and molybdenite in its own behalf as defendant contends, or in behalf of plaintiff as plaintiff contends. It is defendant’s position that the phrase “in behalf of” means and can only mean “in the name of.”

Chief Justice Vinson continues:

“What we have said does not foreclose a true corporate agent or trustee from handling the prop-

erty and income of its owner-principal without being taxable therefor. Whether the corporation operates *in the name* and for the account of the principal, binds the principal by its actions, transmits money received to the principal, and whether receipt of income is attributable to the services of employees of the principal and to assets belonging to the principal are some of the relevant considerations in determining whether a true agency exists."

Here in specific language is precisely defendant's point in the case at bar. The agent referred to in the Utah statute is not the independent factor, broker or commission merchant, but the agent who "operates in the name and for the account of the principal, binds the principal by its actions." In other words, it is perfectly clear that "in behalf of" means exactly the same thing as "in the name and for the account of." Unless the business is done "in the name and for the account of" of plaintiff, the business done is not the business of plaintiff.

Of general interest is the annotation in 10 A.L.R. 2d 576 entitled "Income of Subsidiary as Taxable to It or to Parent Corporation." Attention is likewise invited to annotation in 165 A.L.R. 996 entitled "Right of Owner of all Shares of Corporation or Association Taxable as Corporation to Have Its Income Taxed as His Personal Income." Preceding the latter annotation is the case of *Titus v. United States* at page 991, 150 Fd 2d 508 (CCA

10) (1945). Here the Circuit Court refused to permit the sole stockholder or owner of a "trust taxable as a corporation" to have it set aside for tax purposes. The opinion by Judge Huxman states:

"But we are asked to disregard the express provisions of the trust agreement and look to the actualities of the situation. In substance, it is argued that then thus viewed it becomes apparent that not only was Titus the king-bee but also that he was the only bee in this hive. Parties are not at liberty to say that their purpose in perfecting an organization was different or narrower than that which they formally set forth in their solemn instrument of writing.

"Whether the government could challenge the nature of the trust is quite a different question. That matter is not before us. Titus himself cannot do so."

As Judge Cordozo pointed out in *People ex rel. Studebaker Corp. v. Gilchrist*, 244 New York 114, 155 N.E. 68 (1926):

"The subsidiary in these transactions, if it had any genuine autonomy, . . . was either a buyer or an agent. If in truth and in good faith it was a buyer of the parent's products, its operations were its own. By the very terms of the hypothesis, they are not to be identified with the operations of the seller."

"On the other hand if the sale is to be disregarded as nothing but a cover for an agency, the value of the privilege of doing business in a corporate form as agent for another is not to be confused with the value to the principal of acting

through the agent. The position of the subsidiary may be no better than if its certificate of incorporation had stated that the purpose of its business was to act as factor or intermediary for the products of the parent. The position may be no better, but it can also be no worse."

When it is recalled that the Utah corporation franchise tax is a tax on the *exercise* of the corporate franchise, it is apparent that neither under the Utah law nor under the similar New York law is plaintiff exercising any corporate franchise in New York of selling the Utah product from day to day to customers. Although under its charter it has the legal authority to "sell" its metals, it does not under this authority sell or purport to sell or exercise any franchise to sell any product of the Utah Division in New York. The sale of the Utah product in New York is negotiated and effected by the sales subsidiary under and pursuant to *its* charter and the corporate franchise granted by the state of New York to the sales subsidiary. It sells the Utah product by exercising its own corporate franchise in New York and not the corporate franchise of plaintiff. Thus, it is apparent that even if the existence of an administrative office of plaintiff in New York is here assumed to constitute the doing of business in New York, the business exercised and done is not that of engaging in sales or negotiating or effecting in its own corporate behalf and name any sales of the Utah product whatsoever. Frequent or periodic consultation by plaintiff's officials with the officials of the sales

subsidiary and supervision of the activities of the sales subsidiary does not make the activities of the subsidiary plaintiff's activities. As stated by Judge Learned Hand in *Proctor and Gamble Co. v. Newton*, 289 Fd. 1013 (1923)

"In the case at bar, it does not appear that the organization of the plaintiff is not quite separate from that of the Proctor and Gamble Manufacturing Company and of the Proctor and Gamble Distributing Company. I must assume that each subsidiary has its own set of officials, who actually conduct its business."

As stated by the Court in *Pacific Magnesium v. Westover*, 86 Fd. Sup. 644 (1949):

"The difficulty with the argument is that a corporation and its stockholders are distinct entities. And the taxpayer who has chosen to use the corporate form for business purposes is not free to disregard it, in order to receive the tax benefit to which he might have been entitled as an individual."

Again, as stated in *United States Rubber Co. v. Query*, 19 Fed. Sup. 191 (1937):

"It is the Rubber Products Company, a corporation separate and distinct from plaintiff, which is carrying on business in South Carolina; and the mere fact that plaintiff owns the stock in that corporation and that the two have to a large extent the same officers and directors is no reason for disregarding the corporate entity of either."

Reference is again made here to the Palmolive case, *supra*, and that part of the decision relating to the out-

of-state subsidiary known as the "Buckingham Agency" and whose separate income consisted of collecting commissions from the placing of advertising of the parent company with respect to the goods produced within the state of Wisconsin, the taxing state. Notwithstanding that the out-of-state administrative office of the Palmolive Company undoubtedly exercised a considerable degree of supervision over the activities of the advertising subsidiary, this was nevertheless not sufficient in the court's view to make its out-of-state business attributable to the out-of-state administrative office of the Palmolive Company and permit its separate income to be included with the parent's for apportionment purposes. The District Court's opinion states:

"Its activities were all outside of the state; they had no connection with the manufacture, but consisted of placing advertising of the parent company with advertising houses and collecting commissions thereon. No part of its income was directly or indirectly earned in the state of Wisconsin; no part of it is taxable within the state; and to the extent of the allocation thereof by the tax commission to Wisconsin there should be an injunction as prayed."

The above decision is pertinent here for the reason that plaintiff insists on its right to consolidate and combine the separate operations of the sales subsidiary with the production and administrative operations of plaintiff and thereby establish a basis of claim under our statute

to apportion outside Utah net income attributable both to the administrative work and the selling work outside the state.

Although the facts and the foregoing authorities definitely establish that the sales subsidiary's business is its own business and does not become attributable to or a part of plaintiff's separate business of producing metal, whether plaintiff's administrative office is in Utah, Wyoming or New York, we refer the Court at this point to a line of cases specifically holding that if plaintiff had no administrative office in New York it would not be doing business in New York by reason of marketing its copper and molybdenite product in New York through the sales subsidiary. Plaintiff would not be entitled or permitted to assign to New York sales receipts derived from sales negotiated and effected in New York by a factor or commission merchant conducting the selling business in New York.

In *Irvine Co. v. McColgan*, 26 Cal. 2d 160, 157 Pac. 2d 847 (1945), the Supreme Court of California had before it the question whether a West Virginia corporation authorized to transact business in California and engaged in California in the business of raising and preparing for market horticultural and agricultural products could apportion outside the state sales receipts where the products were marketed outside California through the medium of independent produce brokers, commission merchants and a cooperative marketing association of which the taxpayer was a member.

The Court pointed out that cooperative marketing agreements have been generally classified in law as contracts of "agency" and definitely and expressly on the assumption that an agency relationship in fact existed, the Court nevertheless held that the taxpayer was not doing business outside California and was not entitled to apportion any sales receipts outside the state. The Court in its opinion at page 850-1 of the Pacific Reporter stated:

"Transactions engaged in for a foreign corporation in a state are not necessarily engaged in by the corporation in that state. As stated in *Union Internationale De Placements v. Hoey*, 2 Cir., 96 Fd. 2d 591, 592, 'business transactions within the taxing jurisdiction for the account of a foreign corporation do not necessarily involve the doing of business within the jurisdiction.' Thus, although factors or commission merchants are agents, it has been held that their activities in a state do not constitute the doing of business therein by the foreign principals they represent within the purview of statutes imposing franchise or license taxes. (Citing cases) Support for this position is found in the analogy afforded by decisions to the effect that foreign corporations are not doing business so as to be subject to the qualification laws of, or amendable to process in, states to which their products have been consigned for sale and sold by factors or commission merchants. (Citing cases) The decisions reason that since factors or commission merchants are independent contractors, the disposition of goods in their possession in accordance with the direction of their foreign principals constitutes a part of their busi-

ness rather than the business of the individual or corporations whose products they sell . . . In other words, jurisdiction of foreign corporations for purposes of process and regulation, as well as taxation, is dependent upon their presence or the exercise of their corporate franchises, and the sale of products of such corporations by independent contractors does not involve corporate presence or the exercise of corporate franchises . . ."

"It would seem to follow that if a foreign corporation marketing its products in a state through factors is not thereby 'doing business' in that state, it is not thereby 'doing business' outside of the state in which it engages in production activities. . . .

"We are of the opinion that cooperative marketing associations are factors, or so closely akin thereto that the question whether plaintiff was doing business outside of California by reason of their sales transactions in other states is governed by the foregoing authorities. Section 2026 of the Civil Code defines a factor as an 'agent who, in the pursuit of an independent calling, is employed by another to sell property for him, and is vested by the latter with the possession or *control* of the property, or authorized to receive payment therefor from the purchaser.' Clearly cooperatives which market the produce of their grower members in the manner disclosed by the facts of this case are embraced in that definition, and it has been so held in this state . . . Plaintiff argues, however, that the members of a nonprofit cooperative association in legal effect constitute the association, that the acts of the latter are the acts of the former, and that therefore the cooperatives in this case did not act as factors or in-

dependent contractors in selling plaintiff's produce. The argument is in reality a plea to disregard the corporate entity of the cooperatives for tax purposes. Similar pleas in comparable situations have been rejected, as where, for example, a foreign corporation employed a wholly owned and dominated subsidiary as an instrumentality to market its products in the taxing jurisdiction. . . ."

The Irvine Company case as is apparent from the above is from plaintiff's point of view uncomfortably close and parallel to the case at bar. Plaintiff does its best to attempt to distinguish the case from pages 47 to 50 of its brief. Plaintiff argues that the California decision is predicated solely on the fact that the taxpayer's only office and place of business was in California which marketed the greater portion of its products out of California through commission merchants or factors. Plaintiff seeks to confine the ruling to the proposition that where the corporation's only office and place of business is in the state where its products are produced and the factor has its authority from and responsibility to that office, the sales will be attributable to such office in the state of production. Conversely, it is argued that if the corporation has an office and place of business outside the state of production, the sales made by factor having its authority from and responsibility to such office are to be assigned to that out-of-state office. It is further argued that the "vital distinction" between the Irvine Co. case and the present case is that in the Irvine Co. case, the taxpayer's *entire* activities were confined to the tax-

ing (producing) state, whereas, in the case at bar plaintiff admittedly has a permanent office in New York. It is then claimed to follow that plaintiff "conducted its own sales activities and directed and supervised those of its agents from such out-of-state office."

Plaintiff's "vital distinction" outlined above appears to be without merit although ingenuous. All of the argumentative scenery present in the case at bar was present in the Irvine Company case, namely, the cooperative marketing association of which the taxpayer was a member was claimed not to be a "factor"; the marketing association and the outside produce brokers or commission merchants were claimed to be merely "agents"; corporate entity of the cooperatives was asked to be disregarded; the business done outside California by the marketing association and the produce brokers and commission merchants was claimed to constitute sales business done by the taxpayer outside California so as to permit it to apportion sales receipts outside California.

Both on the reasoning and on the facts the Irvine Co. decision is squarely applicable to the case at bar. The court points out only too clearly that the jurisdictional problem involved is dependent upon the corporation's presence or the exercise of the corporation's corporate franchise outside the state. The Court states:

"... The sale of products of such corporation by independent contractors does not involve corporate presence or the exercise of corporate franchise."

This means and can only mean that the sale of products is assigned to the state of production unless the corporation is present and doing business outside the state *in a selling capacity* or *exercising its corporate franchise to sell* outside the state. The decision stands squarely for the proposition that the business done by the factor or commission merchant is not the business of the producing corporation. Nothing in the opinion supports the view that the separate business conducted by the factor is completely identified with the "administrative office" to the exclusion of the producing state. The existence of an out-of-state administrative office in the Irvine Company case might have entitled the taxpayer to appropriate adjustments in the property and payroll fractions to reflect the net income attributable to such out-of-state office activity, but nothing in the opinion would assign to an out-of-state administrative office sales business conducted by a separate and distinct corporation functioning independently as a factor or commission merchant. Furthermore, the case meets squarely plaintiff's contention here that the sales subsidiary although a factor is nevertheless an "agent" whose acts and transactions constitute the acts and transactions of plaintiff. The Court rejected this argument as "in reality a plea to disregard the corporate entity." Significantly the court concluded that "plaintiff's activity in the marketing of its produce ceased when it delivered the same to the local cooperatives in California, and that plaintiff did not determine the manner, place or time of sale, nor the prices and quantities of produce sold." Just as clearly in the case at bar did plain-

tiff's activity in the marketing of its copper and molybdenite cease when it loaded the same on cars in Utah for out-of-state independent processing and sale. The sales subsidiary and not plaintiff determined the manner, place, time and price of sale.

In the case at bar plaintiff points to no facts whatsoever which show or even tend to show any activities of plaintiff's New York administrative officials which resulted in sales. All of the testimony, evidence and findings of defendant is to the effect that the only activities which resulted in sales were the activities of the sales subsidiary. No official or employee of plaintiff's New York administrative office conducted any activity whatsoever in behalf of plaintiff which resulted in the negotiation, effecting or the execution of a contract covering the sale of a single pound of copper or molybdenite. To apportion sales receipts outside the state, it is necessary for the producing corporation to have *its* own salesmen negotiating and effecting the sales in the name and in behalf of the corporation outside the state. Sales negotiated and effected by factors or commission merchants inside the state does not constitute business done *by* the principal and if done outside the state does not constitute business done outside the state by the principal.

Of interest in the present connection we refer the Court to the following:

In the Matter of *Markt and Hammacher Company*, 258 Appellate Div. 363, 16 N.Y. Sup. 2d 774, affirmed 283 New York 693, 28 N.E. 2d 412 (1940), the opinion of the Appellate Division states:

“In none of this testimony, however, did it appear that the petitioner actually maintained offices or bank accounts, or *operated in its own name* anyplace outside of New York State except possibly Canada.”

In *People ex rel. Southern Cotton-Oil Company v. Roberts, Controller*, 48 N.Y. Sup. 1028 (1898), the court states:

“The goods consigned to the commission merchants were in their possession and control, and *their disposition in accordance with the directions of the relator was a part of their business, not the business of the relator.*”

In *Union Internationale De Placements v. Hoey*, 96 F. 2d 591, the Court stated:

“Independent banks and brokerage houses within the jurisdiction transacting business, as here, do not become such an agent merely because the foreign corporation is one of their customers.”

In *Bank of America v. Whitney Central Bank*, a process case, 261 U.S. 171 (1923), the Court speaking through Mr. Justice Brandeis stated:

“Its regular New York business was transacted *for* it by its correspondents—the six independent New York banks. *They*, not the Whitney Central, *were doing its business in New York*. In this respect their relationship is comparable to that of a factor acting for an absent principal.”

The foregoing cases holding that the business of the factor is not the business of his principal and that when the factor acts he acts in his own behalf and not in behalf of his principal, we turn to the pertinent cases involving the construction of the similar statutory provisions in the Pennsylvania and Massachusetts tax laws. We also take up here the other branch of plaintiff's argument contained in pages 54-59 that the sales subsidiary as “agent” was chiefly situated at, connected with, or sent out from premises of plaintiff owned or rented outside the state.

It will be remembered that the Massachusetts, Pennsylvania and Utah statutes provide for the exclusion of receipts from the sales numerator only where the sales are negotiated and effected by agents in behalf of the corporation and also where it appears that such agents are connected with the corporation's out-of-state premises. No exclusion is permitted unless *both* of these factors are present.

We refer first to the leading case of *Commonwealth v. Bayuk Cigars, Inc.*, 345 Penn. 348, 28 Atl. 2d 134 (1942), affirmed 318 U.S. 746 (1943). This case affirmed the constitutionality of the Pennsylvania statute which, as applied, assigned to Pennsylvania receipts from sales

negotiated and effected out-of-state by a mobile sales force of 42 employees known as "territorial men." These salesmen were all non-residents of Pennsylvania, devoted their time exclusively to the taxpayer's business, performed all of their sales services outside the state and in fact only came into the state of Pennsylvania once a year to attend a general sales meeting. The men traveled constantly calling on various jobbers. They were on a salary basis with all of their traveling and hotel expenses paid by the taxpayer. Much of their business was transacted from hotel rooms. All cigars and tobacco sold by these territorial men outside Pennsylvania were shipped by the taxpayer from its plant in Pennsylvania.

Although clearly and admittedly the "territorial men" were sales employees on salary, negotiating and effecting sales in the name of the taxpayer and performing all of this sales activity outside Pennsylvania, the sales receipts were nevertheless assigned to Pennsylvania for the reason that such employees were not connected with or operating out of premises maintained by the taxpayer outside Pennsylvania. This is, of course, a perfect example of the somewhat restrictive effect of the Massachusetts, Pennsylvania and Utah statute. Such sales activities outside the producing state would under several states' tax statutes constitute the "doing of business" outside the state so as to require an apportionment of income outside the state. However, the Supreme Court of Pennsylvania, with the Supreme Court of the United States affirming, held that out-of-state hotel rooms from which

the sales employees mainly operated did not constitute premises maintained outside the state by the taxpayer and on this one ground permitted the assignment of all the sales receipts to Pennsylvania. The state court's opinion states:

“Appellant also ‘denies that such a tax may be measured by income attributable to the business activity outside the commonwealth’ on the ground of violation of due process. This contention must be rejected for the reason clearly stated in *Butler Bros. v. McColgan* . . . : ‘One who attacks a formula of apportionment carries a distinct burden of showing by “clear and cogent evidence” that it results in extra-territorial values being taxed.’ ”

The Supreme Court of the United States affirmed the judgment of the state court.

Plaintiff on pages 46-47 of its brief seeks to distinguish the *Bayuk Cigars* case on the ground that the selling activities of the salesmen were “supervised, directed and controlled by the home office in Pennsylvania.” It is stated that plaintiff “has no quarrel with this decision” and that it supports plaintiff’s theory that the sales are to be assigned to the head office of the corporation from which the selling activities are directed and controlled and to which those making the sales are responsible. The case, however, cannot be brushed aside so easily. It meets squarely that part of plaintiff’s argument that the sales of copper and molybdenite should not be assigned to Utah because the *sales are made outside the state*. The case flatly holds that production within and sale without

the state is business done entirely within the production state. Even if plaintiff's sales subsidiary were selling as the "territorial men" were selling, that is, in the name of plaintiff, plaintiff still would not be entitled to assign the sales receipts outside Utah for the reason, as we will hereafter show, that the premises of the sales subsidiary are maintained by itself. The Bayuk Cigars case does not hold that administrative "supervision" over the independent selling business conducted by factors or commission merchants is business done or sales negotiated and effected by the administrative office. The case holds definitely that under a statute like that of Utah, if a corporation is doing business within the state producing and manufacturing cigars therein, sales of such goods are assignable to business within the state unless the taxpayer can fit his case squarely within the statutory exception. Plaintiff in the case at bar cannot do this. The sales are negotiated by and in the name of its sales subsidiary and from the subsidiary's own premises.

We refer next to the case of *Commonwealth v. Minds Coal Mining Corp.*, 360 Pa. 7, 60 At. 2d 14 (1948). The following facts are quoted from page 16, Atlantic Reporter:

"The defendant is a corporation of the state of West Virginia duly authorized to engage in business in this state and actually so engaged during the tax year in question. It owns and operates a coal mine in West Virginia, maintains a mine office there, and has a mailing address at P. O. Box 1086, Elkins, West Virginia. It mines no coal

in Pennsylvania. It does, however, maintain its only executive and administrative office at Ramey, Pennsylvania, and two of its officers are chiefly situated there. The defendant made a contract with the Bulah Coal Mining Corporation, hereinafter referred to as 'Bulah,' whereby the latter agreed to act as sales agent of the defendant. *Bulah maintains its own offices in New York, had its own salesmen and sub-agents, and procured sales totaling \$1,585,847.27 during the year 1941. By the contract Bulah agreed to act as sales agent and authorized representative of defendant for the sales of bituminous coal and to observe certain price limitations and federal regulations. It agreed to make contracts with purchasers; to invoice all shipments of coal direct to the customer or other agent; to collect for sales; and to assume the credit risk. Orders for coal were forwarded by Bulah to the mines of the defendant in West Virginia, where coal was allotted by the superintendent of the defendant to fill the several orders. The coal was shipped from West Virginia, Bulah being the consignor. The defendant billed Bulah for the coal and paid it the stipulated commission. Bulah alone collected from the purchaser and was responsible to the purchaser."*

From the above statement it is apparent that the relationship between Minds Coal and Bulah, its sales agent in New York, was essentially the same as the sales relationship between plaintiff and its sales subsidiary with the minor difference, not here material, that Bulah functioned not only as a factor but as a delcredere factor by its assumption of the credit risk. Bulah made the contracts, issued the invoices, collected for the sales and in

all respects dealt as did the plaintiff's sales subsidiary solely and exclusively with the customer. The only difference between the facts of the two cases is as plaintiff points out the fact that the mine was located not in Pennsylvania, the taxing state, but in West Virginia. It is on this lone fact that plaintiff at pages 50-51 of its brief seeks to distinguish the Minds Coal case and would have this Court believe that "sales business" is invariably attached to the "administrative office" regardless of who actually conducts the selling business and irrespective of the special and unique claim of the state of production to the sales receipts where the products are sold out-of-state through independent marketing instrumentalities.

Leaving aside for the moment this fact that the goods were produced outside the taxing state, we proceed into the opinion of the court which after referring to the statutory provisions relating to the gross receipts factor, stated:

"It is admitted that the appellant does not transact all its business in Pennsylvania. By virtue of the above provision, therefore, its gross receipts from sales of coal are assignable to Pennsylvania, unless the defendant comes within the exception. The only sales excepted are 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 *maintained by the taxpayer outside the commonwealth.* (Italics ours.) *The sales negotiated by Bulah were not obtained by*

agents working out of premises maintained by the defendant outside the commonwealth. Under the statute they are, therefore, assignable to Pennsylvania. But, says the defendant, Bulah was an independent contractor and its activities must be disregarded (see brief, page 9). We know of no case where it has been so held. The Continental Rubber case, 347 Pennsylvania, 514, 32 At. 2d 878, 879 referred to by counsel does not so hold. In fact the opinion of the Supreme Court, in discussing the contention that sales were made by an independent contractor, stated 'This would affect the terms of the last two fractions.' We think the difference is thus: If sales are negotiated or effected through an agency maintained by the taxpayer outside of this commonwealth they are not assignable to Pennsylvania; but if they are negotiated or effected by other means, as for example, by an independent contractor serving as a sales agent in another state, maintaining its own offices there, and having its own salesmen or subagents, they are assignable to Pennsylvania. Without prejudging any future case, we may say that we definitely so hold in this instance."

The above opinion when read in the light of the lower court's opinion and the Continental Rubber case and other Pennsylvania cases makes plaintiff's statement on page 52 of its brief, that the Minds Coal decision assigns gross receipts from sales to the state where the executive offices are maintained and not to the state of production, clearly incorrect and not in accord with the decision. The other case involving the Continental Rubber Company dealt specifically with the collateral issue under the statute as to whether the out-of-state agent was negotiating

and effecting the sales *in behalf of* the corporation where such sales were made by the agent in the name of the corporation. In the *Minds* case, both in the lower court, 59 *Dau. C. R.* 95, and in the Supreme Court the decision in favor of the commonwealth was placed on the same ground as that in the *Bayuk Cigars* case, namely, that the sales were not negotiated and effected from premises maintained by the corporation outside the commonwealth. The court itself italicized that portion of the statute relating to the maintaining of premises by the taxpayer outside the state. It then stated: "The sales negotiated by *Bulah* were not obtained by agents working out of premises maintained by the defendant outside the commonwealth. Under the statute they are, therefore, assignable to Pennsylvania." As in the *Bayuk Cigars* case it was sufficient in sustaining the assignment of the receipts to Pennsylvania merely to show that the out-of-state selling office was maintained by *Bulah*. The court did not nor was it necessary to do so make any detailed analysis of whether the sales negotiated by *Bulah* were sales negotiated and effected "in behalf of the corporation."

Furthermore, the opinion of the court makes it quite clear that the sales receipts were assigned to Pennsylvania, not because the sales business conducted by *Bulah* was not *Bulah's* separate, distinct and independent business, nor that the existence of an administrative office in Pennsylvania constituted the conduct of a selling business in Pennsylvania, but by reason of the simple fact that

the corporation was doing business in Pennsylvania and, therefore, subject to tax as the statute directed. The corporation, a West Virginia Corporation, was qualified to engage in business in Pennsylvania and was actually so engaged. It was thus taxable in Pennsylvania. It was taxable under the Pennsylvania law. This law, in the apportionment of the corporation's total net income assigned to Pennsylvania all of the sales receipts of the corporation, unless the corporation could fit within the statutory exception. It was unable to do this for the reason that the sales business conducted by Bulah in New York was not business done outside Pennsylvania by the corporation within the purview of the Pennsylvania statute. The fact that its mine was located in West Virginia and the bulk of its payroll in West Virginia would apparently result in the assignment outside Pennsylvania of a large percentage (approaching two-thirds) of its total net income. Pennsylvania's only claim to tax under the formula, therefore, would be based on the extent to which the Pennsylvania statute assigned sales receipts to Pennsylvania and on the amount of administrative payroll in Pennsylvania. If it had established a branch sales office in New York and had negotiated and effected the sales to customers in its own name and for its own account, Pennsylvania's tax would have been negligible, if any, because all property, all payroll (except perhaps 3 per cent) and all gross receipts from sales would have been excluded from the Pennsylvania numerators of the three fractions. The mere existence of an administrative office in Pennsylvania, in these circumstances, could at most only as-

sign that small proportion of the company's total net income which would result by including the Pennsylvania administrative payroll in the numerator of the payroll fraction.

It is quite true as plaintiff intimates (pages 52-53) that if West Virginia had exactly the same statute as Massachusetts, Pennsylvania and Utah, all of the sales receipts would also have been under the formula assigned to West Virginia, the state of production. This is regrettable, of course, but only another instance of the difficulty of using the sales factor at all. Sales receipts may be and frequently are assigned to two or more states if the statutory formulas are applied literally. The possibility, however, of double taxation does not invalidate the formula. In fact to prevent the possibility of double taxation actually arising, most of the states have a provision similar to subdivision 8 of the Utah statute, which permits an alternative basis of apportionment if double taxation actually exists.

If plaintiff, engaged in production activities in Utah, had its administrative and executive offices in Pennsylvania, processed its blister copper at its *own* refinery in Massachusetts and marketed the copper and molybdenite through its sale subsidiary or an independent factor or commission merchant in New York, the sales receipts would be assigned to all three states, namely, Utah, Pennsylvania and Massachusetts. Plaintiff's recourse, in these circumstances, would not likely be a constitutional attack

on the application of the tax statutes of the three states but would be a re-arrangement of its method of conducting business or by way of a re-arrangement of the method of keeping its accounts to permit a direct allocation, or by way of an application under subdivision 8 of the three statutes for such alternative basis of apportionment as would not result in double taxation.

Although the Minds Coal case would appear to substantiate the claim of New York to an assignment to New York of all of the sales receipts of the Utah Division if the New York and Utah laws were identical on the sales factor, *it is the fact here* in the case at bar that no claim or suggestion is made that even a tax on the full 100% net income of the Utah Division would result in *any* double taxation. New York's statutory provision relating to the sales factor in fact differs from that of Utah, Pennsylvania and Massachusetts and it may only be concluded here that by reason of this fact or by reason of the separate accounting methods employed by plaintiff or otherwise that none of the net income which it alleges is attributable to the activities of the administrative office in New York is so regarded for the purposes of New York franchise tax purposes.

The decision of the Supreme Court of Pennsylvania in *Commonwealth v. Continental Rubber Works*, 347 Pa. 514, 32 At. 2d 878, points up clearly the distinction here being urged, and pointed out in the opinion of defendant below, namely, "between the case of sales in the name and

property, wages and salaries, and gross receipts of all of the subsidiary companies and add them to the same fraction of the taxpayer."

Again,

"The statute is plain. The allocation fractions are to be made of the tangible property, wages and salaries and gross receipts of the taxpayer. That does not authorize a hunt for something outside that may have some effect upon the value of the capital stock of the taxpayer."

Plaintiff's argument here that administrative "supervision" over the sales activities of its sales subsidiary automatically converts the business done by the subsidiary into business done by the administrative officials is directly contrary to the reasoning of the Supreme Court of Pennsylvania in *Commissioner v. Quaker Oats Company*, reported in 350 Pa. 253, 38 At. 2d 325, appeal dismissed 324 U.S. 827 (1945). Unlike the case at bar, the Quaker Oats case dealt with a business operation which was admittedly unitary. The taxpayer company engaged in (1) purchase and storage of grains, (2) manufacture of cereals and cereal products and (3) selling and dealing in cereal products. The business of selling was not separately incorporated or conducted by an affiliated company, but all sales were conducted by and in the name of the taxpayer corporation. Its principal office was in Chicago, Illinois, and all of its manufacturing was done outside of Pennsylvania. "Throughout the United States and abroad it maintained a vast selling enterprise for the marketing of its own products and the products of its sub-

sidiaries." It maintained in Pennsylvania two sales offices, one at Pittsburg and the other at Philadelphia. The company was thus selling in its own name and behalf and from its own premises in Pennsylvania goods and products manufactured outside the state. The sales negotiated by the salesmen in Pennsylvania were not finally consummated until approval and acceptance by the out-of-state home office. The company contended that the gross receipts fraction of the formula was improperly computed and that such sales should be assigned to the out-of-state home office and not to Pennsylvania. The Court stated:

"Appellant would have us construe this to mean that sales attributable to Pennsylvania must be only those which are *both negotiated and effected* within the state, using 'effected' in the sense of *consummated, or completed*. Such a construction would, of course, enable this appellant, or any foreign corporation, to eliminate a third allocative fraction from the tax formula by so arranging its sales machinery that all contracts would be 'accepted' and, therefore, consummated at the home office. This is clearly contrary to the intention of the legislature, which was that *the gross receipts fraction should reflect that portion of corporate activity conducted in this state* resulting in gross receipts to the corporation in the form of sales, rents and royalties. To assign to the word 'effected' the meaning urged upon us by appellant would controvert and frustrate the legislative purpose. 'Effected' has no technical meaning as a legal word of art. It is used in different senses and, often loosely in contracts and statutes. Here, it is clear that it was intended to

mean 'accomplished' or 'brought about': See Webster's New International Dictionary (Unabridged). Given that meaning, it is consistent with the context and purpose of the section. The case of *Commonwealth v. Continental Rubber Works*, 347 Pa. 514, cited by appellant supports this construction and opposes the construction for which appellant contends. There we held that sales negotiated by a branch sales office in Missouri *but approved and accepted* in Pennsylvania were assignable *outside* of Pennsylvania under Sec. 21 (d) above quoted. While it is true that the legislature excepted sales negotiated or effected outside of Pennsylvania, it is clear that it would not have intended the inclusion in the fraction of only those sales which were both negotiated and technically completed in this state, or by salesmen operating from agencies in this state."

The above language again confirms the plain meaning of the Utah statute that only sales negotiated and effected by *salesmen* in the name and in behalf of the corporation from the corporation's out-of-state premises are entitled to assignment outside the state. Not entitled to exclusion under any circumstances are sales negotiated and effected by independent brokers, factors or commission merchants and not by salesmen of the corporation. Just as out-of-state home office control of the local sales activity even down to the point of acceptance and approval of individual orders does not constitute the negotiation or the effecting of the sale by the administrative home office, so also in the case at bar even more plainly would administrative control over the independ-

ent activities of the sales subsidiary not constitute the negotiation or effecting of sales by the administrative office.

As to whether the sales business conducted by the sales subsidiary is in law the conduct of a sales business by plaintiff as parent, we invite the Court's attention to *Superior Coal Company v. Department of Finance*, 36 N.E. 2d 354, (1941) decided by the Supreme Court of Illinois. Here a wholly owned subsidiary of a railway company was engaged in the business of mining coal and selling substantially all of the output to its parent company. The question was whether the subsidiary was engaged in *the business of selling* within the meaning of the retailer's occupation tax law with respect to the sale of coal to the parent corporation.

Bearing in mind that in the case at bar plaintiff's entire output of copper and molybdenite is transferred to the sales subsidiary for resale by the subsidiary, we quote the argument of plaintiff in the Superior Coal Case:

“... Plaintiff maintains that it is, in fact, but a department or branch of the railway company; that it is merely an agent or instrumentality of the parent corporation; that coal mined by the plaintiff for use in the railway company's business is, in reality, mined by the railway company itself, and that the transactions in question between the plaintiff and its parent are no more ‘sales’ than would be any interdepartmental transfer, or the direct mining by the railway company of coal for its own use through an agent, under any circumstances to which the law of agency is applicable.”

With respect to the close inter-relationship, we quote the following:

"It appears that the plaintiff's office has always been maintained at the general offices of the railway company. Fred S. Pfahler, president of the coal company, during the period involved in this litigation, was coal traffic manager of the railway company. Pfahler occupies offices immediately adjacent to the railway company's statistician and near the railway company's law offices. The corporate records of the plaintiff are kept in the office of the secretary, who is also the secretary of the railway company, and are part of the regular files in the office of the secretary of the railway company. Records relating to lands are kept in the office of the railway company's land commissioner. Records relative to taxes are kept by, and in, the office of the railway company's tax commissioner. Likewise the accounting records of the coal company are kept in the office of the controller of the railway company. The controller holds the same position in both companies and neither his salary nor the salary of the accountants, bookkeepers and clerks are paid by the plaintiff, with the exception of one accountant paid by the coal company for 'special work' at the mine. Plaintiff pays, in addition, \$225 per month out of its funds for accountant's traveling expenses. The chief clerk of the coal company's president at Gillespie is an employee of the coal company and paid by it. Attorneys representing the coal company are members of the law department of the railway company. An attorney at Gillespie is employed independently for the purpose of representing the coal company in workman's compensation proceedings . . . There are

other instances in which the two companies are intimately affiliated but which need not be narrated. *In general, the coal company does not reimburse the expenses of the railway company departments incurred in its behalf.* The plaintiff coal company orders material and supplies from third parties *in its own name* and on its own stationery, apparently obtaining credit as a separate corporation and incurring a liability chargeable against its own assets. In communications among the officers of the two companies stationery without letterheads is used, the practice which obtains in interdepartmental correspondence of the railway company, but which is not the practice of either company concerning outside correspondence. The fact remains, inventory, property and funds of the two companies are kept separately, although often in the same offices and by the same individuals."

It further appeared that the subsidiary received checks from the railway company and "deposits them in its own bank account." The Court cites various authorities including that of *In re Bush Terminal Company*, 93 F. 2d 661 (CCA 2), in which the Federal Court had permitted the City of New York to tax the gross receipts derived from sales of steam by a wholly owned subsidiary to its parent corporation. The court rejected the argument of plaintiff and stated:

"Having utilized separate corporate forms for nearly 40 years, having undoubtedly secured financial and economic advantages as a result during this period, and having consistently employed the legal habiliments incident to a sale in

the transactions involved in this litigation, thereby evidencing its real intent, we are of the opinion that the plaintiff is not now in a position to renounce its separate corporate entity and ask that its separate corporate existence be disregarded at the expense of the state."

Again with respect to plaintiff's contention in the case at bar that the sales subsidiary is merely an "agent" of plaintiff and that its business is the business of the administrative office in New York, we invite the court's particular attention to the case of *Esmond Mills v. Commissioner*, 132 Fd 2d 753 (1943) (CCA 1). Here the effort of the taxpayer was not directed at setting aside the separate corporate entity of its sales agent subsidiary, but the separate corporate entity of its purchasing agent subsidiary. It appeared that the Esmond Mills, a Massachusetts corporation, located at Esmond, Rhode Island, was engaged in the business of manufacturing and selling blankets and other products. Its wholly owned subsidiary, the Smithfield Company, also a Massachusetts corporation, located at Esmond, was engaged in the business of buying cotton and wool for its parent on commission. The subsidiary "took title to the goods *in its own name* until transferred to Esmond."

On transfer of title from the subsidiary to the parent, the subsidiary was credited with the cost of the same plus "Commissions" which was the only income of the subsidiary and which was reported on the subsidiary's separate income tax return for the year 1937. The market

price of cotton and wool declining in 1937, the subsidiary reduced the book value of its inventory by \$33,904.95, but did not deduct such amount in its 1937 tax return. The parent, although it did not include the subsidiary's inventory as a part of its own inventory nevertheless paid the subsidiary the above amount of \$33,904.95 and deducted such amount as a loss on its 1937 tax return. The subsidiary also in 1937 obtained the cancellation of certain contracts to buy cotton and wool, the prices in such contracts being higher than those then existing, upon payment in 1937 to certain brokers of the sum of \$31,636.19 which amount the parent advanced to the subsidiary without reimbursement. Such amount was also deducted on the parent's tax return for 1937.

The Circuit Court upheld the decision of the Board of Tax Appeals that the parent could not in its return deduct the losses of its subsidiary and held that the subsidiary was not an "agent" for the reason that in making purchases of cotton and wool *in its own name* it was in all respects conducting its own separate and distinct business. The Court stated at page 755:

"The Board held on the basis of the record that Esmond and Smithfield are separate entities for the purpose of taxation. We believe that there is sufficient evidence in the record to sustain the Board's conclusions. It is true, as the findings indicate, that Esmond owned all of the capital stock of Smithfield and that Smithfield's only activity was the purchase of cotton and wool for it. The courts however will not disregard corporate en-

tities merely because of a parent subsidiary relationship . . . ; they will look behind the intercorporate setup only if there is evidence of a purpose to evade a statute or to practice fraud upon third persons . . .

“The record shows that Smithfield made purchases of cotton and wool *in its own name* and retained title until it transferred the same to Esmond. It carried its own inventory on its own books; it made contracts with third persons *in its own name*; it filed an income tax return in the year in question and reported commissions from Esmond as income, and the balance sheet included within its return lists as inventory the wool and cotton which it held *in its own name*. All of these facts show that the petitioners were of the opinion, and apparently good business dictated, that the two corporations should preserve their separate entities.”

Plaintiff's argument from pages 54 to 59 of its brief that the premises of the sales subsidiary were the premises of plaintiff appears to be clearly unsound and directly contrary to the facts of the case. Among the findings of defendant with respect to this point is the following (F. page 144) :

“d. The business of the Sales Corporation was conducted in its own name from its own office and premises at ‘120 Broadway, New York 5, N. Y.’, shared with its affiliated and parent company, Kennecott, under lease arrangements entered into by Kennecott with the Equitable Office Building Corporation providing not for the exclusive use and occupancy of the premises by Kennecott alone, but for the joint use and occupancy of

the premises as executive and sales offices for itself and subsidiaries. The Sales Corporation was thus occupying and using the premises for an office and a place of business at '120 Broadway, New York 5, N.Y.', not illegally or unlawfully but under and by virtue of a lease entitling it to possession as a subsidiary of Kennecott. In paying and reimbursing the Disbursing Department of Kennecott for its proportionate share of 'New York Office expense,' including rent, separately itemized and computed, the Sales Corporation was paying for and renting its own office and premises from which its own business was conducted and transacted in its own name."

We also refer the Court to pages 113-140 of the Findings where the full and complete details with respect to the New York premises of the sales subsidiary and plaintiff are set forth. Defendant found that the offices and premises of plaintiff and the sales subsidiary in New York were joint offices and premises "in and from which the business and corporate functions of each corporation were separately performed and conducted."

By plaintiff's Exhibit 52 (2), referred to in pages 46-47 of the Findings, Mr. C. K. Lenz, President and Sales Manager of the sales subsidiary, and Mr. H. E. Westlake, Vice President and Assistant Sales Manager of the sales subsidiary, are shown during the period involved to have held no position in plaintiff and were officials only of the sales subsidiary. The "Disbursing Department" of plaintiff for accounting convenience and control handled all disbursements and records pertaining

plies, and the other miscellaneous expenses that usually pertain to the maintaining of an office?

A. That is right."

In these circumstances defendant found that the sales subsidiary was leasing and renting its own premises from which its own separate business was being conducted. Any other finding would have been inconceivable and at variance with the testimony of record. Where a parent corporation takes out a lease of premises for use by itself and subsidiaries for executive and sales offices, where joint offices are in fact maintained from which the separate business of each company is conducted, where the parent immediately on paying the rent in turn bills the subsidiary for its proportionate share of the rent and other office expense, the subsidiary is obviously and clearly paying its own rent and maintaining its own premises.

On Pages 57-8 of its brief, plaintiff, although admitting that the sales subsidiary was charged by plaintiff "for its appropriate portion of the cost of such services" and that among items paid each month by the sales subsidiary was an item designated as "rent", is apparently at the same time attempting to suggest that the sales subsidiary had no premises or office of its own from which its own separate and distinct business was being conducted. The sales force actually engaged in the day-to-day business of negotiating and effecting contracts of sale of copper and molybdenite in the name and in behalf

of the sales subsidiary was, according to the floor plan, in a largely segregated portion of the space jointly occupied. Even so it would make little difference here that the total office space was not clearly marked, delineated and partitioned off between the two companies. Joint use and occupancy of space by two separate and distinct companies, each paying their fair share of the rent, clearly does not constitute being "situated at, connected with, or sent out from" premises of the other within the meaning of our statute.

The initial payment each month by plaintiff of the entire rent covering the joint use of the premises followed by the immediate reimbursement by the sales subsidiary of its share of the rent is exactly the same as if two checks had been mailed and makes it quite obvious that the sales subsidiary was paying its own rent and renting its own premises. In fact, when analyzed plaintiff's argument really simmers down to a plea that the sales subsidiary in effect was a mere phantom with no office or existence at all in New York, the premises, offices and operations being those solely and exclusively of plaintiff. This is of course erroneous as Mr. Lenz testified (Tr. 619, F. p. 139):

"Q. Where does Kennecott Sales Corporation conduct its sales?

A. Its office is, as I have previously stated, in New York City . . ."

Bearing in mind that the payroll factor in the Utah and Pennsylvania statutes has substantially the same language pertaining to the owning or renting of out-of-state premises as that in the sales factor, the Pennsylvania case of *Commonwealth v. American Gas Company*, 352 Pa. 113, 42 At. 2d 161 (1945), involving not the parent but the subsidiary constitutes essentially the adjudication of the same question involved here with respect to the owning or renting of New York office premises by plaintiff's sales subsidiary. It will be recalled that the Utah payroll numerator consists of "the compensation of employees not chiefly situated at, connected with, or sent out from, premises for the transaction of business owned or rented by the corporation outside this state." In the American Gas case it appeared that the taxpayer was a subsidiary of United Gas Improvement Co. In the wage and salary fraction the Commonwealth included the figure of \$5,000 representing the "management fee" paid to the parent company for supplying five officers to the subsidiary company, together with the personnel of the corresponding departments of the parent company, at stated yearly compensations.

The court stated (p. 162):

"Appellant's first contention is that the Court below erred in using the management fee paid to the United Gas Improvement Company as the numerator and denominator of the wage and salary fraction. *It contends that this was a corporate expense but not a payment of wages or salaries.* The management agreement between

the United Gas Improvement Co. and appellant provided that the former should supply to appellant 'from its organization the following officers for our company: vice-president (a financial executive), secretary, treasurer, controller, and general counsel, together with the personnel of the corresponding departments of your company, to perform such routine duties incident to such offices as our company may direct.' It was also provided 'that no salaries are to be paid by our company to these officers, but for their services and the services of their departments, we agree to pay you \$5,000 per year in equal monthly installments as follows: vice-president . . . \$1,500, secretary . . . \$500, treasurer . . . \$750, controller . . . \$1,000, general counsel . . . \$1,250.

"United Gas Improvement was also to be reimbursed for the traveling and living expenses of its employees while performing services for appellant away from the Philadelphia office of the Improvement Company.

"This agreement was a contract for the services of five officers and for clerical assistance. *These officers under the law were officers of appellant, despite their relation to United Gas Improvement Company, who had definite statutory obligations to appellant as its employees.* The device of paying their salaries, through the parent corporation was ingenuous but not conclusive of their status. It is unlikely that the United Gas Improvement Co. would contend that it is engaged in the labor brokerage business, supplying trained personnel to other corporations. *It is clear that the amounts designated for each of the officers of the appellant were salaries which the officers were to receive indi-*

rectly through the United Gas Improvement Co. The court below has held that these persons were employees of appellant engaged in appellant's business during the year 1935, and that the sums paid to the United Gas Improvement Co. for them were wages and salaries within the meaning of the franchise tax act. The record supports this conclusion and it is affirmed."

The above case constitutes clear authority for defendant's contention here under the similar language of the sales or gross receipts factor that the rent paid by the sales subsidiary to plaintiff each month in fact constituted the payment of rent for its own premises, just as in the above case the annual payment of \$5,000 by the subsidiary to the parent was held to constitute the payment by the subsidiary of salaries to *its employees* notwithstanding that the services hired were to be performed by officers and departments of the parent company for the subsidiary. We emphasize also the pertinence of the American Gas case to plaintiff's suggestion (vigorously pressed during the hearing) that the sales subsidiary had no "employees" of its own at all, that all of its functions were performed by "employees" of plaintiff for which a monthly "service charge" was billed to the sales subsidiary, and that the "salaries" and "rent" were merely a couple of items which went into the calculation and measurement of a "service charge". Defendant, however, on the evidence found that the item "rent" was rent and that the item "salaries" was salaries, particularly where

100% of Mr. Lenz's staff and the sales force although initially paid by plaintiff's disbursing department for accounting convenience was immediately billed to and paid by the sales subsidiary.

State v. Northern Pacific Railway Co., 153 N.W. 850 (1915) (Minnesota), is likewise direct authority for the proposition that the work performed by plaintiff's legal, accounting and other departments for the sales subsidiary at cost constituted the separate business of the sales subsidiary. In this case it appeared that Northern Pacific, a common carrier, operated certain freight warehouses at Minneapolis and Duluth on its line of railway using them for the purpose of receiving and transferring freight to cars for shipment, temporarily storing freight, and receiving freight from its cars for delivery to consignees or connecting carriers. Certain other railway companies having lines of railway running into the two cities did not have freight house facilities at such points and the freight of such other companies was handled at the freight houses of the Northern Pacific and "by the employees and agents of" Northern Pacific. The agents and employees of Northern Pacific assumed "to deal and treat with shippers as agents and employees of the said other railway companies." The other railway companies paid Northern Pacific "as compensation for the use of its freight warehouses and the services of its employees in performing such services a certain flat rate per ton for the freight so handled." It further appeared that the Northern Pacific's employees "in performing

the services and in billing and collecting charges as between themselves and the public acted as the agent of such other companies. They reported and accounted directly to such other companies in all such matters but were paid wages by" the Northern Pacific only. The opinion further states:

"The flat rate per ton received by defendant represented as nearly as possible the actual cost of the services performed, and was agreed upon for convenience and ease of accounting."

It also appeared that Northern Pacific owned certain warehouses at Duluth which were situated in wharves or piers and so arranged that Northern Pacific's cars could be loaded or unloaded on one side of the warehouse and freight boats plying to and from the port of Duluth could be loaded or unloaded on the other side. Freight was sometimes temporarily stored in such warehouses. The boat companies were required to unload inbound freight and by arrangement with Northern Pacific, the latter company employed stevedores to perform all the manual labor of handling the freight. The boat lines paid Northern Pacific a certain flat rate per ton for all freight handled in delivering said freight to and from the dock, which rate represented actual cost as nearly as could be determined. The question in issue was whether the sums received from the other railway companies and from the boat companies under the above arrangements represented gross earning to Northern Pacific from its own business or whether being done for the other railway

companies and boatlines constituted the separate business of the other railway companies and the boatlines. The opinion states at page 851:

"The state contends that the monies received by defendant for handling freight of other roads through its warehouses represent earnings derived from operation. Defendant asserts that such is not the case; that the services rendered are rendered by its agents as agents for the other lines; that the monies by it received represents the actual cost of the service rendered and no more; and that in effect it is merely the hiring and disbursing agent for the other roads."

The opinion quotes from *State v. Union Depot Company*, 42 Minn. 142, wherein it was stated in part as follows:

"We cannot see what difference it can make whether they hold the depot property as tenants in common, or put it in the name of a trustee to hold and manage for their common use, or, as in this case, organize a corporation for the same purpose, as a more economical and convenient method of holding the property, managing the business, and apportioning the expenses among themselves."

The Court further stated:

"What has been said relative to monies received by defendant for handling freight for other railway companies through its freight depots and warehouses applies in equal force to monies received by it under its contract with the boat companies. The defendant, in hiring the men to do the work really acted for the boat companies. It paid

for the actual cost of the work, made no profit, and received back from the boat companies only what it expended.

"It merely undertook, for the convenience of all parties, to perform for the boat companies at actual cost a duty which the boat companies owed to shippers growing out of the operation, not of the railroad, but of the vessels."

On page 58 of its brief, plaintiff seeks to illustrate the "lack of substance or reasonable basis" for defendant's position on the premises question by speculating what the decision might have been if plaintiff had *owned* the building rather than leasing premises from the Equitable Office Building Company for itself and subsidiaries. It is claimed "in such case, the space occupied by the employees of the sales corporation would have been in premises 'owned by Kennecott.'" This hypothetical possibility is not involved here but even if plaintiff did own the building and leased premises to the sales subsidiary for the transaction of the subsidiary's sales business therein, the premises would still be "rented" by the sales subsidiary for the transaction of its own business and not the business of plaintiff. The sales subsidiary's rental of premises for its own business most certainly would not constitute ownership of premises by plaintiff for the transaction of a sales business in New York. Furthermore, under our statute such rent, like dividends, received by plaintiff from the sales subsidiary would be specifically assigned and allocated to New York.

Aside therefore from any question pertaining to the property fraction, the payroll fraction and the assignment of receipts from sales of gold and silver outside the state, defendant by its decision has correctly and in every respect fully applied the statutory formula by way of an adjustment to the separate accounts of plaintiff's Utah Division. Defendant's decision has not assigned to Utah any net income whatsoever which is not attributable entirely to Utah. The facts and the pertinent authorities heretofore cited by defendant clearly establish that the sales of copper and molybdenite produced by the Utah Division and negotiated and effected by the sales subsidiary from its own offices and premises in New York do not constitute business done by plaintiff in New York. Plaintiff has failed to establish that the gross receipts from the Utah molybdenite and copper product were within the statutory exception contained in the Utah statute. The sales of copper and molybdenite were not negotiated or effected in behalf of plaintiff but were negotiated and effected in behalf of the sales subsidiary acting in its own name and in the regular course of its own business. Nor was the sales subsidiary chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by plaintiff outside Utah. Mr. Lenz and his sales force were chiefly situated at, connected with and sent out from the sales subsidiary's own premises for the transaction of its own business in premises and offices rented and paid for by the sales subsidiary. The sales of copper and molybdenite have not otherwise been determined by the Tax Com-

mission to be attributable to the administrative business of plaintiff conducted at its New York administrative office nor on the facts of the case could the separate business of the sales subsidiary in negotiating and effecting the sales of copper and molybdenite in any way be deemed to be attributable to, a part of or represent the business of plaintiff conducted by plaintiff in its own premises. In these circumstances we ask under this Point 3 that, in any event, defendant's decision be affirmed.

Plaintiff's argument at pages 59-60 of its brief with respect to the "long standing administrative construction" is we submit without merit for the reason that even assuming the 1941 "settlement," covering the years 1935 to 1941, inclusive, be regarded as "administrative construction" such settlement in view of the facts now of light in the record would be invalid and directly contrary to the specific terms of our statute.

With respect to the 1941 settlement, we quote from *Buick Motor Co. v. City of Milwaukee*, 48 Fd. 2d 801 (1931) page 803:

"It is insisted for appellant that the transactions of 1920 and 1921 between appellant and the commission has estopped the commission from questioning returns made in pursuance of the understanding apparently then reached. Apart from any question of the right of the commission to bind the state by any understanding or contract, it does not appear that what was then done rose to the dignity of a contract, nor that there was a hearing and decision by the commission adjudi-

eating the rights of the parties. In any event, it seems plain that at that time all of the salient facts bearing upon appellant's income were not before the commission."

Furthermore, as stated in *New Park Mining Company v. State Tax Commission*, 113 Utah 410 (1948):

"This is determinative of the case for even if there were an administrative interpretation such as plaintiffs assert, this court could not permit such an interpretation to stand in flat contradiction to the clear terms of the statute."

Also it should be noted that there is nothing in the record to show or in any way tend to show that plaintiff's construction of the statute ever constituted a general administrative practice or construction by defendant of the Utah corporation franchise tax law as applied generally to all corporations doing business within the state. In fact, plaintiff's suggested construction appears to be diametrically opposed to the general construction of the law by defendant and particularly and especially as relates to the complete disregard by plaintiff of the separate corporate entity of and the fair and reasonable intercompany contracts with its sales subsidiary. Plaintiff's attempt here to combine and consolidate the operations of its Utah Division with the operations of its sales subsidiary for the purpose of attempting to apply the statutory formula to such combined and consolidated operations appears to be completely without precedent and opposed

to the clear meaning and general administration of the tax law. See: Annotation in 84 L. Ed. 28 entitled "Administrative or practical construction of statute as precedent for judicial construction."

Plaintiff's brief discussion of the constitutional aspects of the Utah statute and defendant's decision herein contained on pages 61 to 66 of its brief, has been fully considered and answered under defendant's Point I and other cases heretofore cited.

POINT IV.

IN COMPUTING THE "NET INCOME FROM THE PROPERTY" IN THE TOTAL AMOUNT OF \$243,436,508.96 FOR DEPLETION PURPOSES, DEFENDANT ALLOCATED *SOME* OF THE NET INCOME OF PLAINTIFF'S UTAH DIVISION TO POST-MINING OPERATIONS AND IN VALUING PLAINTIFF'S COPPER AND MOLYBDENITE MILL CONCENTRATES, DID NOT ERR IN ARRIVING AT A GROSS INCOME FROM THE PROPERTY OF \$621,940,441.37, NOR DID IT ERR IN DEDUCTING THEREFROM THE SUM OF \$108,653,459.48 REPRESENTING FEDERAL INCOME TAXES ATTRIBUTABLE TO THE MINE AND IN DEDUCTING THEREFROM THE FURTHER SUM OF \$269,850,472.43 REPRESENTING THE COST OF MINING, MILLING AND CONCENTRATING THE ORES.

We turn now to the propriety of defendant's calculation of plaintiff's depletion deduction for the years here involved. By its decision defendant determined that the gross income from the property was in the total amount of \$621,940,441.37. From this it subtracted \$269,850,472.43, representing the total mining, milling and con-

centrating costs for the period, and \$108,653,459.48 of federal taxes attributable to the mine which left a balance of \$243,436,508.96 of net income from the Bingham property before depletion. The statute allowing a deduction for percentage depletion in the amount of $33\frac{1}{3}\%$ of the net income from the property, plaintiff's depletion deduction as determined by defendant was in the total amount of \$81,145,502.98.

Plaintiff contends that in lieu of the net income figure of \$243,436,508.96, the correct net income figure should be in the amount of \$312,647,869.44. We are thus arguing about a difference in net income from the property to which the $33\frac{1}{3}\%$ allowance would be applied in the amount of \$69,211,360.48. Thus, in round figures instead of \$81,000,000.00 of depletion deduction actually allowed by defendant, plaintiff contends that the depletion deduction should be \$104,000,000.00.

Defendant's findings of fact with respect to depletion are contained on pages 168-190 of the Findings.

It is plaintiff's position that the term net income from the property "means the gross receipts from the sale of products less only cost and expenses," as set forth by its Point II on page 67 of its brief. Plaintiff's position is also set forth on pages 170-1 of the Findings as follows:

"Kennecott renews and persists in its contention, considered by the Supreme Court in Case No. 7298, 221 Pac. 2d 857, that it is entitled to depletion on the entire net income of its Utah Divi-

sion arrived at by taking the total gross cash receipts of the refined metals sold in the market and subtracting therefrom its total selling, refining, transportation, smelting, milling and mining costs, including applicable federal income and excess profits taxes. Put in another way, Kennecott uses a formula under which the mill concentrates are valued by subtracting from the amount realized on sales of refined metals (and molybdenite) the costs beyond the concentrating stage, including costs of transportation to smelter, smelting, transportation to refinery, refining, selling and delivery. This resulting figure is the 'gross income from the property.' From the 'gross income' so computed are subtracted the mining, transportation to mills, concentrating (or precipitating) costs, including taxes, and the balance is the 'net income from the property.'

"The effect of Kennecott's formula of computing its depletion deductions is to place the entire profit derived from all of the operations of mining, milling smelting, transportation, refining and selling back on the mining property for the depletion deduction. This method presupposes or assumes that no portion of the profit eventually realized on sale of the refined metals is in any applicable or attributable to the post-mining, smelting, transportation, refining or selling activities. All of the profit for depletion deduction purposes is on the mining operation, none on the post-mining operation."

In support of this position, as outlined above and referred to in the Findings, plaintiff relies upon certain arguments including the following:

(A) It hires the smelting, transportation and refining work done by independent concerns and any profit thereon is earned by such independent concerns.

(B) It is engaged in a unitary business and the successive stages of producing copper and other metal products represent mere cost accumulations, accounting wise, and no profit is realized until final sale.

(C) There is no representative market or field price in Utah for its mill concentrates by virtue of their enormous volume.

(D) Being mere cost accumulations there is no profit "attributable to" the post-mining operations and with no market price established in Utah for the mill concentrates, the Federal Regulation permitting the gross income to be determined by taking the market price of the first marketable product "minus the costs *and proportionate profits* attributable to the transportation and processes" beyond the mining and concentration stage is inapplicable.

(E) The "proportionate profits" referred to in the Federal Regulation and attributable to the post-mining operations only means proportionate profits if there are any, and there are alleged to be none here. The Federal Regulation is construed as if following the phrase "proportionate profits" the phrase "if any" were inserted.

(F) Its construction is supported by the legislative history of the Utah statute pertaining to the depletion deduction.

(G) The 1941 settlement constitutes "long administrative construction."

(H) Defendant used an "algebraic formula."

As stated in the New Park Mining Co. Case, *supra*, the theory behind the depletion deduction is that "wasting assets corporations are allowed a deduction for depletion on the theory that the taxpayer thus recoups its capital investment."

On page 41 of the brief of defendant in Case No. 7298 is the following:

"1. The fair value of the property as reported by the taxpayer for corporation franchise tax purposes for the year 1931, and upon which the minimum tax of $1/20$ of 1% of the fair value of the tangible property in Utah was computed by the taxpayer and accepted by the commission, was for all Utah property \$24,587,407.00, of which \$11,419,540.00 was assigned to mining property as such, exclusive of improvements, machinery and equipment. (R. 95)

"2. The book value of the property as of December 31, 1930, per balance sheet submitted as part of the 1931 Corporation Franchise Tax return was for depletive lands \$8,001,786.53. The balance sheet as of that date also shows non-depletive land in the amount of \$1,566,801.62. (R. 95)

"3. The invested capital in Utah, representing the cost of Kennecott's acquisition in the year 1936 of the Utah mining properties is shown to

be in the total amount of \$108,588,198.09. (R. 118), of which \$61,873,475.00 (R. 79, 80) *was determined to be the cost assignable to the mining property.*

“4. Depletion claimed on the corporation franchise tax returns of this taxpayer for the years 1931 to 1947, inclusive has been in the total amount of \$137,925,347.29. (R. 94)

“5. Depletion claimed and allowed for corporation franchise tax purposes for the years 1931 to 1941, inclusive, has been in the total amount of \$52,240,744.01.”

If we add to the depletion claimed and allowed for the years 1931 to 1941, inclusive, in the amount of \$52,240,744.01, the amount of depletion allowed by defendant below covering the years 1942 to 1950, inclusive, in the sum of \$81,145,502.98, we see that plaintiff has been allowed and granted a depletion deduction covering the years 1931 to 1950, inclusive, aggregating \$133,386,246.99.

We cite the above figures merely for the proposition that if the Legislature opens the weir an inch is no reason for defendant to let the flood come through. The early leading cases in the field of depletion, *Stratton's Independence v. Howbert*, 231 U.S. 399 (1913), and *Stan-ton v. Baltic Mining Co.*, 240 U.S. 103 (1916), established that no taxpayer engaged in the mining business has any constitutional right to depletion. The deduction is merely a matter of legislative grace and should not be tortured and misconstrued to the point where the allowance becomes unreasonable and contrary to the intention of the legislature.

The last two paragraphs of this Court's opinion in No. 7298 containing the Court's decision and its direction to defendant read as follows:

"In disposing of this last contention, we hold that if Kennecott files its return on an allotted basis that it must allocate *some* of its net income to post-mining operations before computing depletion.

"The case is remanded with instructions to determine and enter a deficiency judgment in accordance with the views herein expressed."

The Court's opinion also stated:

"Undoubtedly, each of the post-mining processes appreciates the value of the product and this is reflected in increasing the net income to Kennecott."

Under the Court's mandate covering the year 1942, defendant was thus directed in computing plaintiff's depletion deduction to allocate *some* of its net income to post-mining operations. Defendant has followed this mandate and has allocated *some* net income to the post-mining operations of smelting, transportation, refining and selling. Upon remand of the case for rehearing defendant used the same formula which had been reviewed by this Court in No. 7298, but merely as a means of arriving at a reasonable starting or tentative figure which if it allocated too much net income to plaintiff's post-mining operations could be at the hearing shown as erroneous by plaintiff. Defendant's formula assigned as

net income to the property that proportion of the Utah Division's net income which the mining costs (including depletion and federal taxes as costs) bore to total costs. By this formula the net income actually known and ascertained was spread back to the costs of the successive operations. The formula because "algebraic" is not invalid for that reason. An artilleryman is not judged on the mathematical calculations used in firing his piece but on whether his shell lands in the target area. Algebraic formulas are frequently used in taxation as, for example, in the calculation of interdependent taxes. See: Altman and Keesling, *supra*, where on page 221 it is stated:

"There are other methods, however, which may be more easily learned by those whose algebra the years have dulled."

Defendant concluded that the mining and milling dollars spent by plaintiff did not differ in kind or purpose from the smelting, transport, refining, selling and executive and administrative dollars spent by plaintiff. The Findings at page 177 state:

"The contention that as the mineral product moves through the successive stages of crude ore, mill concentrate, blister copper, and refined copper, only costs but no profits accumulate leads not to the conclusion that all of the profits are applicable to the mining costs but to the act of final sale. If profits are to be allocated back at all there appears to be considerably more logic and reason for allocating them back proportionately to all costs than exclusively to the mining

costs. We see nothing particularly unique about the mining costs to establish their claim to all the profits. The incurring of the other costs is equally necessary to the ultimate realization of any profit."

The Findings at pages 178-9 further state:

"To the known and admitted costs in the amount of \$269,850,472.43 must be added some profit. But how much? Should a 'reasonable' profit of say 6%, 10% or even 20% be added? The Auditing Division in determining the gross income from the property arrived at a value of the mill concentrates for the period here involved of \$621,940,441.37. This figure, as averaged for the period here involved, equals 70.0091629% of the net recovered metals (after deduction for losses in milling, smelting and refining) and the molybdenite concentrate recovered to the extent of the actual sales of such product. The total value of the net recovered metals as aforesaid for the nine year period was \$888,370,057.52. In other words, the fair market value as represented by actual sales of the finished electrolytic copper, gold, silver, platinum, palladium and molybdenite product after mining, milling, smelting, transportation and refining was \$888,370,057.52. The Auditing Division took slightly over 70% of this figure on the average or \$621,940,441.37 as being the fair value of the mill concentrates back at the mining and milling stage. Kennecott says this is unreasonable and that the increase in the cost figure of \$269,850,472.42 (exclusive of federal taxes) to only \$621,940,441.37 of fair value is not enough.

Such increase, according to Kennecott, does not put enough profit on the mill concentrates. Or, on the other hand, is it possible that the figure is in fact too high?"

Defendant carefully considered, analyzed and weighed all of the facts and various contentions of plaintiff in arriving at the gross income and net income from the property. The facts showed clearly that: "Undoubtedly, each of the post-mining processes appreciates the value of the product and this is reflected in increasing the net income to Kennecott." The foregoing statement of this Court carries the same idea as that expressed by the Supreme Court of North Carolina in the *Maxwell v. Kent-Coffey Manufacturing Co.* case, *supra*, as follows:

"The bare fact of sale produces no income. It is merely the act by which the income is captured."

The same thought is likewise contained in the statement of Mr. Justice Brandeis in *Underwood Typewriter Co. v. Chamberlain*, *supra*, where he stated:

"The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states."

It was obvious on the facts that the "profit" of 85c per ton of copper concentrate given by plaintiff to A. S. & R. for smelting the mill concentrate into blister copper could not conceivably or under any circumstances possibly be regarded as constituting the entire or total profit at-

tributable to the conversion of a *mineral* concentrate into the blister copper *metal* product. Nor did it follow that as the blister copper moved on railroad cars closer to market that the *only* value attributable to this closer proximity to market was represented only by the cost of freight. Nor did it follow that the "profit" of \$1.50 per ton of returnable refined copper given to A. S. & R. for refining the blister copper constitute the *only* profit attributable to the conversion of the blister copper into its constituent components of gold, silver, platinum, palladium and electrolytic copper. Nor did it follow that the selling commission to the sales subsidiary of \$1.00 per net ton of copper and \$3.50 per net ton of molybdenite, although fair, represent the *only* profit attributable to the conversion of the finished metal products into cash proceeds. As stated by Mr. Justice Brandeis the profits "were largely earned by a series of transactions" and clearly if earned *by* a series the net income or profits are to *some* extent attributable to each of the series of transactions.

Plaintiff's basic contention that the value of the product at each stage has only been enhanced to the extent of the cost to that stage is clearly erroneous. Furthermore, plaintiff's contention is at variance with the administration of the depletion provisions by defendant generally as applied in other mining industries such as coal, iron, oil, gas and the various non-ferrous metals sold to smelters on a net smelter return basis. A smelting profit is generally recognized in the non-ferrous industry

and the mere fact that plaintiff by reason of its tremendous and enormous tonnage is able to hire its smelting and refining work done very reasonably by A. S. & R. in no way precludes a finding that plaintiff itself has a smelting and refining profit on the work over and above that derved by A. S. & R.

The fact that the A. S. & R.'s Garfield, Utah, smelter is practically dedicated entirely to the smelting of plaintiff's mill concentrates and that there is no other substantial production of copper ores or concentrates in Utah also does not preclude a finding that plaintiff's mill concentrates have a fair value in Utah to plaintiff, even though there be no established "representative" market or field price. Plaintiff as an integrated producer of copper is its own market. The mill concentrates have value to plaintiff. There is no showing in the record whatsoever that the values determined by defendant are arbitrary, unreasonable or erroneous.

There is also nothing in the evidence submitted by plaintiff concerning the legislative history of the depletion provision which adds anything pertinent to what this Court has already considered in No. 7298.

Plaintiff's argument (pages 106-116), attempting to show the Court did not really mean to say plaintiff "must allocate *some* of its net income to post-mining operations," is quite misleading and assumes the very point in issue. The Tables on pages 113-114 demonstrate nothing except that 67% of net income is the same as the sum of 67% of each item of deduction when subtracted from the sum of

67% of each item of income. In both computations plaintiff first *assumes* it is entitled to a depletion deduction of $1/3$ of *total* Utah Division net income (\$8,000,000).

In the case at bar, plaintiff cites the net proceeds and occupation tax laws as authority for allocating 100% of the Utah Division's net income to the "mine" for depletion purposes. Defendant, on the other hand, cites these two laws and the federal cases involving this plaintiff as authority for the proposition that the net income of plaintiff's Utah Division is entirely attributable to *business done* in Utah by plaintiff. A reading of the net proceeds and occupation tax laws will show that the state has separately classified in these laws integrated mining operators conducting their business as plaintiff does here. The separate and additional post-mining profit is in the case of an integrated producer added back into the tax base. In other words the legislature has said that a mine has greater value and the mining occupation tax shall be greater if instead of selling his mine product at the mouth of the mine or selling it to a custom smelter on a net smelter return basis, the operator undertakes himself and for his own account to carry the raw ore up through the various stages into the finished marketable product. Relating the profit attributable to the post-mining operations of extracting the metal from the mineral back to the mine or mine output rests upon a perfectly sound constitutional basis as the cases cited heretofore under Defendant's Point I clearly show.

The legislative wisdom of putting the metal extraction profit back in the net proceeds and occupation tax

base in plaintiff's circumstances is not in issue in this proceeding. The point here is that the corporation franchise tax law requires defendant in determining the net income from the property to separate the post-mining metal extraction profit from the profit attributable to the mining operation for the purpose of computing the depletion deduction. The statute gives defendant no rule or formula to follow in effecting this segregation. The "gross" income has to be determined, in arriving at net income, because the statute says so. The problem thus is one of fact to determine what the fair market value of the mine product is.

The net proceeds and occupation tax laws and federal cases involving this plaintiff, do, however, constitute very clear and persuasive authority that the gross proceeds from out-of-state sales less out-of-state expenses constitute the proper tax base of plaintiff in arriving at net income from *business done* in Utah. Just as the out-of-state enhancement of value from refining is brought back into Utah for tax purposes under the net proceeds and occupation tax laws, so also is it brought back into Utah for taxation under the corporation franchise tax law, because the out-of-state enhancement of value from the refining by A. S. & R. does not constitute business done by plaintiff or its Utah Division outside Utah. It does not follow, however, that the recall of this out-of-state appreciation in value to Utah serves to swell plaintiff's depletion base. This value is taxable because it is from post-mining *business* of smelting and refining. It is not depletable because it is not gross income *from the mine*.

Plaintiff in its argument on the depletion question cites only the New Park Mining Co. case. Reference to the New Park Mining Co. case will show that that case involved *the sale of ores and not metals*. Furthermore, the opinion of the Court shows very clearly that net income from the property means net income from the mine and not other income derived from and attributable to other operations either completely independent of mining or subsequent to the mining operation itself. The capital investment to be recouped by a wasting assets corporation is that portion of the value which is lost by bringing the ore to the mouth of the mine. To allow additional recoupment of capital investment in the mine with respect to income attributable to post-mining or other independent operations would completely thwart and frustrate the legislative purpose. That this was the meaning of the Court is quite clear from the following on page 414:

"But a wasting assets corporation may have income other than that derived from the sale of its capital. On such other income it is not entitled to a deduction for depletion."

This Court in its opinion in No. 7298 drew the same distinction as the federal authorities do between mining activity and post-mining activity. This Court stated:

"Generally speaking, the phrase 'income from the property' means the income from mining. The latter term is usually understood to mean not merely the extraction of ores or minerals from the ground, but also the ordinary treatment processes normally applied by operators in order to obtain

the commercially marketable mineral products. In those cases where the operator sells direct to the smelter and payment is made on the net smelter returns, little difficulty is encountered. Here, however, we go far beyond that as Kennecott is the owner from the time of digging to the day of selling."

Turning to Section 114 (b) (4) (B) of the Federal Internal Revenue Code we find the term "gross income from the property" defined to mean the gross income from *mining*. Mining in turn is defined to include not merely the extraction of the ores from the ground, but also the ordinary treatment processes normally applied in order to obtain the commercially marketable mineral product. The term "ordinary treatment processes" is specifically defined to include in the case of copper, gold and silver ores, the crushing, grinding and concentration of such ores. The smelting and refining of such ores, however, are not included but are expressly excluded as within the term "ordinary treatment processes." Thus, mining includes extraction of the ores from the ground and milling but nothing else. Smelting, refining, transportation and selling are surface post-mining activities not associated with mining.

The Federal Regulations, Reg. 111 Sec. 29.23 (m) 1 (f), deals with the problem and provides in part that where there is no representative market or field price for the ores or concentrates there shall then be used "the representative market or field price of the first marketable

product . . . minus the costs *and proportionate profits* attributable to the transportation and processes beyond the ordinary treatment processes.”

Cases involving the federal depletion allowance in the case of 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 estimated or arrived on a basis which will apportion a proportionate part of the total realized profit to the surface processing activities which take place beyond the mouth of the mine or well.

In *Brea Cannon Oil Co. v. Commissioner*, 77 F. 2d 67 (1935), certiorari denied, 296 U.S. 604, the Circuit Court of Appeals for the Ninth Circuit held that the market value of the wet content of natural gas from the well constituted the income from the property and not the gross proceeds derived from the sales of gasoline to customers. The Court stated at page 68:

“Petitioner’s wells, produced what is known as casing head gasoline, that is, a very volatile gasoline which comes from the well in the form of gas mixed with the more stable gas known as natural, or dry, gas. The mixture is called wet gas. After separation the merchantable products consist of casinghead gasoline and dry gas. The respondent contends and petitioner admits, that *the process of extraction of the casinghead gasoline from the wet gas is a manufacturing process.* The respondent, in estimating the basis upon

which the percentage of $27\frac{1}{2}\%$ should be allowed for depletion took 40% of the gross receipts from the casing head gasoline as the market value of the casinghead gasoline content of the wet gas as it emerged from the well, and held that the remaining 60% of the gross receipts from casinghead gasoline was attributable to the manufacturing process and, consequently, did not constitute 'income from the property' within the meaning of the Revenue Act 1926...

"It is conceded by the petitioner that if the gross proceeds derived from the sale of casinghead gasoline should be apportioned at all, the apportionment of 40% of the gross proceeds from casinghead gasoline as the value of the gasoline content of the wet gas is correct. The sole question for our consideration then is whether or not the amount actually received from the sale of casinghead gasoline by the petitioner is subject to the allowance of $27\frac{1}{2}\%$ for depletion, or whether the depletion should be estimated upon the market value of the gasoline content of the wet gas."

The Court upheld the commissioner and held that the plant for the extraction of the casinghead gasoline from the wet gas should not be regarded as a part of the property, and that the market value of the wet content of the natural gas rather than the gross income derived from the sale of gasoline should be used in computing the gross income from the property for depletion purposes.

Again in *Consumers Natural Gas Company v. Commissioner*, 78 F. 2d 161 (1935) (CCA 2), certiorari denied 56 Sup. Ct. 157, the problem was dealt with in

an opinion by Judge Learned Hand. The Court held that depletion, in the case of a gas well, should be arrived at not on the basis of the gross income from the sales of gas to consumers, but on the basis of an estimated value of the gas at the mouth of the well. The Court stated, pages 161-2:

"Because the formula is rude and imperfect, we are not justified in injecting into the 'basis' the added value imparted to the output by work done upon it after it reaches the surface. That cannot fail to make the deviation greater and to introduce a variable which adds a quite unnecessary discrimination to a result arbitrary enough at best. True, its correction involves some computations; the sales price must be broken down into two component parts, the value contributed by the later services, and the remainder of the gross price."

Again, in *Greensboro Gas Company v. Commissioner*, 79 F. 2d 701 (1935), the Circuit Court of Appeals for the Third Circuit held that a taxpayer which produced and distributed natural gas was only entitled to an allowance for depletion based on the gross value of the gas at the mouth of the well and not when distributed and sold to consumers. The Court stated at page 701:

"If, as the taxpayer contends, the allowance was based on the value of its sales of gas to its consumers, the taxpayer would in effect enjoy an allowance for depletion on its distributing system which is already subject to an allowance for depreciation, and it would, since it both produces and

distributes natural gas at retail, enjoy an unusual advantage over the mere producer of gas in the field."

The above cases are directly applicable to the case at bar. This Court in its opinion in No. 7298 stated that "Undoubtedly, each of the post-mining processes appreciates the value of the product and this is reflected in increasing the net income to Kennecott" and refused to permit plaintiff to charge back as a depletion deduction against the mining operation $\frac{1}{3}$ of this post-mining appreciation of value. So also does Judge Learned Hand's opinion in the Consumers Natural Gas Case refuse to permit the taxpayer to take depletion on "the added value imparted to the output by work done upon it after it reaches the surface." Just as this Court, in No. 7298, required defendant to allocate *some* of the net income to the post-mining operations before computing depletion, so also did Judge Learned Hand in the Consumers Natural Gas case require that "the sales price must be broken down into two component parts, the value contributed by the later services, and the remainder of the gross price."

Furthermore, just as defendant by its decision allocated approximately 30% of the net income to post-mining or manufacturing appreciation in value, so also in the Brea Cannon Oil Case did the Court hold that "the remaining 60% of the gross receipts from casinghead gasoline was attributable to the manufacturing process and, consequently, did not constitute income from the property."

The Greensboro Gas Company case is particularly significant to the case at bar by its insistence that depletion should be based on the gross value of the gas at the mouth of the well and not on the "value of its sales of gas to its consumers." The Court indicated that to do otherwise would in effect give the taxpayer a double deduction on the post-mining operation, one "allowance for depreciation" and another "allowance for depletion on its distributing system."

Acceptance of plaintiff's contention in the case at bar would likewise result in a double deduction, one deduction for the full amount of the *expenses* incurred for smelting, transportation and refining, and another deduction with respect to $\frac{1}{3}$ of the added value imparted to the mill concentrates by such post-mining expenses.

Plaintiff below and during the hearing sought to distinguish the foregoing cases on the ground that the post-mining services of smelting, transportation and refining were hired and that plaintiff itself did not own the smelter, the railroad and the refinery, so that it is not entitled to take depreciation on the physical facilities involved in such post-mining operation. Furthermore, it contended that the present 85c per ton smelting fee, the \$1.50 refining fee and the profit earned by the railroad on freight represented the *only* profit involved in the post-mining operations. The tremendous net income earned by the Utah Division from its integrated operation shows clearly, however, that the smelting and refining fees and

profit earned by the railroad by no means represented all of the post-mining profits. The post-mining operations added values to plaintiff's Utah Division product far in excess of the mere costs of such operation. Defendant in its decision allowed as *expense* all of the smelting, transportatation and refining costs, including plaintiff's periodic amortization payments to A. S. & R. covering plaintiff's share of capital improvements at the smelter and refinery in connection with the smelting and refining of plaintiff's product. Thus if, as plaintiff contends, the allowance was based on the value of the sales of copper and other metal products to customers of the sales subsidiary, plaintiff would in effect enjoy an allowance for depletion on its post-mining system of operations which is already subject to an allowance for expense and would thus enjoy an unusual advantage over the mere producer of mill concentrates. In fact plaintiff's method of operation permitting it to expense rather than depreciate the facilities of its post-mining operations, which it has under contract, makes it even more imperative that the depletion deduction in the Utah statute be construed fairly and reasonably and within the proper limits. The added value imparted to the output of mill concentrates from the Bingham Mine by work done upon such concentrates after they reach the surface is not depletable.

See also *Sheridan-Wyoming Coal Company Inc. v. Helvering*, 125 Fd 2d 42 (1941); *New Idria Quicksilver Mining Co. v. Commissioner*, 144 Fd. 2d 918 (1944).

POINT V.

WITH RESPECT TO THE YEAR 1942, UNDER THIS COURT'S MANDATE IN CASE NO. 7298, DEFENDANT WAS NOT REQUIRED TO USE THE ARBITRARY ALLOCATION FACTOR OF 66.926% BUT TO THE CONTRARY WAS REQUIRED TO COMPUTE THE TAX ON THE SEPARATE ACCOUNTS OF PLAINTIFFS UTAH DIVISION AND ON A BASIS FAIRLY CALCULATED TO ASSIGN TO THIS STATE THE PORTION OF NET INCOME REASONABLY ATTRIBUTABLE TO THE BUSINESS DONE WITHIN THIS STATE AND TO AVOID SUBJECTING THE TAXPAYER TO DOUBLE TAXATION.

By its Point III plaintiff contends that any allocation factor in excess of 66.926% to Utah would exceed the mandate of this Court in No. 7298. Plaintiff states on page 124 of his brief:

“The matter of assigning 100% of sales outside Utah for the calendar year 1942 was settled in favor of such assignment by agreement of the parties and its adoption accordingly by this court. When the commission was reinvested with jurisdiction of that cause by the decision and mandate of this court, a limited power was restored to the commission to find the correct amount of depletion for that year and to do only that.”

Plaintiff, it is suggested, is in a somewhat inconsistent position in arguing that by this Court remanding the case to defendant for a “rehearing,” defendant was reinvested with no jurisdiction over any issue, and particularly the issue of “allocation,” except depletion.

The large group of authorities cited heretofore under defendant's Point II show clearly that plaintiff's position is without merit. Both in the case of defendant and the Tax Court of the United States when a case is remanded for "rehearing" a claim for an increased deficiency in tax may be made by either defendant or the Commissioner of Internal Revenue, as the case may be, provided under the law a claim therefor is made at the rehearing. The Utah Statute provides that the same rules are applicable to the "rehearing" as are applicable to initial proceedings. The only limitation on defendant's statutory right to make an increase of deficiency at the rehearing is that such increase should not be inconsistent with the decision and mandate of this court.

To put some weight into its argument plaintiff seems to infer that there was some sort of "agreement" between plaintiff and defendant with respect to the arbitrary allocation factor of 66.926% and that such factor had been adopted accordingly by this Court in its decision in No. 7298.

It must be that plaintiff is referring to the 1941 settlement under which the years 1935 to 1941, inclusive, were compromised by use of the 66.926% factor which assigned all sales of the Utah Division product outside Utah. The 1941 settlement "agreement" was not regarded by this Court in No. 7298 to be such a binding adjudication of the rights of the parties as to preclude this Court

from making a determination on the issue of depletion contrary to the terms of the "agreement." Such settlement should be accorded no greater dignity in the present connection, particularly where even plaintiff admits that such allocation factor is arbitrary and not consistent with the true facts even on its own theory of the case. For example, in its brief before defendant below plaintiff stated at page 3:

"... the taxpayer's contention as to the correct determination of the tax is set forth in Schedule 2 of petitioner's Exhibit 56 (2)."

This exhibit shows plaintiff using for the year 1942 an allocation factor of 64.676%. A review of the record in No. 7298 which is contained as Exhibit QQ (2) in the present proceeding fails to disclose any "agreement" with respect to the allocation factor of 66.926%. Page 16 of the record shows no specific decision or determination by defendant with respect to such factor. Furthermore, the Agreed Record stipulated to by counsel for both plaintiff and defendant, states as follows (pages 109-110 Exhibit QQ (2)):

"IV.

"As to Allocation of Kennecott's Income to Utah.

"1. Section 80-13-21 requires a taxpayer engaged in business in several states to assign a portion of the net income of its total business to business done within the state of Utah. A formula for determining this allocation is provided with authority under subsection (8) for the commis-

sion to depart from this formula, where its application is deemed unfair or inequitable, and to 'make such allocation as is fairly calculated to assign to this state a portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer with double taxation.'

"2. The principles under which Kennecott was to make its allocation of part of its Utah Copper Division net income to the state of Utah were a specific issue in the controversy settled by the mutual agreement of May 27, 1942. By that settlement it was agreed that 66.926% of Kennecott's Utah Copper Division income alone was to be assigned to the state of Utah. These principles were applied to the tax returns through and including 1941, and Kennecott has consistently followed these principles in its returns for the years 1942, 1943 and 1944.

"3. Inasmuch as the commission will not now accept for the year 1942 the corporation franchise tax return of Kennecott on the same basis accepted prior to 1942 and as established by the agreement of May 27, 1942, Kennecott now asserts its right to file its returns for its entire operations, and to allocate income to Utah on the basis of the allocation formula of Section 80-13-21."

The stipulated record thus shows on its face that defendant did not "accept for the year 1942 the corporation franchise tax return of Kennecott on the same basis accepted prior to 1942 and as established by the agreement of May 27, 1942." It is therefore apparent that the figure of 66.926%, although it may have been

used at one stage by defendant as many other figures were used in the calculation of the deficiencies, can have no greater binding force or precedent than any other figure and if wrong stood to be corrected. The basis, furthermore, on which Case No. 7298 was presented to this Court was that not "figures" but only "principles" were in issue. As stated in plaintiff's brief:

"The parties hereto have cooperated below in endeavoring to shape an inherently complicated tax record in such manner that there could be presented concisely for the determination of this court six questions of *principle*. The mathematical results to follow when these *principles* are determined may then be worked out without, it is expected, subjecting the court to such detail."

Or as stated by defendant in its brief:

"If we attempt to arrive at tax liability for the year in question in terms of dollars and cents, we may find that the legal *principles* at issue would become obscured by reason of the multitude of accounting problems involved. However, as indicated in plaintiff's brief we are concerned with the establishment of *principles* and, thereafter, a correct mathematical result can be arrived at by a correct application of those *principles*."

Also as stated by this Court in its opinion:

"Because of the arithmetical difficulties to be encountered in computing the final tax, the parties have assumed the responsibility of making the final determination based on the *principles* we enunciate."

The issue on allocation was stated by this Court in its opinion to be whether the statute "would permit Kenne-cott to allocate to Utah *a proportionate part* of its total income from all sources as distinguished from allocating *a proportionate part* of the Utah Division's income to this state." This first assignment of error was considered by the Court and in over-ruling plaintiff's contention, the Court held that the tax should be computed not on the basis of the Utah statutory formula, but on the basis of the Utah Division's separate accounts under the authority of subdivision 8 of the statute. The decision of the Court when read in connection with the specific provisions of subdivision 8 show that the remand required defendant to determine what, if any, "proportionate part" of the net income of the Utah Division was attributable to business done outside Utah. Nothing in the decision appears to approve, sanctify or adjudicate the validity of the arbitrary allocation factor of 66.926%. Nothing in the opinion even suggests that if upon the rehearing, additional facts came to light which showed the complete error of the arbitrary allocation factor, that the true and correct factor could not be used by defendant. All that was decided or that this Court directed defendant to do was to calculate the tax on the basis, not of the statutory formula, but on the basis of the Utah Division's separate accounts and by reference to subdivision 8 of the statute to make such allocation of the net income, separately computed of the Utah Division, "as is fairly calcu-

lated to assign to this state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation."

POINT VI.

THE WAIVER BY DEFENDANT OF STATUTORY INTEREST ON ANY DEFICIENCIES TO BE FOUND HEREIN WOULD UNDER THE CIRCUMSTANCES HERE DISCLOSED CONSTITUTE AN ABUSE OF STATUTORY DUTY AND PUBLIC TRUST.

Although Section 80-13-58, U.C.A. 1943, authorizes defendant upon making a record of its reasons therefor to waive in its discretion any interest provided in the law or to compromise the same, there is in the present proceeding no showing whatsoever of undue hardship or other adequate grounds for a waiver of statutory interest. If the tax is owing it should have been paid and if paid now should be paid with interest as provided by law.

Defendant below found (F pg. 191) :

"72. We find that there is no showing of undue hardship or other valid reason which would properly justify this commission to waive or reduce the interest imposed by the statute on the tax deficiencies determined herein."

CONCLUSION

It is respectfully requested that the decision of defendant should either be affirmed or modified by recom-

puting the tax on the basis of the full 100% net income shown and reflected on the separate books of account of plaintiff's Utah Division as to the Court may seem right and proper in the premises.

Respectfully submitted,

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