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UTAH SUPREME COURT
BRIEF
DOCKET NO. 13842 AC & 13843 AC
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CONTINENTAL TELEPHONE COMPANY OF UTAH,
Plaintiff,

vs.

STATE TAX COMMISSION OF UTAH,
Defendant,

and

WALKER BANK & TRUST COMPANY,
Amicus-Curiae.

Two Cases

No. 13842

and

No. 13843

AMICUS CURIAE BRIEF

On Writ of Review to the State Tax Commission of Utah

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IN THE SUPREME COURT OF THE STATE OF UTAH

CONTINENTAL TELEPHONE COMPANY OF UTAH, *Plaintiff,* vs. STATE TAX COMMISSION OF UTAH, *Defendant,* and WALKER BANK & TRUST COMPANY, *Amicus-Curiae.*	Two Cases No. 13842 and No. 13843

AMICUS CURIAE BRIEF

NATURE OF THE CASE

These are consolidated cases arising on petitions for review by this Court of a decision of the State Tax Commission assessing additional corporation franchise taxes.

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DISPOSITION OF THE CASES IN THE TAX COMMISSION

The Tax Commission's Decision No. 288 partially disallowed deductions for federal income taxes taken by Midland Telephone Company and Utah Telephone Company (hereinafter sometimes referred to as "taxpayers") in the computation of Utah corporation franchise taxes.

The prior hearing of this matter was before an administrative commission, under its own rules, which commission is the defendant in this proceeding. Members of the commission who ruled upon these taxpayers' plea also took part in establishing commission assessment policies. This case is not an appeal from a lower court decision, and there has been no previous judicial determination based on the legal merits.

RELIEF SOUGHT

Amicus-Curiae submits that the Court should reverse the administrative decision of the Tax Commission and hold the deductions taken by the taxpayers to be proper.

PURPOSE OF AMICUS CURIAE BRIEF

The major thrust of this amicus brief will be to demonstrate that the brief prepared for the Tax Com-

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mission by the Attorney General relies to a large degree on artificial concepts and arguments which have nothing to do with the legal issues before the Court. The brief ignores fundamental principals, clouds the issues by injecting irrelevant and complicated tax criteria, asks this Court to create inequities among and discriminate against certain Utah taxpayers, and constitutes an effort to vest vast legislative powers in the Tax Commission.

Amicus' special interest in this case arises because as a Utah corporation, it files a federal consolidated return with other out-of-state banking corporations but does not enjoy the privilege (under U.C.A. §59-13-23(1) (1953) which requires 95% ownership by one entity) of filing a Utah consolidated return. Because it must file a separate Utah return, Amicus finds itself in a position substantially similar to that of Continental Telephone. It may be assumed that there are numerous other Utah taxpayers which must follow the same tax return procedure. Because of the importance of this case, not only to Continental Telephone, but also to other Utah taxpayers not represented before the Court, Walker Bank has petitioned to enter as Amicus Curiae.

Beyond the technical substantive issues raised by this case, Amicus wishes to protest before the Court what may be a new approach of the Tax Commission to assessments against all taxpayers. Amicus believes

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the Tax Commission, in this case, has asked the Court to give its approval to a system of assessment which is not grounded upon specific authorization by the Legislature and which relies upon executive branch creation of new tax law by applying phrases and sentences taken out of context to situations far from those considered by the Legislature.

More dangerous, however, is the introduction of the boldly expressed theory that it is appropriate to introduce new interpretations and discriminations between taxpayers if such will increase revenues. (Tax Commission's Finding of Fact ¶ 14 (R. 15) cited in Tax Commission's brief, p. 14).

COLLATERAL CONSIDERATIONS

This case gives rise to issues not here argued, relating to the sanctity of contracts and inequities which may be foisted upon minority stockholders as a result of adherence to a contractual duty without receipt of a correlating contractual right. For example, under circumstances similar to these cases, a subsidiary with minority stockholders may enter into a contract with a parent company after arms length negotiations. The contract could contain a variety of terms and conditions giving rise to rights and duties, privileges and liabilities and may include an agreement to file a consoli-

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dated return. If the Utah company and its minority stockholders are to obtain the fruits of the bargain with the parent company, the Utah company must have equal treatment under Utah law with other Utah taxpayers. The equities involved may give rise to a legal issue, under Utah tax laws, that the payment, by a subsidiary to the parent, of a separately determined federal tax pursuant to contract may be an "ordinary and necessary business expense" within the meaning of the Utah tax law. This is an issue which requires considerable elaboration and discussion, but which has not been raised and briefed by the parties to this case. Walker Bank & Trust Company, as Amicus Curiae, does not expect the issue to be resolved in the present litigation, but nonetheless asks the Court to recognize that an in-depth briefing and argument of the "ordinary and necessary business expense" issue could result in a decision in favor of the taxpayer, even if the Court were to hold against the taxpayer on all other issues. Hence, we urge the Court to withhold making any ruling which might include that issue until such time as the question can be fully presented.

STATEMENT OF MATERIAL FACTS

Amicus-Curiae believes there is one central fact which is not adequately disclosed in either brief. The Tax Commission's disallowance of taxpayers' federal tax deduction for payments actually made imposes

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higher state tax costs upon them than are made by Utah corporations similarly situated but which do not file federal consolidated returns.

It is important that at no point in its brief does the Attorney General dispute the fact that the amount sought to be disallowed would be deductible if there were no federal consolidated return filed since the exact same amount would be paid directly to the Internal Revenue Service.

Under the method employed by the taxpayers to determine their deduction for "taxes paid", they first determine their federal tax liability on a separate return basis. That is, each subsidiary determines what its own federal tax liability would be if it filed a separate rather than consolidated federal income tax return. This amount is then paid to Continental, the stockholder, under a binding federal consolidated return election, and taken as a deduction on the taxpayers' Utah franchise tax return. Continental, in turn, pays the federal consolidated tax liability. There is no "recomputed" tax calculation, and there is no question but that the actual payment of the full amount computed has been made by actual cash transfer out of the state and out of the Utah taxpayers' corporate funds every year.

Amicus-Curiae adopts the reference notations used by the Attorney General on p. 1 of his brief, but adopts the Statement of Facts as set forth in plaintiff's brief,

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with the exception of plaintiff's description on p. 6 of its brief, of the deduction computation which the Tax Commission alleges is proper.

The alleged appropriate computation would partly disallow the federal tax deduction taken by reducing the deduction to the amount which bears the same ratio to the total consolidated federal tax paid by Continental which the taxpayers' net income bears to the net income of all profitable subsidiaries combined.

ARGUMENT

POINT I

PAYMENTS CALCULATED ACCORDING TO FEDERAL LAW UNDER A BINDING ELECTION TO FILE A *FEDERAL* CONSOLIDATED RETURN ARE DEDUCTIBLE AS "TAXES PAID".

(A) *The Plain Meaning of "Taxes Paid" in U.C.A. § 59-13-7(3) (1953) Includes the Payments by the Taxpayers to Continental.*

As described in the Statement of Material Facts in this Brief (p. 5), and in the Statement of Facts in the taxpayers' brief, the taxpayers in this case deducted only their Federal taxes, computed in the same manner as every other Utah corporation computes its taxes.

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They actually paid out those same computed amounts from corporate funds and the payment was reviewed by utility regulatory bodies which completely control the rate of profit they are allowed to make.

The Attorney General is not here challenging any "loophole" or "gimmick" deduction, nor any inflated expense. He is not challenging any hiding of income or step-transaction intended to avoid recognition of gain. The entire question here briefed hinges upon one fact: Instead of making a check out to the Internal Revenue Service, the taxpayers, following Federal regulations, made their payment of federal taxes to their controlling shareholder and agent, Continental Telephone.

Under federal regulations, the taxpayers, who had elected to join in a federal consolidated return, could not deal directly with the Internal Revenue Service with respect to payment of their federal taxes. Treas. Reg. §1.1502-77(a). They were required to deal through their agent,[1] which had the responsibility of satisfying the taxpayers' liability to the government in Washington.[2] The taxpayers were thus making a payment to the government through their agent. Continental.

---

[1] For purposes of the federal consolidated return, the parent is made the agent of all subsidiaries. Treas. Reg. §1.1502-77(a).

[2] Until the tax liability of the entire consolidated group has been satisfied through payment by the agent, Continental and each member of the group is liable for the entire tax due. Therefore, until full payment was made by Continental, taxpayers had a federal tax liability which could far exceed their individual computed liability. Treas. Reg. §1.1502-6(a).

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The basic question to be answered is: Are payments, (1) which are actually made, (2) which are computed according to the federal tax formula all Utah corporations use, and (3) which are paid to the taxpayers' "*agent*" under federal tax regulations (a separate, distinct corporation which has primary responsibility to satisfy taxpayers' federal tax liability), to be treated the same as "taxes paid" by all other Utah corporations?

The Utah statute which the Attorney General admits allows a federal "taxes paid" deduction to other Utah corporations, reads as follows:

> "59-13-7. Deductions from gross income.—In computing net income there shall be allowed as deductions:
> Taxes Paid.
>
> (3) Taxes paid or accrued within the taxable year, except —"
> (The listed exceptions are not at issue in this case.)

The term "taxes" is not defined in the Code. However, the phrase "paid or accrued" is defined in U.C.A. §59-13-1(7) as follows:

> "(7) The terms . . . "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed."

The taxpayers' method of accounting, dictated by

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regulatory bodies, has consistently recognized and accrued federal tax liabilities and federal tax payments determined on a separate return basis. Upon payment of the computed taxes, the corporations suffered an economic "tax" through the loss of the funds so transferred.

Two midwest states (see below), faced with the same question now before this Court, have looked directly at the statute, and agreed that the payments involved here are "taxes paid".

(B) *Recent Kansas and Iowa Decisions have Held that Payments made Under Circumstances Substantially Identical to Those in this Case should be Considered "Taxes Paid", and a Deduction Allowed Therefor on the State Tax Return.*

(1) *The Cities Service Case Fact Situation.*

The taxpayers' brief discusses the similar Kansas cases of *Cities Service Gas Co. v. McDonald,* 204 Kan. 705, 466 P.2d 277 (1970) and *Northern Natural Gas Processing Co. v. McCoy,* 197 Kan. 740, 421 P.2d 190 (1967), on pp. 8, 9, and 10 of its brief. The Attorney General's brief attempts to distinguish the *Cities Service* case on pages 21 and 22 with what Amicus believes to be an erroneous reading of the case and a novel and completely non-legal view of the actions of the Kansas

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Legislature. The Attorney General did not respond to the Iowa case.

Because the facts of *Cities Service* are not accurately set out in the briefs, they are restated here. The taxpayer was a wholly-owned subsidiary which filed a federal consolidated return with the other members of an affiliated group. Cities Service took a deduction on its Kansas state return for federal taxes paid in an amount equal to what its federal tax liability would have been had it filed its federal return on a separate rather than consolidated basis. Cities Service paid that amount over to its parent corporation. For the year in question, the taxpayer had a separately determined federal tax liability of $6,367,534 while the consolidated return showed an operating loss and no federal taxes paid. The refund to the parent which resulted from a carryback of the consolidated loss, and the payments received by the parent from the profit subsidiaries were paid over to the loss subsidiaries as compensation for the consolidated use of those losses.

(2) *The Cities Service Holding.*

The Kansas Supreme Court upheld the conclusion of the district court that no gain resulted to the parent corporation from the payments in question, and that the subsidiary could fully deduct the payment. The Court added that:

> The district court, in its memorandum decision,

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> found that as a result of the accounting procedure utilized in this case, no gain resulted to the parent, . . . from [subsidiary's] payment of $6,-367,534, and [the subsidiary] was poorer to the extent of its liability in that amount. Furthermore, there was no tax saving to [the subsidiary] because of its taxable income and the tax thereon having been reported on the consolidated return. The court concluded that [the sudsidiary] did incur, and pay, federal income tax for the year 1958 in the amount of $6,367,534, and that the director's disallowance of [the subsidiary's] claimed deduction was erroneous. *Cities Service, supra* at 709.

In order to avoid dealing with the real holding of *Cities Service*, the Attorney General set up a "strawman":

> "Apparently, the Kansas case relied upon the reasoning that there was not tax savings to either the parent or the subsidiary company as a result of being included in the consolidated return. (At page 283) Respondent has previously shown substantial tax savings to the parent and subsidiaries." (Tax Commission's brief at p. 21).

The Kansas Court did *not* hold, as the Attorney General would have this Court believe, that there were no benefits to be derived from filing the consolidated return. There were, of course, benefits to the *loss* subsidiaries. The Court merely stated that there was no benefit to the *profit* subsidiary, just as there is no economic benefit to the taxpayers in this case. The Kansas Court felt that this was an added factor weighing in favor of the taxpayer's position.

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Page 22 of the Attorney General's brief states that *Cities Service* has been "overruled" since the Kansas Legislature repealed the statute allowing any corporation, whether or not part of an affiliated group, any deduction of federal taxes whatsoever. Notwithstanding the change in the underlying statute, the reasoning of Kansas' Court in dealing with the statute before it is still of value in construing a similar Utah statute.

The Attorney General does, however, make a valuable point: If the federal tax deduction is to be narowed, specially defined or otherwise modified or eliminated, it should be left to the Utah Legislature to do so, just as the Kansas Court deferred the same question to a subsequent Kansas Legislature.

(3) *Comparison of Controlling Kansas Statute with U.C.A.* § *59-13-7(3) (1953).*

Neither brief sets out and directly compares the controlling statutes involved.

In Kansas, General Statutes 1957 Supp. 79-3206 (a) (3) allows a deduction for federal income taxes "paid" during the year. General Statutes 1949, 79-3202 defining "paid" reads:

> "(8) The word "paid" means 'paid or incurred' or 'paid or accrued' and shall be construed in accordance with the method of accounting used as a basis for computing net income under this act."

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The Court construed "paid" to mean the taxpayer was authorized to deduct its entire federal income tax liability computed on a separate return basis and actually paid to its parent despite the fact that no consolidated tax was paid by the parent with its return. *Cities Service Gas Co. v. McDonald, supra* at 712.

In Utah, U.C.A. § 59-13-7(3) (1953) allows the deduction on the state franchise tax return for "taxes paid or accrued." U.C.A. § 59-13-1(7) (1953) defines "paid or accrued":

> The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed.

The statutory provision in Utah defining "taxes paid" is substantially identical to the Kansas statute. In addition, the method of accounting used by Midland and Utah Telephone to determine their net income included a deduction for federal taxes computed on a separate return basis in the same manner as did the taxpayer in *Cities Service*. The Kansas Supreme Court held that the payment in question amounted to a payment of federal taxes, and allowed the deduction.

(4) *The Massey-Ferguson Case Follows Cities Service.*

A very recent decision by the State Board of Tax Review of Iowa follows the holding of the Kansas Su-

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preme Court in *Cities Service.* See, *Massey-Ferguson Credit Corp. v. Briggs,* Decision No. 48 of State Board of Tax Review of Iowa (July 8, 1974).[3] This case is dealt with by the taxpayers on p. 9 of their brief. However, the Attorney General made no mention of it in his brief.

In *Massey,* a federal consolidated return was filed. The taxpayer was a subsidiary which joined in the federal return, made payments to its parent equal to its separately determined tax liability, and took a deduction for one-half that amount on its state tax return (the Iowa statute allows a deduction for one-half the "taxes paid"). The Iowa Board of Tax Review specifically followed *Cities Service* and allowed the deduction in full even though no consolidated tax was paid on the federal consolidated return.

(5) ***The Trunkline Case, Relied Upon by the Attorney General, is Distinguished by the Cities Service Case.***

The state argued in *Cities Service*[4] that *Trunkline Gas Company v. Collector of Revenue* (La.App. 1965), 182 S.2d 674, which on its face is factually similar, should be used as a precedent to disallow the de-

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[3] See Appendix p. iii for the text of this Decision.

[4] The Attorney General makes the same argument on page 22 of his brief. The taxpayers discuss the case at page 10 of their brief.

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duction. The Louisiana statute relevant to the deduction in *Trunkline* provides that:

> . . . The amount of federal income taxes to be so deducted shall be that portion of the total federal income tax which is levied with respect to the particular income derived from sources in this state *to be computed in accordance with rules and regulations of the collector of revenue* . . . R.S. 47:241. (Emphasis added)

Pursuant to the authority *specifically granted* by the statute, the state promulgated a regulaion which provided, in part, that:

> Where a corporation includes its net income in a consolidated federal income tax return, the portion of the total consolidated tax attributable to such corporation shall be determined by allocating the tax of the consolidated group to the several members of the group on the basis of the percentage of the total tax which the tax of such member, as computed on a separate return, would bear to the total amount of taxes for all members of the group so computed. . . . ITR 55.2.

The Kansas Supreme Court refused to follow *Trunkline.* The Court's refusal was based on the fact that Louisiana had a regulation directly in point, while Kansas did not, and the Kansas Legislature had never authorized the promulgation of such a regulation.

(6) *The Cities Service Distinction of Trunkline also applies in this Case.*

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The Attorney General cites the *Trunkline* case as the authority to be followed in Utah. He maintains that Regulation 13 is similar to the Louisiana regulation with respect to the "taxes paid" deduction. It appears to be the Attorney General's position that the mere existence of Regulation 13 distinguishes the *Cities Service* case.

The Attorney General's brief is misleading when it says (emphasis added):

> "[Trunkline's parent did not pay] Federal income taxes within the contemplation and intentment of LSA-RS 47:55 and 47:241, as to entitle the Trunkline Gas Company to full credit deduction of the Federal income tax attributable to Louisiana derived income, which it computes to be due the Federal Government as though it were paying this tax on the basis of a separate tax return. (At page 679) Apparently, the Louisiana Court based its decision on the statute requiring payment in fact. *It should be noted that the statute providing for the deduction of Federal taxes in Louisiana is the same, word-for-word, as the statute in question in Utah.* (See Utah Code Annotated, Section 59-13-7(3) (1953)) (Tax Commission's brief, p. 22).

The Attorney General's statement is based on a half-truth. The statutes providing for full *deduction* are, indeed, the same.

> "L.S.A.-R.S. 47:55. Deductions from gross income; taxes generally.

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"In computing net income, there shall be allowed as deductions all taxes paid or accrued within the taxable year except: [The excepts have no application to this case.]"

(See, *Trunkline, supra* at 677)

"U.C.A. 59-13-7. Deductions from gross income.—In computing net income there shall be allowed as deductions: . . .
Taxes Paid

(3) Taxes paid or accrued within the taxable year, except— . . ."

However, the "statute in question" in Utah is § 59-13-1(7) (quoted on p. 9) while the "statute in question" in Louisiana was R. S. 47:241. They are completely dissimilar in that they define entirely different terms, and more to the point, Louisiana grants specific regulatory authority while Utah does not. The Louisiana statute provides:

"L.S.A.-R.S. 47:241. Net income subject to tax.

"The net income of a nonresident individual or foreign corporation subject to the tax imposed by this Chapter shall be the sum of the net allocable income earned within or derived from sources within this state, as defined in R.S. 47:243, and the net apportionable income derived from sources in this state, as defined in R.S. 47:244, less the amount of federal income taxes at-

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> tributable to the net allocable income and net apportionable income derived from sources in this state. The amount of federal income taxes to be so deducted shall be that portion of the total federal income tax which is levied with respect to the particular income derived from sources in this state *to be computed in accordance with rules and regulations of the collector of revenue.*
> (See, *Trunkline, supra* at 677). (Emphasis added)

The Utah and Kansas statutes are substantially identical both in allowing the deduction for taxes paid, and in their definition of "paid or accrued." Neither Kansas nor Utah authorizes the promulgation of regulations dealing specifically with the deduction of federal taxes paid. See U.C.A. § 59-13-7(3) (1953). On the other hand, Louisiana specifically authorizes such regulations. Considering the similarity of the Kansas and Utah statutes and the dissimilarity of the Utah and Louisiana statutes, it is submitted that, unless the Tax Commission can establish a specific legislative grant of regulatory authority (discussed in this brief beginning at p. 27), it cannot logically be maintained that our Utah *statute,* § 59-13-7(3), requires disallowance of taxpayers' deductions. It is, therefore, appropriate for the Utah Court to follow the Kansas case rather than the Louisiana case and hold that the taxpayers' payments to Continental were, in fact, "taxes paid."

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POINT II

THE ATTORNEY GENERAL HAS MISCONSTRUED THE FEDERAL REGULATIONS DEALING WITH CONSOLIDATED RETURNS.

The Attorney General, at p. 19 of his brief, has made certain representations as to how the federal consolidated return regulations work. Unfortunately, he has misconstrued these regulations to the end that erroneous prejudicial concepts are interjected.

The first full paragraph on p. 19 of the Attorney General's brief deals with the payments made by profit subsidiaries to loss subsidiaries to compensate the latter for the use of their losses. The first sentence of that paragraph says "likewise, taxes are reduced by moving in and out of different percentage tax brackets, in general." This implies that a consolidated group can reduce its federal taxes by these payments. This is simply not true. There is no moving in and out of different tax brackets. There is only one tax bracket, and that is applied to the consolidated taxable income. Any shifting of funds between subsidiaries does not change the *consolidated* taxable income, and therefore, has *nothing to do* with determining how much federal tax the affiliated group pays.

In a similar erroneous and irrelevant claim, the second paragraph on p. 19 of the Attorney General's brief states in part that:

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> The Treasury Department has provided that corporations qualifying under Regulation Section 1.1502-33(d)(2) may treat these tax-compensating payments as a deductible tax payment, both to the profit member making the payment and to the loss member receiving it. *The resulting tax effect is obvious.* (Emphasis added)

If anything is obvious, it is that Treas. Reg. § 1.1502-33(d) has *nothing to do* with "taxes paid." The only relevance of Treas. Reg. § 1.1502-33(d) is to illustrate that the method used by the taxpayers is an accepted *method of accounting.*

Treas. Reg. § 1.1502-33 pertains to "Earnings and Profits" (as opposed to "net taxable income"). The U.S. Supreme Court has found the "earnings and profits" concept (here dealt with in Treas. Reg. §1.1502-33 (d)(2)) a good deal less than obvious:

> "earnings and profits' in the tax sense, . . . does not correspond exactly to taxable income [and] does not necessarily follow corporate accounting concepts."[5]

The earnings and profits concept is primarily intended to serve as an aid in the definition of the income *of shareholders* of a corporation. Thus, its role is to serve as an aid in ascertaining the extent of the pool of funds, in excess of the invested capital of the corporation, that is available for distribution *to the shareholders* of the corporation. Hence, the concept serves

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[5] **Commissioner v. Wheeler, 324 U.S. 542, 546 (1945).**

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to differentiate those corporate distributions which represent gains on invested capital, which should be taxable, from those that represent a nontaxable return of capital.

Every corporation must maintain an earnings and profits account in order to determine the amount of any distribution which is to be taxed as a dividend under I.R.C. §316(a). The earnings and profits account of a corporation is reduced by federal income taxes accrued or paid. Bittker & Eustice, *Federal Income Taxation of Corporations and Shareholders* (3d Ed. 1971) at 7-18. Reducing the earnings and profits account reduces income which is potentially taxable to a shareholder as a dividend. Therefore, it is necessary to have rules on how to allocate this reduction when only one tax is paid by a consolidated group. This is the problem dealt with by Treas. Reg. §1.1502-33(d). That regulation *does not* allow a deduction from gross income for these compensating payments. Therefore, the tax effect of this federal regulation is not obvious. In fact, it has absolutely nothing whatsoever to do with the amount of federal income tax which is paid by a consolidated group.

POINT III

THE DECISION OF THE TAX COMMISSION IS ERRONEOUS INSOFAR AS IT IS BASED UPON U.C.A. SECTION 59-13-17.

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The Tax Commission states in Conclusion of Law No. 2 (R. 16):

> Utah Code Annotated 59-13-17, which provides that in any case of two or more corporations owned or controlled directly or indirectly by the same interest, the Utah State Tax Commission is authorized to distribute, apportion or allocate gross income or deductions between and among such corporations, 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 such corporations.

As partial justification for the attempted application of §59-13-17, the Attorney General, in his brief at p. 14,[6] states "... that the failure to apply the Utah State Corporate Franchise Tax Regulation, No. 13, would cost the State of Utah revenue. . . ." Certainly the fact that the State of Utah will gain or lose revenue is not pertinent to the correct application of §59-13-17. The correct application of §59-13-17 can only be determined by an analysis of the section itself.

The Tax Commission is attempting to use §59-13-17 to disallow part of the deductions taken by Midland and Utah Telephone. This is a misuse of the section. Section 59-13-17 authorizes the Tax Commission to ". . . distribute, apportion or allocate gross income or de-

[6] The misapplication of §59-13-17 is discussed in taxpayers brief beginning at p. 16.

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ductions . . .," but it does not authorize the Tax Commission to *disallow* a deduction, in whole or in part. The absence of the word "disallow" from § 59-13-17 is not merely a matter of semantics.

Section 59-13-17 is taken almost word for word from § 482 of the Internal Revenue Code. The only changes in § 59-13-17 are those necessary to convert it from a federal to a state statute. The substance of the provision remains the same as § 482. Bittker & Eustice in their work on corporate taxation state that:

> . . . the Commissioner's powers under § 482 only permit the *reallocation* of incomes or deductions among various members of the affiliated group, *the section cannot be used to disallow deductions,* and in this respect is narrower than § 269. Bittker & Eustice, *supra* at 15-22. (second emphasis added)

In dealing with the proper use of § 482, Bittker & Eustice go on to state that:

> One of the principal features of the regulations is the correlative adjustment procedure of Regs. § 1.482-1(d) (2). By requiring an appropriate correlative adjustment to be made on behalf of other members of the group who are affected by the primary adjustment under § 482, the regulations emphasize the fact that § 482 is an allocation section, rather than a disallowance provision. For example, if income is reallocated from subsidiary X to subsidiary Y under § 482, the income of X must be decreased to take account of

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> the fact that the income has been attributed to Y. *Id.* at 15-30.

The above citation from Bittker & Eustice points up the proper use of §§482 and 59-13-17. Those sections assume that a total deduction figure has already been arrived at (e.g., the amount of a federal "taxes paid" deduction), and that the only question remaining is how much of the total deduction each subsidiary should get.

To illustrate the proper use of §59-13-17 consider the following example:

> A and B are wholly owned subsidiaries of X and all three corporations join in filing a federal consolidated return. A is profitable, but B operates at a loss. B has an asset which it has fully depreciated, and which could be used in A's business. The fair market value of the asset is $100,000. B sells this asset to A for $200,000.

The sale is made because, although B will have a large gain on the sale, it will have no taxable income (and therefore no tax) because it has been operating at a loss. On the other hand, A will have a higher basis in the asset which it can depreciate. The net effect is that A will be able to shelter more tax dollars, because of the higher depreciation costs, but there will be no cost to the group because of B's financial position.

This example is a proper situation for the application of §59-13-17. Under that section, it would be ap-

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propriate for the Tax Commission to allow A to depreciate the asset on a $100,000 basis only. As a corresponding adjustment, the Tax Commission would reduce the gain attributable to B by $100,000. To apply the section properly, there must be this corresponding adjustment.

In the present case, the Tax Commission is not seeking to make an adjustment. What the Tax Commission seeks to do is to entirely disallow part of a deduction. Under the application sought by the Tax Commission, there would be no corresponding adjustment for any other subsidiary. No other susidiary of Continental would be able to eliminate from its income the amount of the deduction disallowed the taxpayers. Such a use of §59-13-17 is not proper, and should not be permitted by the Court. The substantive determination of what the "taxes paid" deduction is should be left to the provisions specifically dealing therewith. Section 59-13-17 should be left for the situation where the allocation of an already determined deduction is being improperly manipulated.

As has been shown repeatedly throughout this brief, there is no distortion of income and there is no evasion of taxes whatsoever. There is therefore no basis on which to consider use of §59-13-17.

POINT IV

THE TAX COMMISSION'S APPLICATION

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OF REGULATION 13 TO THESE TAX-PAYERS IS IN ERROR.

(A) *No General Authority to Regulate is Given by the State Constitution.*

The Attorney General's citation of the Constitution on p. 7 of his brief, by the words quoted, only gives power to "administer and supervise" laws, not interpret or issue regulations.

(B) *The Tax Commission Has No Authority Under U.C.A. §59-5-46 To Promulgate Franchise Tax Regulations.*

U.C.A. §59-5-46 (1953), according to the Attorney General in his brief at page 8, is a general source of power for the promulgation of Regulation 13. However, by citing this section as authority for Regulation 13, the Attorney General proposes to give the Tax Commission unlimited regulatory authority far beyond that given by the Legislature and never approved by this Court.

The title of U.C.A. §59-5-46 (1953) is "General Powers and Duties." That code section was enacted under Chapter 5 of Title 59. Chapter 5 of Title 59 is entitled "Assessment of Property", and deals generally with the assessment of property. Chapter 13, on the other hand, is the chapter wherein the powers of

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the Tax Commission with respect to the franchise tax are contained.

The relevant statutory scheme is made clear by reference to Exhibits "A" and "B".[7] Exhibit "A" shows the general listing of the chapters included under Title 59, "Revenue and Taxation." Section 59-5-46 (1953) is subsumed under the title "Assessment of Property." It seems more than strange that such broad regulatory power over the franchise tax would be placed in an obscure section dealing with the assessment of the property tax.

Exhibit "B", the first page of Chapter 5, shows that the chapter clearly is concerned with the specific area of property assessment and the Tax Commission's role in property assessment, not corporate franchise taxes, nor general, all-encompassing regulatory grants.

In addition, the Attorney General's contention that U.C.A. §59-5-46 (1953) gives the Tax Commission the power to promulgate corporate franchise tax regulations does not comport with a proper construction of that section. Each subsection in U.C.A. §59-5-46 (1953) deals with some aspect of the assessment of the property tax and the powers of the Tax Commission with respect thereto. The purpose of the section was to detail the powers and duties of the Tax Commission with respect to the property tax. Section 59-5-46 has

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[7] Appendix, pp. i and ii.

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nothing to do with the corporate franchise tax which is separately treated in Chapter 13 of Title 59.

It seems clear that the Attorney General's claim for the Tax Commission of general regulatory authority under §59-5-46, and therefore, the main base of Points I and II in the Attorney General's brief, must fall since it focuses on a few words rather than the law in its context. The Attorney General has erred in ignoring the plain-spoken purpose and policy of Chapter Five. Judge Learned Hand once said,

> "There is no more likely way to misapprehend the meaning of language—be it in a constitution, a statute, a will or a contract—than to read the words literally, forgetting the object which the document as a whole is meant to secure." *Central Hanover Bank & Trust Co. v. Commissioner*, 159 F.2d 167, 169 (2d CA 1947).

It would be hard to find a better case to illustrate this perceptive observation. In sum, an attempt is made to derive an over-arching expansion of regulatory power from the "literal" meaning of this section deeply buried in the property tax assessment chapter.

One final point should be made. The Attorney General's construction of a general regulatory power for the Tax Commission under U.C.A. §59-5-46 (1953) is completely at odds with the clear intent of the Legislature only to make specific grants of regulatory power, section by section, with respect to the corpor-

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ation franchise tax. See the discussion under POINT IV.

(C) ***Regulation 13 Can Apply only to Taxpayers which File Utah Consolidated Returns.***

(1) ***The Attempt to Apply Regulation 13 to These Taxpayers Must Fail if it is Grounded Upon U.C.A. § 59-13-7(3).***

Following the lead of the Utah Constitution, the Utah Legislature has not given broad grants of regulatory power to the Tax Commission. Where the Legislature has felt that regulation is necessary, it has made very specific grants of regulatory power. This can best be illustrated by U.C.A. § 59-13-7 (1953), which is the section containing the federal income tax deduction. That section has various subsections, each of which deals with a different deduction. In § 59-13-7, the Legislature gives the Tax Commission authority to promulgate rules and regulations with respect to some deductions, but not others. For example, Subsection 10 of that section, dealing with the deduction of future expense liabilities as a result of a casual sale of real property, directs the Tax Commission to prescribe regulations pertaining thereto. The subsection provides:

> There shall be allowed as a deduction:
>
> In the case of a casual sale or other casual disposition of real property, a reasonable allowance for future expense liabilities incurred under the provisions of the contract under which such

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> sale or other disposition was made, under such regulations as the tax commission may prescribe. U.C.A. § 59-13-7(10) (1953). (Emphasis added)

In addition, the Legislature directs the Tax Commission under U.C.A. § 59-13-7(8) (1953) to prescribe rules and regulations with respect to depletion deductions. These subsections contrast with the "taxes paid" deduction of U.C.A. § 59-13-7(3) (1953), which makes no mention of any authority given to the Tax Commission with respect to the prescription of rules and regulations for the deduction of "taxes paid."

It is evident from these illustrations that where the Legislature desires regulation by the Tax Commission, it makes a specific grant of authority. Without such authority the Tax Commission has no power to make law by regulation. If a need for regulatory authority in this area is found to exist, the proper forum for the executive branch is in the Legislature.

(2) *The Attempt to Apply Regulation 13 to these Taxpayers Must Fail if Grounded on U.C.A. §59-13-23.*

(a) *For Regulation 13 to be Valid, it Must Have Been Promulgated by the Tax Commission under Authority Granted in U.C.A. §59-13-23 (2) (1953).*

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As discussed above, the Tax Commission does not have a general power to promulgate Regulation 13, nor does it have authority under U.C.A. §59-5-46 1953). Whatever power the Tax Commission has for the promulgation of Regulation 13 must come from U.C.A. §59-13-23(2) (1953).[8]

Utah Code Annotated §59-13-23 (1953) deals with the filing of *Utah* consolidated returns. Subsection (2) of that section provides that:

> "(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." (Emphasis added).

The Attorney General, in his brief at p. 10, tries to extend the application of regulations promulgated under the authority of U.C.A. §59-13-23(2) (1953) to all "affiliated groups" (whether or not they file Utah consolidated returns). This is an incorrect interpretation of that subsection.

As discussed in Point III and Point IV D, there is no authority for Regulation 13 inherent in §59-13-17 and no other section has been cited as authority for Regulation 13.

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Section 59-13-23 is entitled "Consolidated Returns." Each subsection of that section deals with some aspect of the "privilege" of filing a Utah consolidated return. The very language of the subsection says that it applies to ". . . corporations making a consolidated return . . ." If a corporation does not file a Utah consolidated return the section does not apply to it.

The Attorney General's argument to expand the Utah consolidated return statute to cover taxpayers who do not file a Utah consolidated return, must be restated (with emphasis supplied), to appreciate the point upon which it relies:

> "The statute authorizes the Tax Commission to prescribe such regulations for 'of each corporation in the group, both during and after the period of *affiliation* . . . .' Certainly, after the *period of affiliation*, a corporation would not be filing a consolidated Utah income tax return; hence, the above subsection (2) reaches *all* situations dealing with an affiliated group of corporations, as defined.[9]

The Attorney General misinterprets the meaning of this sentence by taking it out of context.

Franchise Tax Regulation 4, §4.9, makes a subsidiary which was part of an affiliated group, but is not now "affiliated", liable for any deficiency against the affiliated group for a period during which a consolidated return was filed, if such return included the sub-

[9] Tax Commission's Brief at p. 10.

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sidiary. This liability remains even after the subsidiary is no longer a member of the affiliated group. It is this situation which the sentence relied on by the Attorney General was intended to cover.

The Attorney General, on p. 10 of his brief, states that the taxpayers "make no contention that they are not a member of an affiliated group as defined in the above-cited statutes". This point is irrelevant. Section 59-13-23, and the regulations promulgated thereunder, do not rely for their application on the "affiliation" of corporations. Rather, an "affiliated group" must elect to file a Utah consolidated return before this section is operative. "Affiliation" has significance only in that corporations must be "affiliated" to file a consolidated return. The taxpayers did not file a Utah consolidated return, and are, therefore, not bound by the regulations promulgated under authority of §59-13-23.

(b) *The Kennecott Case Ties the Validity of Regulation 13 to the Filing of a State Consolidated Return under U.C.A. §59-13-23 (2) (1953).*

The Attorney General argues that the Utah Supreme Court upheld the constitutional validity of Regulation 13 in the *Kennecott* case. The Attorney General concludes from the *Kennecott* case that the Tax Commission has blanket authority to apply Regulation 13 to

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any Utah corporate taxpayer.[10] The portion of the opinion which the Attorney General so construes reads:

> Kennecott further contends that the Commission erred in its allocation of deductible federal income tax to the Utah affiliated group. This matter was handled in accordance with the regulation of the Commission rather than federal regulations. Kennecott was bound by the regulations of the Commission and we perceive no error in its application. *Kennecott Copper Corp. v. State Tax Commission*, 27 U.2d 119, 125, 493 P.2d 632 (1972).

There is an important factual difference between the *Kennecott* case and this case: Kennecott filed a Utah consolidated return. The taxpayers in this case filed a federal consolidated return, but their Utah returns were filed separately. The language of the Court in *Kennecott* specifically mentioned that the allocation was to be made to the *Utah* affiliated group (a reference to the fact that the deduction in question was taken on a Utah consolidated return). The Court further pointed out that Kennecott was *bound* by the regulations of the Tax Commission. This was a reference to U.C.A. § 59-13-23(1) (1953) which makes the filing of a Utah consolidated return conditional on the acceptance of regulations which deal with state consolidated returns. Kennecott had, therefore, accepted Regulation 13.

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[10] See, Conclusion of Law No. 3 in the Tax Commission's decision in **The Matter of Midland Telephone**, Decision No. 288.

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The Tax Commission emphasized the importance of Kennecott's consent in their Conclusions of Law from the *Kennecott* hearing before the Tax Commission. The Tax Commission's *Kennecott* decision contained 25 Conclusions of Law. Of those 25 Conclusions of Law, only one dealt with the question of the deductibility of federal taxes. That conclusion was Conclusion of Law No. 14:

> Kennecott accepted and is bound by Commission regulations governing the filing of consolidated returns, including Regulation 4 and Regulation 13 and, therefore, the action of Kennecott in claiming a deduction for Federal Taxes pursuant to Treasury Regulation 1.1502-33(d)(2) is improper.[11]

The Tax Commission disposed of Kennecott's entire "taxes paid" argument with the statement that Kennecott was bound by Regulation 13 since Kennecott had *consented* to its application.

The importance of consent to the consolidated return regulation was again emphasized by the Attorney General in his appeal brief to the Utah Supreme Court in *Kennecott*:

> Tax Commission Regulation 4(4)(b), conditions the Tax Commission's acceptance of a consolidated return upon the filing by the affiliated group of a Form 22, wherein the group consents

[11] Regulation 4 deals with who may file Utah consolidated returns, etc., and is not an issue here.

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> to the application of Utah Regulations as adopted. (See the Tax Commission's Brief, *supra* at 55.)

Although it cited the regulation rather than the controlling statute (§ 59-13-23(1)), the Attorney General's point was that Kennecott had no room to argue that Regulation 13 did not apply to it since Kennecott had specifically consented to Regulation 13's application by filing a Utah consolidated return. This is reiterated at page 57 of the Attorney General's *Kennecott* brief:

> Thus, it appears that Kennecott in filing a consolidated return in the State of Utah has agreed to be bound by the Commission Regulations governing the filing of such consolidated returns, including but not limited to Regulation 13. Under the provisions of Regulation 13, no Federal tax can be assigned to loss items and Federal Regulation 1.1502-33(d)(2) has no applicability.

The Attorney General cites *Kennecott* for the proposition that Regulation 13 has general application to all Utah corporate taxpayers.[12] However, the material quoted *supra* from page 125 of the *Kennecott* opinion is the only material in the opinion which deals with the question of the deductibility of the federal income taxes paid by Kennecott's federal consolidated group, and even then the Court merely held that Kenne-

[12] Tax Commission's brief at p. 18.

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cott was bound by that regulation since it filed a Utah consolidated return. It did *not* deal with the general application of Regulation 13 to separate return taxpayers.

(c) ***Midland and Utah Telephone Did Not File a Utah Consolidated Return and are not Bound by the Tax Commission's Utah Consolidated Return Regulations, including Regulation 13.***

Utah Code Annotated §59-13-23(1) (1953) provides in pertinent part that:

> 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.* (Emphasis added)

Utah Code Annotated § 59-13-23(1) (1953) by its terms limits application of regulations promulgated under authority granted by subsection (2) to those corporations which file Utah consolidated returns, and thereby consent to such subsection (2) regulations.

The taxpayers do not file and have never filed Utah consolidated returns. Midland and Utah Telephone

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file their state returns on a separate basis. Since they do not file Utah consolidated returns, they are not subject to the provisions of U.C.A. § 59-13-23 (1953). Consequently, they did not and could not consent to the Tax Commission's regulations dealing with Utah consolidated returns. They did not and could not give the Form 22 consent obtained from Kennecott by the Tax Commission. Since Regulation 13 was promulgated under authority granted the Tax Commission by the Legislature to deal with *Utah* consolidated returns and requires consent for its application, it did not and could not apply to either taxpayer in this case.

(D) *The Attempt to Apply Regulation 13 to These Taxpayers Must Fail if Grounded on U.C.A. § 59-13-17 (1953).*

There is no grant of regulatory power in § 59-13-17. That section only applies, as the Attorney General admits on p. 14 of his brief, when the Tax Commission has found that a properly determined tax grounded on another statute is being evaded.

POINT V

REGULATION 13, IF VALID, CANNOT, BY ITS OWN TERMS, APPLY TO THE PRESENT CASE.

(A) *Introduction.*

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There are only two subsections of Regulation 13 which may under any construction apply to the taxpayers. The first is Regulation 13, § 13.3. That subsection is entitled "Accrual Basis Taxpayer". The second possibly applicable section is Regulation 13, § 13.4, entitled "Assignment of Federal Incomes Taxes". As will be pointed out in more detail below, neither of these subsections applies in this particular case.

(B) *Section 13.3 of Regulation 13 is Merely an Accounting Method Definition.*

Subsection 13.3(a) is the pertinent part of § 13.3. That subsection provides:

> "In the case of an accrual basis taxpayer, the amount of federal income tax to be allowed as a deduction in arriving at the total corporate net income for Utah franchise tax purposes is normally limited to the amount of the actual federal income tax liability in connection with its federal return for the same period.

The Attorney General, for purposes of this case, construes this subsection to mean that taxpayers' federal tax deduction is limited to their computation of the proportionate share of the total federal consolidated tax actually paid over by taxpayer's shareholder corporation.

However, the Attorney General's present construction is clearly at odds with the original meaning of sub-

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section 13.3(a). The subsection was meant to be an instruction to an accrual basis (as opposed to cash basis) taxpayer as to the method it must employ in determining the timing of its federal tax deduction for any particular year. The issue dealt with in subsection 13.3(a) is whether the federal tax deduction is limited to the amount of federal taxes due *on the net income* of the taxpayer *for the applicable year,* or whether the taxpayer may also deduct taxes assessed for previous years which it pays in the present year or which come to a final determination through litigation or administrative procedure in the present year.

The purpose of subsection 13.3(a) is made clear by the other subsections under § 13.3. Since, as explained above, under subsection 13.3(a), the accrual basis taxpayer may not deduct, in a current year, taxes which are paid in that current year, but on net income from prior years, subsection 13.3(b) provides that the taxes accruing for the prior years must be taken by filing amended returns for those prior years rather than deducting the amount currently.

Consider the following illustration:

> A corporation is an accural basis taxpayer. It has paid federal income taxes since 1960. In 1975, the IRS assesses a deficiency of $10,000 for 1972. In 1975, A pays the $10,000 deficiency and accrues a federal tax liability of $50,000 for its 1975 taxable income. Under Regulation 13,

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> A may only deduct $50,000 on its 1975 return even though it accrued $60,000 in taxes that year. It must deduct the other $10,000 by amending its 1972 return.

As the subsections illustrate, the intent of subsection 13.3(a) was to instruct the corporate taxpayer that it could deduct currently only those federal taxes which are based on *current* net income. It has *nothing to do* with the problem before this Court.

This conclusion is bolstered when the Court considers the *addition* made to subsection 13.3(a) of Regulation 13 effective for tax years beginning *after* January 1, 1973. The amendment was made by the Tax Commission following the *Kennecott* case, which was the first court case to question Regulation 13. The 1973 addition to Regulation 13.3(a) provides:

> In case the corporation was included in a consolidated return for federal income tax purposes, the amount of federal income tax to be allowed as a deduction in arriving at the net income of the corporation shall be limited to its proportionate share of the actual federal income tax due with the federal consolidated return for the same period. The proration of the allowable federal tax must be made only to profit-producing corporations included in the consolidated return.

The intendment of the language in this addition is quite clear. Without any reference to new legislation, it attempts to expand Regulation 13 to deal with sep-

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arate corporations which file federal consolidated returns. Even if this bootstrap amendment were found to be controlling, it affects only tax years beginning after January 1, 1973. As the Attorney General states in his brief at p. 16:

> "The [present] Corporation Franchise Tax Regulation No. 13 . . . is *not* the regulation in effect under the present fact situation during the taxable years in question and should be disregarded. (AB-Appendix) (See Exhibit 17) In particular, *the second paragraph in Section 13.3 (a)* is not found in the Regulation 13 applicable to this situation." (Emphasis added)

The Attorney General has made taxpayers' case —the very computation which the Tax Commission seeks to impose upon the taxpayers (§ 13.3(a), second paragraph) is "*not* the regulation in effect under the present fact situation" and "in particular, the second paragraph in Section 13.3(a) is not found in the Regulation 13 applicable to this situation."

The Tax Commission cannot have it both ways. Either the 1973 amendment to Regulation 13 is valid and does not apply in the years in question to these taxpayers or it was redundant and totally unnecessary.

A more reasonable premise is that, following the *Kennecott* challenge, the Tax Commission realized that Regulation 13, as it existed prior to January 1, 1973, could *not* cover corporations filing consolidated federal returns and *separate* Utah returns.

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It should not go unnoticed that the Attorney General has failed to respond adequately to the above argument in its brief at p. 16. Certainly, totally unsupported (see Tax Commission's brief at p. 16) conclusionary statements are not sufficient. The Attorney General's complete response to the above argument is as follows:

> "Appellant's argument . . . in this matter, is untenable. This argument is irrelevant and bears similarity to the 'subsequent repairs' reason for nonadmissibility of evidence under the Utah Rules of Evidence 51." [13]

The "similarity" suggested by the Attorney General does not explain in any way why taxpayers' argument is "untenable" or "irrelevant". Rule 51 is, of course, a policy decision to encourage "subsequent repairs."

(C) *Section 13.4 of Regulation 13 is an Allocation Provision which Does Not Apply to the Taxpayers.*

The only other part of Regulation 13 which the Attorney General now construes to apply to Midland and Utah Telephone is § 13.4. The pertinent portion of § 13.4 of Regulation 13 provides as follows:

> "An assignment of a portion of the *total allowable federal income tax deduction* on the

[13] Tax Commission's brief at p. 16.

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> Utah corporation franchise tax return may be required for certain purposes . . . Corporation Franchise Tax Regulation No. 13, § 13.4(a). (Emphasis added)

This section contemplates a situation where the "total allowable federal income tax deduction" has already been determined. In such a case, this section then provides a means by which the liability is allocated between income allocable to Utah and income derived from activities outside of Utah. The section does not, contrary to the contention of the Attorney General, purport to determine the *amount* of the "total allowable federal income tax deduction".

This construction of subsection 13.4(a) is made even clearer by subsection 13.4(c) and the addition to subsection 13.3(a). Subsection 13.4(c) is an amplification of subsection 13.4(a), and provides that "federal income tax assignments are to be made to profit-producing items or divisions only." The plain meaning of "items or divisions" is that the entities receiving the assignments are all part of the same corporation rather than corporate subsidiaries of the same parent corporation. If the section had been intended to apply to subsidiary corporations such as Midland and Utah Telephone, it would have used the word "corporations" rather than "items or divisions". This construction can be illustrated by the addition to subsection 13.3(a) effective after January 1, 1973. That addition clearly was intended to apply to subsidiary *corporations* filing

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federal consolidated returns. The addition to subsection 13.3(a) refers to "profit-producing *corporations.*" The conclusion follows, that when the Tax Commission in its regulation intends that application be made to subsidiary *corporations,* it clearly states that intention.

The following is an example of how subsection 13.4 was intended to work:

> X has subsidiaries A and B. A, is a Utah corporation with divisions doing business in and out of Utah. B, a California corporation, does business only in that state. The X group files a federal consolidated return.
>
> The amount of federal tax liability allocated to A is the "total allowable federal income tax deduction" of A. That amount is not determined under subsection 13.4(a), which assumes the amount of the total deduction has already been determined, but rather it is computed under statute and generally accepted methods of accounting. Once the *amount* of "total allowable federal income tax deduction" is determined for A, subsection 13.4(a) requires that a portion of that total deduction be allocated to *Utah income* and a portion be allocated to *non-Utah income.*
>
> Subsection 13.4(a) is not intended to determine how the total consolidated tax is to be divided between A and B, which are separate corporations.

In our case, the Court must determine the taxpayers' "total allowable federal income tax deduction". This is not covered by subsection 13.4(a) which only

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covers the *allocation* A must make *between* Utah and non-Utah income. The taxpayers' income *allocation* is not in dispute here. Therefore, the taxpayers' share of the total Continental deduction is not brought into issue by subsection 13.4(a).

The Attorney General in his brief at p. 16 also cites subsection 13.4(b) of Regulation 13 as authority for its present position. Such a construction is inconsistent both with the language of subsection 13.4(b), and with the general purpose of § 13.4 as set out above.

Subsection 13.4(b) speaks in terms of "assigning" federal income taxes to "segments of net income subject to federal income tax. . . ." The term "segments of net income" is consistent with the example above. That term deals with intracompany assignments. It was not meant to be used for assignments between separate corporations. If the latter had been the intent of the subsection, it would have used a phrase such as "subsidiary's net income." Subsection 13.4(b) just does not apply to the taxpayers since there is no dispute as to whether they properly allocated any tax deduction between Utah and non-Utah income.

POINT VI

REVENUE RAISING POLICY CONSIDERATIONS MUST BE LEFT SOLELY TO THE UTAH LEGISLATURE.

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The Attorney General has attempted to prejudice the consideration of the legal merits of this case by introducing two categories of non-legal revenue "policy" considerations which the Court should reject.[14] The first attempts to make the obvious sound dangerous— that the Tax Commission will collect less revenue than it seeks if it loses this case. The second category is a mistaken version of the federal tax law and its impact on Utah revenues, and is highlighted by such phrases as: "subsidize the elimination of intercompany profits"; "Legislature should set the guidelines if affiliated companies are to get tax relief"; "reduction of the franchising fee necessarily discriminates against intrastate domestic corporations"; "federal tax loopholes"; "ties the State of Utah to everchanging federal tax regulations."

The Attorney General points out in its "Policy" No. 1 that if the Tax Commission loses this case it will be deprived of the additional revenues it seeks. This is, of course, implicit in any case involving the Tax Commission and is not relevant to a correct application of the law. In any case, the increase would be fleeting because of the stifling effect on competition and future growth created by such discriminatory applications of the tax laws.

The second category results from the Attorney General's misunderstanding of the federal tax law. In

[14] **Tax Commission's brief at pp. 23-24.**

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summary, the taxpayers determine their "taxes paid" deduction based on their Utah net income just as any other Utah corporation. They then pay this amount to Continental, their agent for payment of federal taxes, just as any other Utah corporation would pay it to the Internal Revenue Service. The taxpayers ask only for the same deduction they would be entitled to if they did not file a federal consolidated return. They do not seek an advantage over any other Utah corporation.

The Attorney General misunderstands these basic facts. There will be no reduction of the franchising fee if the taxpayers win this case. Rather, the taxpayers' franchising fee will be an identical percentage of their taxable Utah income as is any other Utah corporation's. The federal regulations which the Attorney General refers to as impinging on Utah revenues have nothing to do with the determination of the franchise tax. Those federal regulations only affect the taxpayers' "*earnings and profits*" — which is a concept entirely distinct from taxable income and has nothing to do with any tax the corporations pay.

Amicus Curiae would like to point out the real impact of this case if the Tax Commission prevails — the franchising fee will be increased for the taxpayers and all other Utah corporations filing federal consolidated returns. The Tax Commission is attempting to punish these Utah corporations, regulated in all respects by Utah and serving Utah consumers, for filing

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federal consolidated returns. Without some expression to the contrary, the intention to exact the penalty here sought by the Tax Commission should not be attributed to the Utah Legislature.

CONCLUSION

The State Tax Commission's decision denying a full "taxes paid" deduction to Midland Telephone Company and Utah Telephone Company should be reversed.

Respectfully submitted,

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APPENDIX

EXHIBIT "A"

UTAH CODE ANNOTATED 1953

REPLACEMENT VOLUME 6B

TITLE 59

REVENUE AND TAXATION

Chapter 1. Tax on Tangible Property, 59-1-1.
2. Exemptions, 59-2-1 to 59-2-3, 59-2-5 to 59-2-13, 59-2-17 to 59-2-31 [59-2-4, 59-2-14 to 59-2-16 Repealed].
3. Definitions, 59-3-1.
4. Situs, 59-4-1, 59-4-2.
5. Assessment of Property, 59-5-1 to 59-5-19, 59-5-21 to 59-5-46, 59-5-47 to 59-5-67, 59-5-67.2 to 59-5-81, 59-5-83 to 59-5-111 [59-5-20, 59-5-46.1, 59-5-67.1, 59-5-82 Repealed].
6. Apportionment, 59-6-1 to 59-6-3.
7. Equalization, 59-7-1 to 59-7-15.
8. County Auditors' Duties, 59-8-1 to 59-8-10.
9. Levies, 59-9-1 to 59-9-5, 59-9-6.1 to 59-9-13 [59-9-6 Repealed].
10. Collection of Taxes, 59-10-1 to 59-10-72.
11. Miscellaneous Provisions, 59-11-1 to 59-11-15 [59-11-16 Repealed].
12. Inheritance Tax, 59-12-1 to 59-12-37, 59-12-39, 59-12-40, 59-12-42 to 59-12-44 [59-12-38, 59-12-41 Repealed].
13. Franchise and Privilege Taxes, 59-13-1, 59-13-3 to 59-13-19, 59-13-22 to 59-13-97 [59-13-2, 59-13-20, 59-13-21 Repealed].
14. Individual Income Tax, 59-14-1 to 59-14-72 [59-14-73 to 59-14-80 Repealed].
14A. Individual Income Tax Act of 1973, 59-14A-1 to 59-14A-98.
15. Sales Tax, 59-15-1 to 59-15-4, 59-15-4.6 to 59-15-22 [59-15-4.5 Repealed].
16. Use Tax, 59-16-1 to 59-16-3, 59-16-3.6 to 59-16-22, 59-16-24, 59-16-25 [59-16-3.5, 59-16-23 Repealed].
17. Chain Store License, [59-17-1 to 59-17-9 Repealed].
18. Tobacco Licenses, 59-18-1 to 59-18-4, 59-18-5 to 59-18-15, 59-18-17 to 59-18-19 [59-18-4.1, 59-18-16 Repealed].
19. State Tax System Committee, 59-19-1 to 59-19-7.
20. Uniform System of Accounts, 59-20-1 to 59-20-3.
21. Oleomargarine Excise Tax, [59-21-1 to 59-21-25 Repealed].
22. Multistate Tax Compact, 59-22-1 to 59-22-9.
23. Charitable Trusts, 59-23-1 to 59-23-13.

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EXHIBIT "B"

Collateral References.

Taxation⟹98.

84 C.J.S. Taxation §§ 339 to 348.

Place for taxation of dam, flowage rights, or water power, 64 A. L. R. 143.

CHAPTER 5

ASSESSMENT OF PROPERTY

ARTICLE 1. GENERAL PROVISIONS, 59-5-1 to 59-5-3.5.
2. ASSESSMENT BY COUNTY ASSESSOR, 59-5-4 to 59-5-18.
3. ASSESSMENT OF TRANSIENT LIVESTOCK AND HONEYBEES, 59-5-10 to 59-5-29.
4. DUTIES OF COUNTY ASSESSOR, 59-5-30 to 59-5-36.
5. STATE TAX COMMISSION, 59-5-37 to 59-5-51.
6. ASSESSMENT BY STATE TAX COMMISSION, 59-5-52 to 59-5-65.
7. MINING OCCUPATION TAX, 59-5-66 to 59-5-85.
8. FARMLAND ASSESSMENT ACT OF 1969, 59-5-86 to 59-5-105.
9. ADMINISTRATION OF PROPERTY TAX ASSESSMENT, 59-5-106 to 59-5-111.

ARTICLE 1

GENERAL PROVISIONS

Section 59-5-1. Rate of assessment of property.
59-5-2. Assessment by county assessor—Basis of property taxation for county and subdivisions.
59-5-3. Assessment by state tax commission—Properties assessed by, enumerated.
59-5-3.5. Prorata application of ad valorem tax on property taken by eminent domain or by right of entry agreement.

59-5-1. Rate of assessment of property.—All taxable property, not specifically exempt under Article XIII, section 2, of the Constitution of Utah, must be assessed at thirty per cent of its reasonable fair cash value. Land and the improvements thereon must be separately assessed.

History: R. S. 1898 & C. L. 1907, § 2506; C. L. 1917, § 5866; R. S. 1933 & C. 1943, 80-5-1; L. 1947, ch. 102, § 1; 1961, ch. 142, § 1.

Compiler's Notes.

The 1947 amendment substituted "forty per cent of its reasonable fair cash value" for "at its full cash value."

The 1961 amendment inserted "not specifically exempt under Article XIII, section 2, of the Constitution of Utah" and substituted "thirty per cent" for "forty per cent."

Administration of act.

The state tax commission administers this act. Kennecott Copper Corp. v. State Tax Comm., 327 U. S. 573, 90 L. Ed. 862, 66 S. Ct. 745, affirming 150 F. 2d 905.

Building restrictions and easements.

To assess property without regard to a building restriction or an easement would be to assess it without regard to the nature and extent of the property interest which the assessed owner has in the land, in complete disregard of its fair cash value which would be in violation of this section. Hayes v. Gibbs. 110 U. 54, 169 P. 2d 781, 168 A. L. R. 513.

Burden of proof.

Burden to show inequality of assessment was on taxpayer. First Nat. Bank v. Christensen, 39 U. 568, 118 P. 778.

Coal lands.

A blanket assessment of all coal lands in county could not be made at a flat or uniform rate. Ririe v. Randolph, 51 U. 274, 169 P. 941.

Deductions.

Value of stock of corporation doing business in state cannot be diminished, for purposes of taxation, by deducting from it value of property not situated or taxable in state. Commercial Nat. Bank v. Chambers, 21 U. 324, 61 P. 560, affd. 182 U. S. 556, 45 L. Ed. 1227, 21 S. Ct. 863.

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BEFORE THE STATE BOARD OF TAX REVIEW
LUCAS STATE OFFICE BUILDING
DES MOINES, IOWA

MASSEY-FERGUSON CREDIT CORPORATION, *Appellant,* vs. D. G. BRIGGS, DIRECTOR OF REVENUE, *Respondent.*	No. 48 Decision

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This matter came on for hearing before the State Board of Tax Review on December 13, 1973. Present at the hearing on behalf of the Appellant was William D. Griffin, State and Local Tax Manager, Massey-Ferguson, Inc. Present on behalf of the Department of Revenue were Harry M. Griger, Assistant Attorney General, and Vernon Raile, Supervisor, Corporation Audit Section. The State Board of Tax Review consisting of Louis I. Nussbaum, Chairman, Edwin A. Hicklin and Keith A. McKinley, Members, upon con-

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sideration of the notice of appeal from the order of the Director, the answer filed, having heard all evidence and arguments, does hereby make the following:

FINDINGS OF FACT

1. That the State Board of Tax Review has jurisdiction of the parties and of the subject matter herein.

2. That the Appellant appealed from the order of the Director of Revenue dated June 15, 1973, which order denies Appellant's claim for refund of corporation income tax in the amount of $7,510.00 for the fiscal year ending October 31, 1969.

3. That the facts are summarized in the Director's order of June 15, 1973, and were not in dispute at the hearing before this Board.

CONCLUSIONS OF LAW

Under the provisions of Section 422.35(4), Code of Iowa, a corporation may deduct 50 per cent of the federal income taxes *"paid or accrued"* by the corporation during the taxable year.

In this case the Appellant accrued total federal income taxes in the amount of $1,833,021.00 arising out of profits from its operation during the fiscal year in

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question. Had the Appellant filed a separate federal corporate tax return, this would have been its tax liability. It did not, however, file a separate return but rather filed a consolidated return with other subsidiaries of Massey-Ferguson, Inc. Due to offsetting losses by other subsidiaries the over-all effect was that the consolidated federal corporate return produced no income tax. And as a matter of fact there was a refund of estimated tax paid.

As between the Appellant and Massey-Ferguson, Inc., there was an intercompany transaction in which the Appellant paid to the parent company the amount of its tax liability and the same was credited to surplus by the parent company.

This Board adopts the position that in filing a separate state corporate tax return the Appellant is entitled to claim 50 per cent of the federal income tax which is "*accrued*" by that corporation in determining its state tax liability under the provisions of Section 422.35(4).

In support of this position the Board favorably considers the language of the Supreme Court of Kansas in the case of *Cities Service Gas Company v. McDonald,* 466 P2nd 277. In this case the Court is considering a factual situation much like the one at hand and a Kansas statute similar to our own statute.

Inasmuch as this matter can be disposed of through

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the interpretation of the above referenced section, the Board need not consider nor pass on the question concerning the filing of a consolidated state corporate tax return.

IT IS THEREFORE ORDERED by the State Board of Tax Review, Mr. Nussbaum and Mr. McKinley concurring and Mr. Hicklin dissenting, that the Director's order in upholding the Department of Revenue's assessment against Appellant be reversed, that the assessment against the Appellant be cancelled, and that Director be ordered to refund to the Appellant the sum of $7,510.00, plus interest as may be required by Statute.

Done at Des Monies, Iowa, this 8th day of July, 1974.

IOWA STATE BOARD OF
TAX REVIEW

By /s/ Louis L. Nussbaum
Louis L. Nussbaum, Chairman

By /s/ Keith A. McKinley
Keith A. McKinley

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