

2017

## Utah State Tax Commission, Respondent-Appellants, v. See's Candies, Inc., Petitioner-Appellee.

Utah Supreme Court

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IN THE UTAH SUPREME COURT

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Utah State Tax Commission,

*Respondent-Appellants,*

v.

See's Candies, Inc.,

*Petitioner-Appellee.*

No. 20160910-SC

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BRIEF OF APPELLANT UTAH STATE TAX COMMISSION

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On appeal from the Fourth Judicial District Court  
The Honorable Samuel D. McVey  
No. 140401556

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## JURISDICTIONAL STATEMENT

The Utah Supreme Court has original jurisdiction over this appeal under Utah Code sections 78A-3-102(3)(e)(ii) and 78A-3-102(3)(f).

## ISSUE PRESENTED

Utah Code section 59-7-113 authorizes the Utah State Tax Commission to distribute, allocate, or apportion income or deductions among related corporations to prevent evasion of taxes or to clearly reflect income. The Commission used its Section 113 authority here to reallocate income between two wholly-owned subsidiaries of the same parent corporation after one subsidiary made royalty payments to the other that purported to reduce the payor subsidiary's Utah taxable income by around 82% a year for eight years. The district court reversed the Commission's reallocation, finding that the Commission had failed to justify its action under an "arm's length" standard that the Internal Revenue Service applies when deciding whether to reallocate corporate income to calculate federal corporate income tax.

The question presented is whether the district court erred here by applying federal tax regulations, and the IRS's "arm's length" standard under those federal regulations, to limit the Commission's authority under Section 113.

**Preservation and Standard of Review:** The Court reviews the district court's factual findings for clear error and its legal conclusions for correctness. *Housekeeper v. State*, 2008 UT 78, ¶ 18, 197 P.3d 636. The interpretation of a statute is a question of law that is reviewed for correctness. *Harvey v. Cedar Hills City*, 2010 UT 12, ¶ 10, 227 P.3d

256. Utah law “affords no deference to federal regulations on questions of law.” *Hughes Gen. Contractors v. Utah Labor Comm’n*, 2014 UT 3, ¶ 8, 322 P.3d 712.

The Commission preserved this issue below. R. 0453-486, 500-535.

## **DETERMINATIVE PROVISION**

### **Allocation of income and deductions between several corporations controlled by same interests**

If two or more corporations (whether or not organized or doing business in this state, and whether or not affiliated) are owned or controlled directly or indirectly by the same interests, the commission is authorized to distribute, apportion, or allocate gross income or deductions between or 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 of such corporations.

Utah Code § 59-7-113.

## **STATEMENT OF THE FACTS AND THE CASE**

This appeal presents a straightforward issue of statutory construction: Can the Utah State Tax Commission apply section 59-7-113 according to the statute’s plain language and Utah’s corporate franchise and income tax laws, or must the Commission apply the statute in accordance with voluminous federal regulations and federal corporate income tax laws? The district court chose the latter approach. To explain why that was wrong, the Commission first reviews the relevant Utah tax statutes then describes the underlying facts and proceedings below.

### **I. The Utah Code Establishes Rules For Fairly Representing A Multistate Corporation’s Utah Tax Liability.**

With one relevant exception discussed below, Utah taxes corporations doing



business in the State based on their income. Where, as here, a corporation is related to other corporations, those in the statutorily defined “unitary group” file a combined report that includes all of the filing information for every member of the unitary group. *See* Utah Code §§ 59-7-101(30), -402, and -403.<sup>1</sup> The unitary group’s domestic business income is then apportioned to Utah based on the percentage of its property, payroll, and sales in Utah compared to the same nationally. *See* Utah Code, Title 59, Chapter 7, Part 3 (“Allocation and Apportionment of Income – Utah UDITPA Provisions”).

By requiring combined reporting, rather than separate reporting, Utah tax law neutralizes income shifting among members of the unitary group. But it does not offset the distorting effects that can occur from transactions between corporations that are related, but not part of the unitary group. Utah Code section 59-7-113 addresses that loophole by expressly authorizing the Commission to ensure that a corporation’s otherwise taxable income is clearly reflected in such circumstances. It provides:

If two or more corporations (whether or not organized or doing business in this state, and whether or not affiliated) are owned or controlled directly or indirectly by the same interests, the commission is authorized to distribute, apportion, or allocate gross income or deductions between or 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 of such corporations.

Utah Code § 59-7-113.

One exception to this tax-on-income framework is for insurance companies. Utah taxes insurance companies on their premiums rather than their income. Utah Code

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<sup>1</sup> This brief cites to the most recent version of the Utah Code because, unless otherwise noted, the provisions have remained substantively the same since the audit period even though the code citations may have changed.

§ 59-9-101(1)(a); R. 0501, ¶ 2, 0505, ¶ 24. Thus, any insurance companies that are part of the same corporate family will not be part of a unitary group.

**II. See's Candies, A Berkshire Hathaway Subsidiary, Sold Its Intellectual Property To Columbia Insurance Company—Another Berkshire Hathaway Subsidiary—And Now Pays Over \$50 Million A Year In Royalty Payments To Use See's Intellectual Property.**

See's Candies ("See's") was established in California in 1921.<sup>2</sup> Ex. 35, p. 8. It sells candy in Utah and elsewhere under the See's tradename. Ex. 33; R.0501, ¶ 1. In 1972, Berkshire Hathaway Corp. ("Berkshire Hathaway") purchased See's. R. 0501, ¶ 1. Twenty-five years later, Berkshire Hathaway sought to have its subsidiaries' intellectual property transferred to Columbia Insurance Company ("Columbia"), another wholly owned subsidiary of Berkshire Hathaway.<sup>3</sup> Ex. 20; R. 0501-02, ¶¶ 3-6. As part of this initiative, See's sold all of its intellectual property—including the See's tradename—to Columbia in exchange for 544.98 shares of BH Columbia stock. Ex. 24; R. 0502, ¶ 4. Both the intellectual property and the stock were valued at an estimated \$450 million. R. 0502, ¶ 4. The BH Columbia stock is not publicly traded. *Id.* And See's has never received a dividend from BH Columbia.<sup>4</sup> R. 0505, ¶ 25.

After selling its intellectual property to Columbia, See's continued to sell candy in Utah under the See's tradename as before. R. 0502-03, ¶¶ 4-5, 8-12. Only now, See's had to pay Columbia for a license to use the See's name. R. 0502, ¶ 5, 0505, ¶ 25. From

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<sup>2</sup> See's Candies files a combined return with See's Candy Shops, Inc., which are referred to collectively as "See's." R. 0501, ¶ 1.

<sup>3</sup> All of Columbia's stock is held by Berkshire Hathaway in BH Columbia. R. 0501, ¶ 2. BH Columbia and Columbia are collectively referred to as "Columbia."

<sup>4</sup> The district court found that the stocks still had value for See's because it was not planning on expanding and the transaction allowed See's "to deploy excess cash in exchange for stock in a growing [Warren] Buffett company." R. 0504, ¶ 15.

1999 to 2007, See's paid over \$479 million in royalties to Columbia for national use of the See's tradename. Ex. 37; *see also* R. 0505, ¶ 23. The annual royalty payments grew from \$48 million to \$61 million:

TAX YEAR	AMOUNT
1999	\$ 48,884,531
2000	\$ 49,231,731
2001	\$ 51,015,583
2002	\$ 50,847,136
2003	\$ 50,494,850
2004	\$ 53,150,101
2005	\$ 56,075,650
2006	\$ 58,610,418
2007	\$ 61,171,928

*Id.*

The payment amounts were based on two three-year contracts between See's and its sister corporation Columbia for the periods from January 1, 1998 through December 31, 2000, and January 1, 2001 through December 31, 2003. R. 0503, ¶¶ 10, 12. Under those contracts, See's agreed to pay Columbia 18% of its net domestic sales in exchange for non-exclusive use of the See's tradename. R. 0502-03, ¶¶ 5, 7-12; 505, ¶ 25. At the same time, Columbia agreed to pay See's 1.5% of the royalties in exchange for See's maintaining and protecting the intellectual property, for example through advertising and customer subscription lists. Ex. 30; Ex. 33; R. 0503, ¶¶ 9-10, 12. This results in a net payment to Columbia of 16.5%. R. 0503, ¶¶ 9-10. For 2004 through 2007, there was no agreement in place. R. 0504, ¶ 14; Ex. 33. Even so, See's continued to pay Columbia 16.5% of its net domestic sales and Columbia continued to allow See's to use the See's tradename. *See id.*

See's has no contractual option to reacquire its intellectual property. Ex. 30; R. 0502, ¶ 5, 0505, ¶ 25. So as long as See's sells candy under the See's tradename it will need to pay royalties to Columbia. *See id.*

While See's could previously control how and who used its intellectual property, Columbia now makes these determinations. R. 0505, ¶ 25. See's license from Columbia is non-exclusive; thus, for example, Columbia has licensed See's intellectual property to Mattel in addition to See's. *Id.*

### **III. The Commission Reallocated See's Deductions For Royalty Payment Expenses To Clearly Reflect See's Income Under Section 113.**

See's business activities in Utah remained the same before and after it transferred its intellectual property to Columbia.<sup>5</sup> But after the transfer, See's began deducting its royalty payments to Columbia from its taxable corporate income. These deductions reduced See's Utah corporate franchise tax by about 82% per year for the years audited.<sup>6</sup> R. 0502-03, ¶¶ 4-5, 8-12; R. 0505, ¶ 23; Ex. 12.

The Tax Commission's Auditing Division audited See's and in 2009 issued a tax assessment that reallocated See's deductions for royalty payments to income for the period January 1, 1999 through December 31, 2007. The reallocation increased See's Utah tax by a total of \$246,914 plus \$73,698 in interest for the eight audited years.<sup>7</sup> R. 0507, ¶ 37.

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<sup>5</sup> See's earned its income from selling candy in Utah and elsewhere. R. 0502-03, ¶¶ 4-5, 8-12

<sup>6</sup> A reduction in the Utah corporate franchise tax of 82% indicates a corresponding 82% reduction in taxable income. R. 0502-03, ¶¶ 4-5, 8-12; R. 0505, ¶ 23; Ex. 12.

<sup>7</sup> Because Utah does not tax insurance companies on their income, reallocating See's income does not result in Utah double taxing the same income through Columbia. Columbia's annual Utah tax liability, based on its premiums, was in the low double-digits of dollars. R. 0501, ¶ 2; *see also* Ex. 67-75 (Columbia paid premium tax in four of the

See's appealed the Division's assessment to the Commission, which held that the reallocation was appropriate under Section 113. R. 0050-74. The Commission concluded that a reallocation under Section 113 required showing two elements: (1) that the corporations are owned or controlled by the same interests, and (2) that a distribution, apportionment, or allocation of gross income or deduction is necessary to prevent evasion of taxes or to clearly reflect the income of any such corporation. R. 0071, ¶ 1. As to the first element, the Commission noted that there was no dispute that See's and Columbia are controlled by the same interests. R. 0071, ¶ 2. As to the second element, the Commission found that the 75% (or more) decrease in income that resulted from See's deductions for royalties it paid to Columbia does not reflect the income or profits that See's generates through its business activities in Utah.<sup>8</sup> R. 0071-72, ¶ 3. Thus, it concluded that it was necessary to disallow See's deductions to clearly reflect its income in the subject tax years.<sup>9</sup> *Id.*

#### **IV. The District Court Reversed The Commission's Decision And Applied Federal Regulations To Achieve A Different Result.**

See's sought review of the Commission's decision by trial de novo in the district

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nine subject years; the values paid were \$12, \$18, \$27, and \$42).

<sup>8</sup> The Commission found that that during the audit period the royalty deduction decreased See's income by 75% or more. R. 0071, ¶ 3. The district court found that during the audit period the deductions reduced See's corporate franchise tax by about 82%. R. 0505, ¶ 23.

<sup>9</sup> In reallocating See's income, the Commission put See's back in the position it was in before it sold its intellectual property to Columbia. The Commission thus acknowledged that See's was entitled to a deduction for the expenses associated with managing its intellectual property. See's, however, did not present any evidence of Columbia's expenses to manage See's intellectual property. Accordingly, the Commission upheld the Division's reallocation of the full amount of the royalty payments deduction. R. 0072, ¶ 4.

court. Following a hearing, the district court reversed the Commission.

The district court found that Section 113 was unambiguous in authorizing the Commission to redistribute deductions if necessary to clearly reflect income. R. 0518. It further agreed that this discretion is broad. R. 0519. But it found the provision was “less clear regarding conditions that should exist” before the Commission adjusts income and determined “there should be some law to guide how its discretion should operate in getting deductions to clearly reflect income.” R. 0518-0519. Because Section 113 is silent and the Commission has not promulgated any rules, the district court noted that “a key question is whether the section in question can stand on its own or whether it incorporates some other direction.” R. 0519. It then determined that because Section 113 is “virtually identical” to 26 U.S.C. § 482 the Commission’s authority under Utah law should be limited by 26 U.S.C. § 482 “and its accompanying tome of regulations.” R. 0527.

Internal Revenue Code (“Internal Revenue Code” or “I.R.C.”) § 482 provides:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he 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 organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

26 U.S.C. § 482. An outline of the federal regulations the district court adopted for guiding application of Section 113 is attached in the Addendum.<sup>10</sup>

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<sup>10</sup> The outline is from 26 C.F.R. § 1.482-0 (2007). The substantive regulations follow in

The district court did not analyze what it means to “prevent evasion of taxes” or “clearly to reflect the income of any such corporations” under Section 113’s plain language. Instead, it found that See’s had established an arm’s length transaction, as is required by the federal regulations. *See* R. 0528-32. Nonetheless, it acknowledged that, under Utah law, statutes providing for a deduction are to be construed against the taxpayer and reduced the deduction for royalty payments by 10%. R. 0517-18, 0533-34.

The Commission timely filed this appeal.

### SUMMARY OF ARGUMENT

Utah Code section 113 gives the Commission the broad authority “to distribute, apportion, or allocate gross income or deductions between or among” certain corporations. But it can do so only between corporations that are owned or controlled by the same interests and if it determines that the distribution, apportionment, or allocation is necessary either (1) to prevent evasion of taxes or (2) to clearly reflect the income of any such corporation. *Id.* This appeal is about whether Section 113’s plain language is enough, standing alone, to guide the Commission and Utah courts—or whether the Commission and Utah courts must engraft additional, expansive federal regulations when applying Section 113.

Section 113’s plain language should be read as a whole and interpreted in harmony with other statutes in the same and related chapters. *Miller v. Weaver*, 2003 UT 12, ¶ 17, 66 P.3d 592. Section 113 and other provisions of Title 59, Chapter 7, reflect the Legislature’s desire to clearly represent corporations’ Utah income and business activity



for purposes of the corporate franchise tax.

See's and Columbia are both owned by Berkshire Hathaway. After over 70 years of developing its brand, in 1997 See's decided to sell its intellectual property to its sister corporation, Columbia, for 544.98 shares of BH Columbia privately-held stock valued by a transfer pricing study at around \$450 million. The BH Columbia stock has not issued a dividend since it was acquired in 1997. As a result of this arrangement, for as long as Columbia requires, See's must pay tens of millions of dollars per year to sell candy under the See's tradename. And it can no longer control how or who uses the See's name; for example, Columbia has licensed See's intellectual property to Mattel in addition to See's.

Given those facts, the Commission correctly concluded that all preconditions to its exercising its Section 113 authority were met. Both subsidiaries have the same parent company. And a plain reading of Section 113's requirement that a reallocation is appropriate to "clearly . . . reflect the income of any such corporations" suggests reaching a value for income free from distortions. The See's/Columbia intercompany transactions have distorted See's income because, although See's business has not changed—it continues to sell candy in Utah under the See's tradename—the transactions reduced See's taxable Utah income by approximately 82% each of the subject tax years. As a result, the Commission appropriately applied Section 113 to allocate the amounts that See's sought to deduct as royalty payment expenses to See's apportionable income.

Rather than analyze Section 113's plain language, the district court defined the Commission's discretion under Section 113 "by reference to" what it viewed as "the virtually identical federal statute, 26 U.S.C. section 482, and its accompanying tome of

regulations on the same subject of apportionment and the need for arm's length analysis.” The district court's decision to adopt that federal law as a limit on the Commission's Section 113 authority was error.

Utah's system of corporate taxation is entirely separate from the federal system. Had the Legislature wanted to simply follow the federal system, it could have adopted the Internal Revenue Code wholesale. It did not. Instead, it has adopted only discrete federal definitions and concepts by explicitly incorporating those federal tax provisions into the Utah Tax Code. Because Section 113 does not explicitly incorporate I.R.C. § 482, the Legislature did not intend I.R.C. § 482 or its accompanying regulations to limit the Commission's authority under Section 113.

Section 113 and I.R.C. § 482 also operate in very different contexts. Consequently, it is not appropriate to use that provision and its accompanying regulations to limit the Commission's ability to carry out its duties under Utah law. *See, e.g., Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 165, 184 (1983) (distinguishing between the unitary business principle employed by several states and the arm's length approach employed by the federal government). In addition, while the federal government has elected to tax the income of insurance companies, the Utah Legislature has decided to instead tax insurance company's premiums. *Compare* 26 U.S.C. § 831 *with* Utah Code §§ 59-9-101(1)(a), 31A-3-102 (2007). So Section 113 is not “virtually identical” to I.R.C. § 482 as the district court suggested, and it was not appropriate for the district court to look to federal law for guidance, or to rewrite Section 113 by wholesale adoption of Internal Revenue Service regulations.

## ARGUMENT

### I. The Commission Correctly Applied Section 113 To Reallocate See's Income.

#### A. Section 113's plain language gives the Commission broad authority to allocate income among sister corporations if it is necessary to prevent evasion of taxes or to correctly reflect corporate income earned in Utah.

The Court construes statutes according to their plain language, read as a whole and interpreted in harmony with other statutes in the same and related chapters. *Miller v. Weaver*, 2003 UT 12, ¶ 17, 66 P.3d 592. It “follow[s] the cardinal rule that the general purpose, intent or purport of the whole act shall control, and that all the parts be interpreted as subsidiary and harmonious to its manifest object.” *Id.* (internal quotation omitted).

Section 113's plain language gives the Commission broad authority “to distribute, apportion, or allocate gross income or deductions between or among” certain corporations. Utah Code § 59-7-113. But it does so in a very narrow set of circumstances. First, it can only distribute, apportion, or allocate income or deductions between “corporations (whether or not organized or doing business in this state, and whether or not affiliated) [that] are owned or controlled directly or indirectly by the same interests.” *Id.* Second, the Commission can only distribute, apportion, or allocate income or distributions among such corporations if it determines that the distribution, apportionment, or allocation is necessary either (1) to prevent evasion of taxes or (2) to clearly reflect the income of any such corporation. *Id.*

This Court noted the breadth of the Commission's authority under Section 113 when it stated that the text “indicates a legislative intent to cover *all* situations dealing with either direct or indirect corporate affiliates without regard to whether they file individual

state or consolidated state corporate franchise tax returns.” *Continental Tel. Co. of Utah v. State Tax Comm’n of Utah*, 539 P.2d 447, 451 (Utah 1975) (emphasis added). Indeed, “the language of that section authorizes the Tax Commission to so apportion income and deductions of corporations within such controlled groups as to fairly and equitably reflect the income earned in Utah.” *Id.* (citation omitted). Such a broad grant of authority is necessary because the Legislature cannot anticipate all possible ways that corporations owned or controlled by the same interests can shift income resulting in the avoidance of tax or a corporation’s income not being clearly reflected.

Other provisions in Title 59, Chapter 7 support the conclusion that the Legislature intended Section 113 to give the Commission broad authority to reallocate income between sister corporations to clearly represent such corporations’ Utah income and business activity.

For example, section 59-7-320 provides that “if the allocation and apportionment provisions of this part do not fairly represent the extent of the taxpayer’s business activity in this state,” the taxpayer can petition or the Commission can require, if reasonable, elimination of a factor (property, payroll, or sales), inclusion of an additional factor, use of separate accounting, or “the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.” Utah Code § 59-7-320; *see also Kennecott Copper Corp. v. State Tax Comm’n*, 493 P.2d 632, 635-36 (1972) (upholding the constitutionality of section 59-7-320’s predecessor and the Commission’s redetermination of depletion allowances and allocation of deductible federal income tax under the statute); *Deseret Pharm. Co., Inc. v. State Tax Comm’n*, 579 P.2d 1322, 1327

(Utah 1978) (holding that the party seeking relief from the statutory apportionment formula must show that without relief an unreasonable result will occur, such as the taxes imposed being grossly disproportionate to the taxpayer's business activity in the state, and upholding Commission's alternative method in that case).

Similarly, Utah's corporate franchise tax provisions require a unitary group to file a combined report that includes all of the filing information for every member of the unitary group. *See* Utah Code §§ 59-7-101(30), -402, -403. With combined reporting, the income of the unitary group is clearly reflected because any intercompany transactions net out. *See generally* Utah Code, Title 59, Chapter 7; *see also* R. 0916-17. For example, if See's and Columbia were part of a unitary group, there would be no need to reallocate See's income.<sup>11</sup> Instead, each year Columbia's reporting of its income from See's royalty payments would net out See's deduction for those payments. The adoption of combined reporting again confirms legislative intent to not allow a unitary group to evade taxes or distort income through intercompany transfers.

Section 113 is consistent with the objective of Title 59, Chapter 7—to correctly reflect the extent of a taxpayer's business in the State. But it reaches a different situation than section 59-7-320 or the combined reporting provisions. Where related companies are not part of a unitary group, Section 113 allows the Commission to correct any distortive effect of intercompany transactions if doing so will prevent evasion of taxes or clearly reflect a taxpayer's income.

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<sup>11</sup> The Commission found that See's and Columbia are not part of a unitary group because insurance companies are not taxed on their income in Utah. R. 0068 fn. 37. See's did not argue otherwise to the district court. *See* R. 0532.

**B. The Commission correctly exercised its authority under Section 113 to reallocate See's income.**

As noted, Section 113 describes when the Commission may allocate, apportion, or distribute income or deductions between certain corporations. It provides that: (1) if two or more corporations are controlled by the same interests, the Commission may distribute, allocate, or apportion gross income or deductions between such corporations (2) if doing so will either (a) prevent evasion of taxes or (b) clearly reflect the income of such a corporation. Each of those requirements is met here. Accordingly, the district court erred by reversing the Commission's decision to reallocate income from Columbia to See's.

**1. See's and Columbia are controlled by the same interests.**

Section 113's first requirement is undisputed. Both See's and Columbia are 100% owned and controlled by the same parent corporation, Berkshire Hathaway. Ex. 51; R. 0501, ¶¶ 1-3.

**2. Reallocating See's apportionable income from its deductions for royalty payments prevents evasion of taxes.<sup>12</sup>**

No Utah court has interpreted the phrase "to prevent evasion of taxes" in Section 113. But the provision's plain language read in context with other Tax Code sections, supports reallocating See's royalty payments as income to avoid the evasion of taxes. *Jensen v. Intermountain Health Care, Inc.*, 679 P.2d 903,906 (Utah 1984) (the plain language of statute is the best indicator of legislative intent); *Miller*, 2003 UT 12, ¶ 17 (the plain language of the statute should be read as a whole and interpreted in harmony with

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<sup>12</sup> Although the Commission did not analyze this prong in its decision, R. 0069-70, it did argue at the district court that See's evaded tax, *see, e.g.*, R. 0508.

other statutes in the same and related chapters). And “[w]here a statute’s language is unambiguous and provides a workable result, [courts] need not resort to other interpretive tools, and our analysis ends.” *Richards v. Brown*, 2012 UT 14, ¶ 23, 274 P.3d 911.

On the one hand, Black’s Law Dictionary defines “tax evasion” as “[t]he willful attempt to defeat or circumvent the tax law in order to illegally reduce one’s tax liability. Tax evasion is punishable by both civil and criminal penalties.” Black’s Law Dictionary 1187 (Abridged 7th Ed. 2000). On the other, Utah Code provisions discuss civil penalties for actions taken “with intent to evade any tax.” Utah Code §§ 59-1-401(7)(a), 59-7-529(2). This language suggests that there is a difference between evading a tax and willfully evading a tax, supporting treatment of “evasion” as akin to avoidance. The dictionary definition of “evade” also supports such a reading. “‘Evade’ is defined as avoidance of something by effort, skill, dexterity, contrivance, subterfuge, ingenuity, or artifice.” *Silver v. Aud. Div. of State Tax Comm’n*, 820 P.2d 912, 915 (Utah 1991) (citing 31 C.J.S. *Evade* (1964) and concluding that “intent to evade” requires “a conscious desire to avoid a legal requirement with which the actor knows he or she is obligated to comply.”). There is nothing in this definition to suggest that evading tax means doing something illegal.<sup>13</sup>

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<sup>13</sup> Federal courts interpreting the “prevent evasion of taxes” language in I.R.C. § 482 have found that “evasion” is interchangeable with “avoidance” and there is no need to show that a taxpayer had an ulterior motive in its planning or execution of a transaction. *Foster v. Comm’r*, 756 F.2d 1430, 1432 (9th Cir. 1985); *Central Cuba Sugar v. C.I.R.*, 198 F.2d 214, 215-216 (2nd Cir. 1952). At the district court, the Commission cited federal cases for its analysis of the “prevent evasion of taxes” language. The district court seemed to suggest that such reliance supported the close interaction between state and federal income tax laws. See R. 0524-25. While the Commission does not question the ability of the courts to look to federal case law as persuasive authority where the underlying statutes are



In its decision, the Commission did not analyze this prong because the statute is written in the disjunctive and it found reallocation was necessary to clearly reflect See's income. R. 0070. The Commission agrees that the facts here do not satisfy this prong if it means to *illegally* avoid taxation. But to the extent the Legislature intended "evasion of tax" to mean "avoidance" of a tax, the facts support such a finding.

During the eight subject tax years, See's paid over \$479 million of its income from selling candy in Utah and elsewhere as royalty payments to use the See's intellectual property that it owned and developed for over seventy years but sold to a sister corporation, Columbia, for around \$450 million in stock. R. 0501, ¶ 1, 0502-03, ¶¶ 4-5, 8-12, 0505, ¶ 23; Ex. 35; Ex. 37. Assuming Columbia continues to renew the contract, See's will have to continue to pay tens of millions of dollars per year for as long as it wants to sell candy under the See's name. Ex. 30; R. 0502, ¶ 5, 0505, ¶ 25. Even though See's business has not changed—it continues to sell candy in Utah under the See's tradename—these intercompany transactions purported to decrease See's taxable Utah income by approximately 82% each year. R. 0502-03, ¶¶ 4-5, 8-12; R. 0505, ¶ 23.

Insurance companies are taxed on their premiums and not their income in Utah. So by transferring millions of dollars of See's national profit from making and selling candy to profit of Columbia for holding See's intellectual property, Berkshire Hathaway is able to

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analogous and the reasoning is logical, *see Langeland v. Monarch Motors, Inc.*, 952 P.2d 1058, 1062 n. 4 (Utah 1998), what the district court did here was very different. Instead of finding (and relying upon) another court's interpretation of an analogous federal statute as logical, applicable, and persuasive, the district court adopted a federal agency's extensive regulations and made them a part of Utah law as though the Commission had adopted them through the public rule-making process.

avoid taxation on the Utah portion of that income.<sup>14</sup> Those activities establish an intent to “evad[e] . . . taxes” for purposes of Section 113 that made the Commission’s reallocation of income appropriate under this prong.

**3. Reallocating See’s deductions for royalty payments clearly reflects See’s Utah income.**

The Commission’s reallocation of income from Columbia to See’s also meets Section 113’s second requirement because the reallocation “clearly. . . reflect[s] the income of” See’s. The reallocation clearly “reflects” See’s actual Utah income because it “make[s] manifest or apparent . . . a likely cause, plausible conditioning factor, fitting background element, or concomitant” of See’s income; it “show[s]” that income. Webster’s Third New Int’l Dictionary 1908 (1976). In other words, the Commission’s reallocation of income among related corporations was necessary to remove distortions of See’s income.<sup>15</sup>

The Commission found that the deductions for royalty payments distorted—did not accurately show—See’s income, and did not reflect the profits earned through its business operations in Utah.<sup>16</sup> R. 066-67. It noted that before See’s sold its intellectual property

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<sup>14</sup> The Utah portion of that income is around \$50,000 to \$60,000 per year. R. 0505, ¶ 23.

<sup>15</sup> This is consistent with this Court’s analysis in *Deseret Pharmaceutical Co., Inc. v. State Tax Commission*, of what it means to “fairly represent” the extent of a taxpayer’s business activity in Utah. The Court held there that a party seeking to deviate from apportionment must show that if the apportionment provisions are followed “an unreasonable result will occur, such as, the taxes imposed are grossly disproportionate to the taxpayer’s business activity in this state, or extraterritorial income is being taxed.” *Deseret Pharm. Co. v. State Tax Comm’n*, 579 P.2d 1322, 1327 (Utah 1978).

<sup>16</sup> In its decision, the Commission cited to federal case law and recognized that it may be useful to refer to federal regulations associated with I.R.C. § 482. R. 0068-69. But ultimately its decision was based on the language in the Utah Code and its finding that the Division’s assessment was allowed by Section 113 and necessary to clearly reflect See’s

to Columbia, See's had only one person, who had other duties, managing those assets. R. 0067; *see also* R. 0504, ¶ 16. And after the sale, the evidence showed that it still did not take all of the time of a single Columbia employee to manage the See's intellectual property. R. 0067; *see also* R. 0504, ¶¶ 16-18. The Commission also stated that although Columbia unquestionably had incurred expenses managing See's intellectual property, "See's did not argue that the expenses would be anywhere near the amounts of the royalty deductions it took, which range around \$50 million or more each year of the Audit period."<sup>17</sup> R. 0067.

The Commission further explained that See's sold its intellectual property for stock that did not give dividends, and that it agreed to a non-exclusive license. *Id.* It was "not convinced that See's, a company whose name and Intellectual Property are so important to its business, would have entered into this arrangement had it not felt confident that Berkshire would ensure that its business would not be harmed by the arrangement." *Id.*

And, as a result of selling its intellectual property to Columbia, See's will have to pay Columbia millions of dollars per year for as long as it wants to sell candy under the See's name. Ex. 30; R. 0502, ¶ 5, 0505, ¶ 25. By the end of the audit period, See's had already paid more than the value of the stock it received from its sister corporation, BH Columbia. R. 0501, ¶ 1, 0502-03, ¶¶ 4-5, 8-12, 0505, ¶¶ 23, 25; Ex. 37. This intercompany transaction has distorted See's income because, although See's business has not changed—it continues to sell candy in Utah under the See's tradename—the

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income. *See* R. 0068-70.

<sup>17</sup> The Commission agrees that an adjustment for the expenses associated with managing See's intellectual property, if supported by evidence, would have been appropriate.

transactions purported to reduce See's taxable Utah income by approximately 82% each of the subject tax years without a concomitant 82% decrease in sales.<sup>18</sup> R. 0502-03, ¶¶ 4-5, 8-12; R. 0505, ¶ 23.

Reallocating See's deductions for its royalty payments to Columbia restores See's income to the same basis on which it was calculated before its intercompany intellectual property sale, and clearly shows the income that See's earned from selling candy. This reallocation falls within Section 113's plain language. And it adheres to the Legislature's policy of fairly and correctly representing a taxpayer's business activity in the State. *See* Utah Code Title 59, Chapter 7, Part 3.

## **II. The District Court Erred In Using Federal Law To Interpret The Scope Of The Commission's Authority Under Section 113.**

The district court did not conduct a plain language analysis of Section 113 to ascertain the scope of authority that the Legislature gave the Commission. Instead, relying on the Legislature's decision to incorporate certain provisions of the Internal Revenue Code into *other* sections of Utah's tax code—and on what the district court viewed as “virtually identical” text in I.R.C. § 482 and Section 113—the district court “conclude[d] it is appropriate to define the Commission's discretion” under Section 113 “by reference to the virtually identical federal statute, 26 U.S.C. section 482, and its accompanying tome of regulations on the same subject of apportionment and the need for arm's length analysis.” R. 0524-27.

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<sup>18</sup> Similarly, in its decision the Commission stated that it “believes that the Division has properly used Section 59-7-113 to dissolve the fiction that See's earnings dropped approximately 75% or more between those years prior to the transfer of its Intellectual Property to Columbia and those years after the transfer and to place See's on parity with other entities.” R. 0069.

The district court erred by interpreting Section 113 through the prism of I.R.C. § 482 for two reasons. First, the Legislature has incorporated *other* Internal Revenue Code provisions into *other* sections of the Utah Tax Code—but it expressly *failed* to incorporate I.R.C. § 482 into Section 113. That omission shows the Legislature’s intentional decision that I.R.C. § 482 would *not* limit the Commission’s authority under Section 113. Second, differences between I.R.C. § 482 and Section 113 do not support defining Section 113 by reference to federal regulations under I.R.C. § 482.

**A. By explicitly incorporating federal tax provisions into some parts of the Utah Tax Code—but omitting I.R.C. § 482 from Section 113—the Legislature manifested its intent that federal law would not inform the Commission’s power under Section 113.**

The district court’s incorporation of I.R.C. § 482 and its regulations into Section 113 contravenes Utah law on statutory interpretation. In interpreting a statute, courts “employ plain language analysis to carry out the legislative purpose of the statute as expressed in the enacted text.” *Richards*, 2012 UT 14, ¶ 23. Courts “presume that the legislature was deliberate in its choice of words and ‘used each term advisedly and in accordance with its ordinary meaning.’” *Id.* This Court also acknowledges the significance of the Legislature’s *non*-use of particular words; it “presume[s] that the expression of one term should be interpreted as the exclusion of another,” and it “therefore seek[s] to give effect to omissions in statutory language by presuming all omissions to be purposeful.” *Penunuri v. Sundance Partners, Ltd.*, 2013 UT 22, ¶ 15, 301 P.3d 984 (internal quotation omitted). Further, where a statute’s language is unambiguous and provides a workable result, courts do not resort to other interpretive tools and the analysis ends. *Richards*, 2012 UT 14, ¶ 23.

Section 113 is workable on its face as demonstrated in the prior section. And its failure to mention I.R.C. § 482 or its regulations further shows the Legislature’s intent not to incorporate those provisions. Where the Legislature has wanted to incorporate federal tax provisions into the Utah Tax Code, it has done so explicitly. Indeed, other provisions in the same chapter as Section 113—Utah Code Title 59, Chapter 7—define certain Utah Tax Code terms by reference to the Internal Revenue Code. *See, e.g.,* Utah Code § 59-7-101 (2007) (defining parent-subsidary controlled group, ownership of outstanding voting stock, corporation, foreign operating company, S corporation, and safe harbor lease by reference to the Internal Revenue Code); *see also* Utah Code § 59-7-102 (2007) (for example, exempting from Chapter 7, organizations that are “exempt under Section 501, Internal Revenue Code”).

Provisions in other chapters of the Utah Tax Code confirm the point. For example, in Utah Code Title 59, Chapter 10, the Legislature defines “adjusted gross income” for a resident or nonresident individual “as defined in Section 62, Internal Revenue Code” and for a resident or nonresident estate or trust “as calculated in Section 67(e), Internal Revenue Code.” Utah Code § 59-10-103(1)(a). For purposes of Chapter 10, it also refers to the Internal Revenue Code in defining “distributable net income,” “federal taxable income,” “long term capital gain,” “partnership,” “short term capital gain,” and “Utah small business corporation.” Utah Code § 59-10-103(1) (2007). The Legislature further indicated that any term used in Title 59, Chapter 10 has the same meaning as when used in a comparable context in the Internal Revenue Code unless a different meaning is clearly required and “[a]ny reference to a specific section of the Internal Revenue Code or other

provision of the laws of the United States relating to federal income taxes shall include any corresponding or comparable provisions of the Internal Revenue Code as amended, redesignated, or reenacted.” Utah Code § 59-10-103(2). Chapter 10 goes on to, for example, define “personal exemptions” and “standard deduction” by reference to the Internal Revenue Code. Utah Code §59-10-104.1.

Chapter 10’s instruction that any term used in that chapter has the same meaning as when used in a comparable context in the Internal Revenue Code (unless a different meaning is clearly required) is particularly instructive. It shows the Legislature knew how to incorporate federal tax law by reference for an entire *chapter* of the Utah Tax Code when it wanted to—and it expressly *omitted* such a chapter-wide interpretive rule for chapter 7 (where Section 113 is located). Plus, in most instances where the Legislature has incorporated the Internal Revenue Code it has done so to define concrete figures or terms, not to impose limits on the Commission’s authority.<sup>19</sup>

And the Utah Tax Code is not the only place where the Legislature has indicated that Utah courts should be guided by federal interpretations. For example, Utah Code section 76-10-3118 provides: “The Legislature intends that the courts, in construing this act, will be guided by interpretations given by the federal courts to comparable federal antitrust statutes and by other state courts to comparable state antitrust statutes.”

Given the Legislature’s demonstrated ability to expressly incorporate federal law into Utah law, Section 113’s silence about I.R.C. § 482 or other federal tax law speaks

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<sup>19</sup> This approach is helpful to many taxpayers because instead of starting over to prepare Utah returns they can start with information from their federal returns. Even so, the Utah Legislature has not adopted the federal code wholesale and instead diverges where it feels appropriate.



volumes. And, under Utah law, is conclusive. Since the Legislature is presumed to be deliberate in its choice of words, *Richards*, 2012 UT 14, ¶ 23, and this Court seeks “to give effect to omissions in statutory language by presuming all omissions to be purposeful,” *Penunuri*, 2013 UT 22, ¶ 15, the Legislature’s failure to explicitly reference federal provisions in Section 113 indicates the Legislature did not intend federal tax law to limit the Commission’s authority under Section 113.<sup>20</sup>

See’s disputed this conclusion before the district court, arguing that “federal regulations under a similar federal statute must apply or else there is no limit on the Tax Commission’s actions.” R. 0520. That objection fails for two reasons. First, it ignores the plain preconditions that Section 113 itself imposes on the Commission’s use of this authority. *See supra* Section I.A. Second, See’s request argues in effect that the courts should override clear statutory text on policy grounds—an argument that ““misperceives the judicial function.”” *Hughes Gen. Contractors, Inc. v. Utah Labor Comm’n*, 2014 UT 3, ¶ 29 n. 9 (Utah 2014) (quoting *Schroeder Invs., L.C. v. Edwards*, 2013 UT 25, ¶ 25). This Court “must implement the particular balance of policies reflected in the terms of [the] statute.” *Id.* “Those terms are the law – even when” the Court “might find the policies behind the statute should properly have dictated a different rule.” *Id.* “Public

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<sup>20</sup> This is particularly true here because the district court incorporated regulations that, for the most part, did not exist when the Legislature enacted Section 113’s identical predecessor, section 59-13-17. Section 59-13-17 was enacted by 1953 at the latest. *See Continental Telephone*, 539 P.2d at 450 (discussing “59-13-17, U.C.A. 1953”). While some federal regulations were adopted as early as 1935, the regulations were modified significantly in 1968 and again later in 1993. *See* Reuven S. Avi-Yonah, “The Rise and Fall of Arm’s Length: A Study in the Evolution of U.S. International Taxation,” *U. of Mich. Law School, Law & Economics Working Papers Archive: 2003-2009*, Paper 73, pp. 3-10, [http://repository.law.umich.edu/law\\_econ\\_archive/art73](http://repository.law.umich.edu/law_econ_archive/art73) (last visited May 1, 2017).

policy concerns, however grave, do not deputize this court to ignore the terms of a statute and act legislatively.” *Id.*

In sum, Section 113’s plain language indicates the legislative intent not to incorporate federal law as a limit on the Commission’s Section 113 authority. Thus, the district court erred in defining the Commission’s discretion under Section 113 by reference to I.R.C. § 482 and its accompanying regulations.

**B. Section 113 and I.R.C. § 482 differ in language and in context of application.**

The district court adopted I.R.C. § 482 and its accompanying regulations because it found I.R.C. § 482 was “virtually identical” to Section 113. R. 0527. In doing so, it cited an Office of the Utah Attorney General informal opinion (no. 79-214) and *Buzas Baseball v. Salt Lake Trappers*, 925 P.2d 941, 947 n.5 (Utah 1996), for the proposition that “[i]dentity in language in Utah and federal statutes presumes identity of construction, so that we look to federal law for guidance.” R. 0525-27. But it is one thing for a Utah court to look at how federal courts have analyzed similar language—and another thing entirely for the court to bypass the Legislature and incorporate the regulations passed by a federal agency. *See Langeland v. Monarch Motors, Inc.*, 952 P.2d 1058, 1062 n.4 (Utah 1998) (“Although the Federal Rules of Civil Procedure served as their model, and in many respects the Utah Rules obviously resemble the Federal Rules, the Utah Rules are an independent body of rules. Thus federal cases interpreting analogous Federal Rules are compelling to our interpretation of the Utah Rules only insofar as their reasoning is logical and persuasive.”). The district court here did not merely say it agreed with a federal court’s analysis of similar language in a federal statute; it incorporated federal regulations

into Utah law because it thought the language of the state and federal statutes was similar and it seemingly felt that the authority the Legislature gave to the Commission was too broad. R. 0518-19.

That interpretive approach is flawed. It raises serious federalism concerns. Utah's system of taxation is entirely separate from the federal system. Article XIII, sections 4-5, of the Utah Constitution authorize the Legislature to pass statutes imposing an income tax. Article XIII, section 6 establishes a State Tax Commission that shall, among other things, "administer and supervise the State's tax laws" and "have other powers as may be provided by statute." The Legislature has implemented this authority in Chapter 59 of the Utah Code.

To be sure, the Legislature can follow the Internal Revenue Code when it deems it appropriate to do so—and it in fact has followed the Internal Revenue Code in many instances. *See supra* at Section II.A. In making such determinations, the Legislature considers Utah's tax policy and the effect each adoption of a federal statute will have on the rest of the Utah Tax Code. Such instances do not show a wholesale intent to follow federal law, but rather a determination on an issue-by-issue basis of the particular circumstances where it wants to follow or borrow from federal law.

It was further inappropriate for the district court to look to I.R.C. § 482 for guidance on Section 113's meaning because its language differs from I.R.C. § 482. Whereas Section 113 discusses "corporations," "whether or not organized or doing business in this state," I.R.C. § 482 governs "organizations, trades, or business" "whether or not incorporated, whether or not organized in the United States." *Compare* Utah Code

§ 59-7-113 *with* 26 U.S.C. § 482. The Internal Revenue Code also allows the Secretary to distribute, apportion, or allocate credits and allowances in addition to gross income and deductions. *Id.* Finally, in addition to other minor grammatical changes, the Internal Revenue Code adds the following sentence: “In the case of any transfer (or license) of intangible property (within the meaning of section 963(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.” *Id.*

If the Legislature had wanted the Commission’s authority to mirror the Internal Revenue Service’s authority, it could have simply adopted the language of I.R.C. § 482 wholesale—substituting “state” for “United States” and “commission” for “Secretary”—or, better yet, specifically incorporated I.R.C. § 482 by reference. But the Legislature did not do that. The Legislature’s decision to vary Section 113 from I.R.C. § 482 confirms that it did not intend to adopt I.R.C. § 482 and its regulations wholesale.

This Court’s recent precedent distinguishing related state and federal statutes in a non-tax context supports finding that the district court erred here. In *Hughes General Contractors*, this Court compared a provision of the federal Occupational Safety and Health Act with a provision of the Utah Occupational Safety and Health Act. 2014 UT 3, ¶ 1. Both the federal and the Utah provisions required the employer to provide a place of employment free of recognized hazards and to comply with the standards promulgated under the subject act. *Id.* ¶ 22. But the federal statute listed those two requirements in separate subsections while the Utah Code included them in a single unitary provision. *Id.* Based on that slight difference, the Court found that the Utah provision was not a

mirror-image of its federal counterpart and therefore did not have to be interpreted the same way that federal courts had interpreted the federal provision.<sup>21</sup> *Id.* ¶¶ 8, 22-23. So too here. Section 113, although similar, is not a mirror-image of its federal counterpart and need not be interpreted the same.

Even if the language of Section 113 was identical to I.R.C. § 482, they operate differently because of differences between the Utah and Federal tax codes. *See Miller*, 2003 UT 12, ¶ 17 (internal quotation omitted) (courts “follow the cardinal rule that the general purpose, intent or purport of the whole act shall control, and that all the parts be interpreted as subsidiary and harmonious to its manifest object.”).

As noted in *Continental Telephone*, “[u]nder present federal law, the filing of a consolidated return permits an economically related group of corporations to report on a basis of transactions entered into with outsiders, which means, in general, gain or loss on intercompany transactions between the related corporations is eliminated from income of the reporting corporation.” *Continental Telephone*, 539 P.2d at 448-49; *see also* 26 U.S.C. § 1501 (giving an affiliated group the option to file a consolidated return in lieu of separate returns); 26 U.S.C. § 1504 (defining “affiliated group,” in part, as one or more “includible corporations” connected through stock ownership with a common parent corporation and defining “includible corporations” as “any corporation except. . .”).

By comparison to the “affiliated group” inquiry under federal law, the Utah Code

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<sup>21</sup> In rejecting the multi-employer worksite doctrine as a matter of Utah law, the Court also noted that the federal doctrine is supported by an express federal regulation which is afforded deference under *Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984), while Utah law “affords no deference to federal regulations on questions of law.” *Hughes Gen. Contractors*, 322 P.3d 712, ¶ 8.

combines entities that form a “unitary group.” *See* Utah Code §§ 59-7-402 and -403; Utah Code § 59-7-101(30) (defining a “unitary group” as a group of corporations that is related through common ownership and are economically interdependent based on centralized management, functional integration, and economies of scale). The U.S. Supreme Court has distinguished the unitary business principle from the arm’s length approach employed by the federal government. *Container Corp.*, 463 U.S. at 165, 184.

As discussed above, the current case is one circumstance where combined reporting does not net out the effect of intercompany transactions. This is because Utah excludes insurance companies from the “unitary group” filing a combined report since insurance companies are exempt from the corporate franchise tax. Utah Code §§ 59-9-101(1)(a), 31A-3-102 (2007). The federal government and some other states have taken a different approach by taxing the income of insurance companies. *See, e.g.*, 26 U.S.C. § 831. But electing not to tax an insurance company’s income does not suggest the Legislature intended to allow a corporation to distort its income by making payments to a related insurance company. Instead, the Legislature passed Section 113, which allows the Commission to prevent a corporation from avoiding tax on its income through intercompany transactions with a related insurance company without having to impose a tax on the income of insurance companies. Section 113’s existence suggests that the Legislature foresaw that there could be circumstances where transactions distort income or deductions or they cause the evasion of taxes and it wanted the Commission to be able to reallocate that income to clearly show it. *See Miller*, 2003 UT 12, ¶ 17 (finding that the plain language of the statute should be read as a whole and interpreted in harmony with

other statutes in the same and related chapters).

In short, the Legislature's failure to specifically refer to I.R.C. § 482 (or to adopt its exact language) in Section 113, along with the significant differences between the Utah and federal tax codes, indicate that there is no identity of construction or purpose justifying the district court's decision to look to federal law for guidance when interpreting Section 113. Thus, the district court erred when it defined the Commission's authority under Section 113 by reference to I.R.C. § 482 and its accompanying federal regulations.

## CONCLUSION

Read as a whole, Utah Code Title 59, Chapter 7, reflects a policy of allowing the Commission to determine a taxpayer's income from its business activities in Utah minus the distorting effects of intercompany transactions. Nothing in the Title 59, Chapter 7 suggests that the Legislature intended to limit the Commission's ability to achieve such a result only when the underlying transaction was not done at "arm's length." As a result, the district court erred in defining the Commission's discretion under Section 113 by reference to I.R.C. § 482 and its accompanying regulations.

Instead, under a plain reading of Section 113, the Commission can distribute, apportion, or allocate income or deductions between related companies where doing so is necessary to either prevent avoidance of taxes or clearly show such a corporation's income. Here, although See's business did not change—it continued to sell candy in Utah under the See's tradename—the sale of its intellectual property to a sister corporation, and licensing back of that intellectual property, purported to reduce See's taxable Utah income by approximately 82% each year. Thus, the Commission appropriately implemented Section



113 when it reallocated See's deductions for royalty payments to Columbia as income to See's.

The Commission respectfully requests that this Court reverse the district court's decision to incorporate federal law and uphold the Commission's application of Section 113.

Respectfully submitted this 1st day of May, 2017.

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**CERTIFICATE OF COMPLIANCE WITH RULES 24(f)(1) AND 27(b)**

1. This brief complies with the type-volume limitations of Utah R. App. P. 24(f)(1) because:

- this brief contains 9,053 words, excluding the parts of the brief exempted by Rule 24(f)(1)(B).

2. This brief complies with the typeface requirements of Utah R. App. P. 27(b) because:

- this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 13 point Times New Roman.

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## CERTIFICATE OF SERVICE

I hereby certify that on the 1st day of May 2017, a true and correct copy of the BRIEF OF APPELLANT, UTAH STATE TAX COMMISSION was filed with the Court and served via electronic mail and/or United States mail, postage prepaid, to the following:

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# ADDENDUM

26 C.F.R. § 1.482-0  
CODE OF FEDERAL REGULATIONS  
TITLE 26—INTERNAL REVENUE  
CHAPTER I—INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY  
SUBCHAPTER A—INCOME TAX  
PART 1—INCOME TAXES

NORMAL TAXES AND SURTAXES  
DEFERRED COMPENSATION, ETC.  
METHODS OF ACCOUNTING  
ADJUSTMENTS

Treas. Reg. § 1.482-0

§ 1.482-0 Outline of regulations under section 482.

This section contains major captions for §§ 1.482-1 through 1.482-8.

**§ 1.482-1 Allocation of income and deductions among taxpayers.**

(a) In general.

(1) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(a)(1).

(2) Authority to make allocations.

(3) Taxpayer's use of section 482.

(b) Arm's length standard.

(1) In general.

(2) Arm's length methods.

(i) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(b)(2)(i).

(ii) Selection of category of method applicable to transaction.

(c) Best method rule.

(1) In general.

(2) Determining the best method.

(i) Comparability.

(ii) Data and assumptions.

(A) Completeness and accuracy of data.

(B) Reliability of assumptions.

(C) Sensitivity of results to deficiencies in data and assumptions.

(iii) Confirmation of results by another method.

(d) Comparability.

(1) In general.

(2) Standard of comparability.

(3) Factors for determining comparability.

(i) Functional analysis.

(ii) Contractual terms.

(A) In general.

(B) Identifying contractual terms.

(1) Written agreement.

(2) No written agreement.

(C) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(d)(3)(ii)(C).

(iii) Risk.

(A) In general.

(B) Identification of party that bears risk.

(C) Examples.

(iv) Economic conditions.

(v) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(d)(3)(v).

(4) Special circumstances.

(i) Market share strategy.

(ii) Different geographic markets.

(A) In general.

(B) Example.

(C) Location savings.

(D) Example.

(iii) Transactions ordinarily not accepted as comparables.

(A) In general.

(B) Examples.

(e) Arm's length range.

(1) In general.

(2) Determination of arm's length range.

(i) Single method.

(ii) Selection of comparables.

(iii) Comparables included in arm's length range.

(A) In general.

(B) Adjustment of range to increase reliability.

(C) Interquartile range.

(3) Adjustment if taxpayer's results are outside arm's length range.

(4) Arm's length range not prerequisite to allocation.

(5) Examples.

(f) Scope of review.

(1) In general.

(i) Intent to evade or avoid tax not a prerequisite.

(ii) Realization of income not a prerequisite.

(A) In general.

(B) Example.

(iii) Nonrecognition provisions may not bar allocation.

(A) In general.

(B) Example.

(iv) Consolidated returns.

(2) Rules relating to determination of true taxable income.

(i) Aggregation of transactions.

(A) In general.

(B) Examples.

(ii) Allocation based on taxpayer's actual transactions.

(A) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(f)(2)(ii)(A).

(B) Examples.

(iii) Multiple year data.

(A) In general.

(B) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(f)(2)(iii)(B).

(C) Comparable effect over comparable period.

(D) Applications of methods using multiple year averages.

(E) Examples.

(iv) Product lines and statistical techniques.

(v) Allocations apply to results, not methods.

(A) In general.

(B) Example.

(g) Collateral adjustments with respect to allocations under section 482.

(1) In general.

(2) Correlative allocations.

(i) In general.

(ii) Manner of carrying out correlative allocation.

(iii) Events triggering correlative allocation.

(iv) Examples.

(3) Adjustments to conform accounts to reflect section 482 allocations.

(i) In general.

(ii) Example.

(4) Setoffs.

(i) In general.

(ii) Requirements.

(iii) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(g)(4)(iii).

(h) Special rules.

(1) Small taxpayer safe harbor. [Reserved]



(2) Effect of foreign legal restrictions.

(i) In general.

(ii) Applicable legal restrictions.

(iii) Requirement for electing the deferred income method of accounting.

(iv) Deferred income method of accounting.

(v) Examples.

(3) Coordination with section 936.

(i) Cost sharing under section 936.

(ii) Use of terms.

(i) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(i).

(j) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-1T(j).

**§ 1.482-2 Determination of taxable income in specific situations.**

(a) Loans or advances.

(1) Interest on bona fide indebtedness.

(i) In general.

(ii) Application of paragraph (a) of this section.

(A) Interest on bona fide indebtedness.

(B) Alleged indebtedness.

(iii) Period for which interest shall be charged.

(A) General rule.

(B) Exception for certain intercompany transactions in the ordinary course of business.

(C) Exception for trade or business of debtor member located outside the United States.

(D) Exception for regular trade practice of creditor member or others in creditor's industry.

(E) Exception for property purchased for resale in a foreign country.

(1) General rule.

(2) Interest-free period.

(3) Average collection period.

(4) Illustration.

(iv) Payment; book entries.

(2) Arm's length interest rate.

(i) In general.

(ii) Funds obtained at situs of borrower.

(iii) Safe haven interest rates for certain loans and advances made after May 8, 1986.

(A) Applicability.

(1) General rule.

(2) Grandfather rule for existing loans.

(B) Safe haven interest rate based on applicable Federal rate.

(C) Applicable Federal rate.

(D) Lender in business of making loans.

(E) Foreign currency loans.

(3) Coordination with interest adjustments required under certain other Internal Revenue Code sections.

(4) Examples.

(b) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-2T(b).

(c) Use of tangible property.

(1) General rule.

(2) Arm's length charge.

(i) In general.

(ii) Safe haven rental charge.

(iii) Subleases.

(d) Transfer of property.

**§ 1.482-3 Methods to determine taxable income in connection with a transfer of tangible property.**

(a) In general.

(b) Comparable uncontrolled price method.

(1) In general.

(2) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) In general.

(B) Adjustments for differences between controlled and uncontrolled transactions.

(iii) Data and assumptions.

(3) Arm's length range.

(4) Examples.

(5) Indirect evidence of comparable uncontrolled transactions.

(i) In general.

(ii) Limitations.

(iii) Examples.

(c) Resale price method.

(1) In general.

(2) Determination of arm's length price.

(i) In general.

(ii) Applicable resale price.

(iii) Appropriate gross profit.

(iv) Arm's length range.

(3) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) Functional comparability.

(B) Other comparability factors.

(C) Adjustments for differences between controlled and uncontrolled transactions.

(D) Sales agent.

(iii) Data and assumptions.

(A) In general.

(B) Consistency in accounting.

(4) Examples.

(d) Cost plus method.

(1) In general.

(2) Determination of arm's length price.

(i) In general.

(ii) Appropriate gross profit.

(iii) Arm's length range.

(3) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) Functional comparability.

(B) Other comparability factors.

(C) Adjustments for differences between controlled and uncontrolled transactions.

(D) Purchasing agent.

(iii) Data and assumptions.

(A) In general.

(B) Consistency in accounting.

(4) Examples.

(e) Unspecified methods.

(1) In general.

(2) Example.

(f) Coordination with intangible property rules.

**§ 1.482-4 Methods to determine taxable income in connection with a transfer of intangible property.**

(a) In general.

(b) Definition of intangible.

(c) Comparable uncontrolled transaction method.

(1) In general.

(2) Comparability and reliability considerations.

(i) In general.

(ii) Reliability.

(iii) Comparability.

(A) In general.

(B) Factors to be considered in determining comparability.

(1) Comparable intangible property.

(2) Comparable circumstances.

(iv) Data and assumptions.

(3) Arm's length range.

(4) Examples.

(d) Unspecified methods.

(1) In general.

(2) Example.

(e) Coordination with tangible property rules.

(f) Special rules for transfers of intangible property.

(1) Form of consideration.

(2) Periodic adjustments.

(i) General rule.

(ii) Exceptions.

(A) Transactions involving the same intangible.

(B) Transactions involving comparable intangible.

(C) Methods other than comparable uncontrolled transaction.

(D) Extraordinary events.

(E) Five-year period.

(iii) Examples.

(3) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-4T(f)(3).

(4) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-4T(f)(4).

(5) Consideration not artificially limited.

(6) Lump sum payments

(i) In general.

(ii) Exceptions.

(iii) Example.

(7) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-4T(f)(7).

**§ 1.482-5 Comparable profits method.**

(a) In general.

(b) Determination of arm's length result.

(1) In general.

(2) Tested party.

(i) In general.

(ii) Adjustments for tested party.

(3) Arm's length range.

(4) Profit level indicators.

(i) Rate of return on capital employed.

(ii) Financial ratios.

(iii) Other profit level indicators.

(c) Comparability and reliability considerations.

(1) In general.

(2) Comparability.

(i) In general.

(ii) Functional, risk and resource comparability.

(iii) Other comparability factors.

(iv) Adjustments for differences between tested party and the uncontrolled taxpayers.

(3) Data and assumptions.

(i) In general.

(ii) Consistency in accounting.

(iii) Allocations between the relevant business activity and other activities.

(d) Definitions.

(e) Examples.

**§ 1.482-6 Profit split method.**

(a) In general.

(b) Appropriate share of profits and losses.

(c) Application.

(1) In general.

(2) Comparable profit split.

(i) In general.

(ii) Comparability and reliability considerations.

(A) In general.

(B) Comparability.

(1) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(c)(2)(ii)(B)(1).

(2) Adjustments for differences between the controlled and uncontrolled taxpayers.

(C) Data and assumptions.

(D) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(c)(2)(ii)(D).

(3) Residual profit split.

(i) In general.

(A) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(c)(3)(i)(A).

(B) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(c)(3)(i)(B).

(ii) Comparability and reliability considerations.

(A) In general.

(B) Comparability.

(C) Data and assumptions.

(D) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(c)(3)(ii)(D).

(iii) Example.

(d) Effective date. [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-6T(d).

**§ 1.482-7 Sharing of costs.**

(a) In general.

- (1) Scope and application of the rules in this section.
- (2) Limitation on allocations.
- (3) Coordination with § 1.482-1.
- (4) Cross references.
- (b) Qualified cost sharing arrangement.
- (c) Participant.
- (1) In general.
- (2) Treatment of a controlled taxpayer that is not a controlled participant.
- (i) In general.
- (ii) Example.
- (3) Treatment of consolidated group.
- (d) Costs.
- (1) Intangible development costs.
- (2) Stock-based compensation.
- (i) In general.
- (ii) Identification of stock-based compensation related to intangible development.
- (iii) Measurement and timing of stock-based compensation expense.
- (A) In general.
- (1) Transfers to which section 421 applies.
- (2) Deductions of foreign controlled participants.
- (3) Modification of stock option.
- (4) Expiration or termination of qualified cost sharing arrangement.
- (B) Election with respect to options on publicly traded stock.
- (1) In general.
- (2) Publicly traded stock.
- (3) Generally accepted accounting principles.
- (4) Time and manner of making the election.
- (C) Consistency.



(3) Examples.

(e) Anticipated benefits.

(1) Benefits.

(2) Reasonably anticipated benefits.

(f) Cost allocations.

(1) In general.

(2) Share of intangible development costs.

(i) In general.

(ii) Example.

(3) Share of reasonably anticipated benefits.

(i) In general.

(ii) Measure of benefits.

(iii) Indirect bases for measuring anticipated benefits.

(A) Units used, produced or sold.

(B) Sales.

(C) Operating profit.

(D) Other bases for measuring anticipated benefits.

(E) Examples.

(iv) Projections used to estimate anticipated benefits.

(A) In general.

(B) Unreliable projections.

(C) Foreign-to-foreign adjustments.

(D) Examples.

(4) Timing of allocations.

(g) Allocations of income, deductions or other tax items to reflect transfers of intangibles (buy-in).

(1) In general.

(2) Pre-existing intangibles.

(3) New controlled participant.

- (4) Controlled participant relinquishes interests.
- (5) Conduct inconsistent with the terms of a cost sharing arrangement.
- (6) Failure to assign interests under a qualified cost sharing arrangement.
- (7) Form of consideration.
  - (i) Lump sum payments.
  - (ii) Installment payments.
  - (iii) Royalties.
- (8) Examples.
  - (h) Character of payments made pursuant to a qualified cost sharing arrangement.
    - (1) In general.
    - (2) Examples.
      - (i) Accounting requirements.
      - (j) Administrative requirements.
        - (1) In general.
        - (2) Documentation.
          - (i) Requirements.
          - (ii) Coordination with penalty regulation.
        - (3) Reporting requirements.
    - (k) Effective date.
    - (l) Transition rule.

**§ 1.482-8 Examples of the best method rule.**

- (a) Introduction.
- (b) Examples.

**§ 1.482-9 Methods to determine taxable income in connection with a controlled services transaction. [Reserved].**

For further guidance, see § 1.482-0T, the entries for § 1.482-9T.

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