

1965

Vincent Drug Company, Inc. v. State Tax Commission of Utah : Appellant's Brief

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IN THE SUPREME COURT OF THE STATE OF UTAH

VINCENT DRUG COMPANY, INC.,
Plaintiff and Appellant,

— vs. —

STATE TAX COMMISSION
OF UTAH,
Defendant and Respondent.

APPELLANT'S

Writ of Review of the Decision of the
State Tax Commission

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TABLE OF CONTENTS

	Page
STATEMENT OF NATURE OF CASE.....	1
DISPOSITION BEFORE STATE TAX COMMISSION.....	1
NATURE OF RELIEF SOUGHT.....	2
STATEMENT OF FACTS.....	2
ARGUMENT:	
POINT I.	
THAT THE UTAH CORPORATE TAX ON A COR- PORATION NEWLY CREATED OR BEGINNING TO DO BUSINESS IN UTAH IS A TAX UPON THE PRIVILEGE OF DOING BUSINESS WITHIN THE STATE	5
POINT II.	
THAT THE APPELLANT WAS A DE FACTO COR- PORATION DURING THE PERIOD OF JANUARY 2, 1962, TO MAY 2, 1962.....	7
POINT III.	
THAT A DE FACTO CORPORATION IS LIABLE TO THE STATE FOR CORPORATE FRANCHISE TAX....	10
POINT IV.	
THAT THE RESPONDENT ERRED IN ITS COM- PUTATION OF TAX AND INTEREST ON THE ASSESSMENT LEVIED	14
CONCLUSION	15

Authorities Cited

Brown v. Webb, 60 Ore. 526, 120 P. 387.....	8
In re Detroit and Windsor Ferry Co., 232 Mich. 574, 205 N.W. 102	6
J. M. and M. S. Browning Co. v. State Tax Commission, 107 Utah 457, 154 P. 2d 993.....	6
Marsh v. Mathias, 19 Utah 350, 56 P. 1074.....	9-12
Nevada Trailer Finance Co. v. State Tax Commission, 5 Utah 2d 177, 299 P. 2d 126.....	11
Norville v. State Tax Commission, 98 Utah 170, 97 P. 2d 937, 126 A.L.R. 1318.....	7
Postal Telegraph-Cable Co. v. Oregon Short Line Railroad Co., 23 Utah 474, 65 P. 735.....	8

TABLE OF CONTENTS — (Continued)

	Page
Salina Canyon Coal Co. v. Klemm, 76 Utah 372, 290 P. 161	16
Swofford Brothers Dry Goods v. Owen, 37 Okla. 616, 133 P. 193	7
Utah Light & Traction Co. v. United States, Utah, 230 F. 343, 144 C.C.A. 485.....	19

Statutes Cited

Internal Revenue Code, Section 7701.....	13
Utah Code Annotated, 1953, Section 16-10	2
Utah Code Annotated, 1953, Section 16-10-120	12
Utah Code Annotated, 1953, Section 59-13-1(3)	3-13
Utah Code Annotated, 1953, Section 59-13-21	5-15

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VINCENT DRUG COMPANY, INC.,

Plaintiff and Appellant,

— vs. —

STATE TAX COMMISSION

OF UTAH,

Defendant and Respondent.

} Case
No. 10384

APPELLANT'S BRIEF

STATEMENT OF NATURE OF CASE

The Appellant corporation was assessed with a franchise tax deficiency by the Respondent on the theory that during the period it transacted business in Utah prior to the date of its corporate charter it was not subject to the corporate tax.

DISPOSITION BEFORE STATE TAX COMMISSION

Following a hearing on the assessment levied, the commission sustained the deficiency.

NATURE OF RELIEF SOUGHT

The Appellant petitions the Court to reverse the Decision of the commission and to hold that the corporation's accountant correctly filed the Appellant's returns, and that the deficiency was incorrectly assessed.

STATEMENT OF FACTS

The facts are uncontroverted, being stipulated by counsel below. Stipulation of Facts.

Pearl M. Vincent, dba Vincent Drug Company, a single proprietorship, was engaged in the general drug store and prescription business for many years prior to 1962. Business was conducted at 21 North Main Street, Midvale, Utah.

On January 2, 1962, Articles of Incorporation were filed for the Appellant in the office of the Secretary of State. The filing and license fees totaling \$45 were paid at that time. Mrs. Vincent transferred all of her inventory and business assets to the Appellant for its capital stock. The incorporators concluded all preparations, certificates of stock were issued, and business began.

Near the end of January, 1962, the Secretary of State returned the Articles to counsel for the Appellant, advising that the street addresses of the incorporators and initial directors had been omitted, contrary to the requirements of the new Business Corporation Act which had become effective the day prior to the filing. Chapter 16-10, Utah Code Annotated, 1953. The license and filing fees were not returned.

After the filing but prior to the return of the Articles, counsel for the Appellant terminated his private practice in order to accept federal employment. Although a change of address card was properly filed with the United States Post Office, the Articles were delivered to counsel's former office, and were not obtained by him, nor was he aware of their return, for several weeks.

Thereafter, on May 2, 1962, the Articles, amended to include the street addresses of the incorporators and directors, were filed and the Certificate of Incorporation was issued by the Secretary of State.

As permitted by law, the Appellant elected to conduct its business on a fiscal year ending March 31. A corporate tax return was properly prepared by the corporation's accountant for the period of January 2, 1962 to March 31, 1962, and was timely filed. Additionally, the Appellant used this initial tax return as the basis for computing its corporate franchise tax liability for the ensuing year as required by Section 59-13-21, Utah Code Annotated, 1953. The total tax liability for the reported period and for the following taxable year amounted to \$24.92, which sum was accepted with the return by the Respondent.

The Appellant's accountant properly prepared and filed the tax return for the fiscal year ended March 31, 1963, and the tax liability of \$737.37 was paid. The Respondent accepted the return and the corporation's check.

On February 20, 1964, the Respondent advised the Appellant that for franchise tax purposes the date of the

Certificate of Incorporation, May 2, 1962, was controlling. The initial return filed by the Appellant for the period ended March 31, 1962, and the accompanying computations for the prepaid tax of the first complete taxable year were therefore unacceptable. The Respondent held that the return filed by the corporation for the year ended March 31, 1963, was its first valid return, and computed the tax for the following year upon that base, making a total tax liability of \$1,541.77, or a deficiency of \$769.48. The taxpayer was assessed for the additional tax alleged to be due. The Respondent has not questioned the accuracy or content of the returns filed — only their necessity.

Pursuant to the Appellant's petition, a hearing was held before the State Tax Commission November 9, 1964. The Commission sustained the assessment and entered its written Decision April 20, 1965. It was therein concluded by the Commission that:

- “1. The franchise tax in Utah is a tax upon exercising the corporate franchise;
2. Petitioner commenced to exist as a corporation only when all conditions precedent prescribed by the Utah statute, including the issuance of a corporate charter, has been complied with;
3. Corporation franchise tax does not apply to an organization performing business activities in the guise of a corporation;
4. The deficiency against the Vincent Drug Company, Inc., in the amount of \$769.48, together with interest at the legal rate from and after March 31, 1963, until paid, should be assessed.

tained." Decision, p. 2-3, Conclusions of Law 1-4.

ARGUMENT

POINT I.

THAT THE UTAH CORPORATE TAX ON A CORPORATION NEWLY CREATED OR BEGINNING TO DO BUSINESS IN UTAH IS A TAX UPON THE PRIVILEGE OF DOING BUSINESS WITHIN THE STATE.

The Appellant finds itself in somewhat of a unique situation in contending that it is liable for the franchise tax for a period greater than the State Tax Commission is willing to accept. While the mathematical formula devised by the Legislature is interesting, it is unimportant for the purpose of this action. The resulting anomaly, however, is that to extend the period for which the taxpayer is liable, as the Appellant petitions, would abate the deficiency assessment herein made, and the decrease the Appellant's tax liability.

The critical legislative provision is Section 59-13-21, Utah Code Annotated, 1953, which states:

"A Corporation which commences to do business in this state shall upon incorporation or qualification prepay the minimum tax of \$10, and upon the filing of its return within two months and fifteen days after the close of its first taxable year it shall pay a tax for the privilege of doing business in the state during the period covered by the return, computed in the manner provided for the computation of a tax based upon a return for a

fractional part of a year, with credit allowed for the amount prepaid.

“The tax to be paid by the corporation for the privilege of doing business in this state during the twelve-month period commencing with the expiration of its said first taxable year, shall be equal to an amount which bears the same ratio to the sum determined as the tax for the period covered by the return, disregarding the \$10 minimum, as twelve bears to the number of months included in such period, but in no event shall such tax be less than \$10, and one quarter of said tax shall be due and payable at the time of filing its said first return; one quarter on or before five months and fifteen days after the close of its taxable year; one quarter on or before eight months and fifteen days after the close of its taxable year; and one quarter on or before eleven months and fifteen days after the close of its taxable year.”

Thus, the franchise tax is not an income tax. It is neither a property tax nor an organization tax. As it respects a corporation (as defined by the Legislature) newly organized, it is a tax imposed on the privilege of doing business in Utah. *J. M. and M. S. Browning Co. v. State Tax Commission*, 107 Utah 457, 154 P. 2d 993. It is in no way a tax upon the right to be a corporation, but solely on the right to transact business. As it has before been said, the tax is upon the franchise “to do,” not upon the franchise “to be.” *In re Detroit and Windsor Ferry Co.*, 232 Mich. 574, 205 N.W. 102.

In construing the applicability and effect of taxing statutes, this Court has ruled that that interpretation

will be adopted which lays the tax burden uniformly on all standing in the same degree with relation to the tax adopted, and will avoid an interpretation which would lead to an impractical, unfair or unreasonable result. *Nerrille v. State Tax Commission*, 98 Utah 170, 97 P. 2d 937, 126 A.L.R. 1318.

It is therefore necessary that in deciding the issue now before this Court as to whether or not the Appellant, Vincent Drug Company, Inc., was doing business in Utah within the meaning of the statute and the contemplation of the Legislature during the period of January 2, 1962 to May 2, 1962, the Court must adopt that position leading to a practical and equitable result consistent with the status of all entities subject to the corporate franchise tax.

POINT II.

THAT THE APPELLANT WAS A DE FACTO CORPORATION DURING THE PERIOD OF JANUARY 2, 1962 TO MAY 2, 1962.

It is well settled in the law that a de facto corporation possesses all the powers of a de jure corporation except that it is open to direct attack in quo warranto proceedings by the State to arrest its usurpation of power. So long as the State does not initiate such an action, the corporation is under the protection of the same law and is governed by the same legal principles as a corporation de jure. *Swofford Brothers Dry Goods v. Owen*, 37 Okla. 616, 133 P. 193. It is fundamental that the

legality of the existence of a corporation which has been so far organized in compliance with statutory requirements as to have achieved a de facto existence cannot be questioned collaterally by the State or by any other party. *Postal Telegraph-Cable Co. v. Oregon Short Line Railroad Co.*, 23 Utah 474, 65 P. 735. If the State, which alone can grant the authority to incorporate, remains silent during an open and notorious assertion and exercise of corporate powers, it along with private individuals and concerns will be estopped from raising any inquiry once the defect is corrected. Thus, if the Vincent Drug Company was a de facto corporation during the period in question, the State Tax Commission is now estopped from asserting that the Appellant did not have such existence and character as to make it liable for the corporate tax.

The factors essential to the existence of a de facto corporation are:

1. A valid law under which a corporation with the powers assumed might be incorporated;
2. A bona fide attempt to organize a corporation under such law; and
3. An actual exercise of corporate powers. *Brown v. Webb*, 60 Ore. 526, 120 P. 387.

The Appellant had prepared its Articles of Incorporation for filing with the Secretary of State. The Articles were full and complete except for the omission of the street addresses of the incorporators and original directors. The purposes therein enumerated, the capital

structure, and the corporate organization are lawful and in no way violate the broad scope of authority permitted by the applicable statutory provisions. The business aim of the corporation and the powers with which it was clothed are valid and were not questioned by the Respondent.

The Articles were properly filed and the license and filing fees were paid. An organization meeting was then held with all shareholders and directors present. Directors were elected and officers appointed. Certificates of stock were issued. The corporate seal was affixed to all documents. By-Laws were prepared and adopted. A corporate buy and sell agreement was executed with the shareholders.

The business sign, advertising materials, licenses, accounts with supplier, and official papers were all changed to show the new business name. A checking account was opened, and the Appellant began business on January 2, 1962. Since then the corporation has conducted its business and has exercised and enjoyed its corporate existence.

From the foregoing facts, consistent with the Findings of Fact of the Commission, it is obvious that the requirements for existence as a de facto corporation were amply met and demonstrated by the Appellant during the period in question.

In *Marsh v. Mathias*, 19 Utah 350, 56 P. 1074, the facts are substantially identical to those here under exam-

ination. This Court there said that where a bona fide attempt was made to incorporate, and business was in fact commenced, the entity was a de facto corporation.

It is therefore submitted that the Respondent is estopped from maintaining that the Appellant was not imbued with corporate power and existence during the months in question, but rather must concede that for every purpose the corporation was cloaked with the guarantees, rights and obligations generally afforded corporations by the statutes of this State. *Utah Light & Traction Co. v. United States*, Utah, 230 F. 343, 144 C.C.A. 485; *Salina Canyon Coal Co. v. Klemm*, 76 Utah 372, 290 P. 161. Any holding to the contrary would amount to a collateral attack by the Commission on the Appellant's existence. The deficiency cannot be sustained.

POINT III.

THAT A DE FACTO CORPORATION IS LIABLE TO THE STATE FOR CORPORATE FRANCHISE TAX.

In determining the intent of the Legislature regarding the Appellant's initial four months' existence, it is helpful to note the analogous problem of a foreign corporation doing business in Utah without properly qualifying.

The questioned taxing statute treats foreign and domestic corporations alike. It states that the initial \$10 prepayment is required at the time of "incorporation or qualification." It then requires the computation and

payment in advance for the first full year of the corporation following the expiration of its initial taxable period for the right to do business.

The Business Corporation Act permits a foreign corporation to transact business in this State even though it has not complied with the statutory requirements for qualification. Section 16-10-120, Utah Code Annotated, 1953. Its contracts and dealings are unaffected by its lack of statutory authority. Having the same privileges as a qualified foreign corporation, it must also be subject to the same liabilities. The law will not permit a non-qualifying foreign corporation to avoid taxation simply because the statute requires the initial tax "upon incorporation or qualification."

This very problem confronted the Court in 1956 in the case of *Nevada Trailer Finance Co. v. State Tax Commission*, 5 Utah 2d 177, 299 P. 2d 126. The Court there held that a foreign corporation, actually doing business in Utah, could not escape liability for tax on the ground that it was not qualified to do business within the State. It should obtain no advantage over other foreign corporations legally doing business in the State by failing to comply with the terms of the statute.

The Legislature later expressly set forth its intent in the event such problems arose:

"A foreign corporation which transacts business in this state without a certificate of authority shall be liable to this state, for the years or parts thereof during which it transacted business in this

state without a certificate of authority, in an amount equal to all fees and taxes which would have been imposed by the laws of this state upon such corporation had it duly applied for and received a certificate of authority to transact business in this state as required by this act and thereafter filed all reports required by this act, plus all penalties imposed by the laws of the state for failure to pay such fees and taxes. The attorney general shall bring proceedings to recover all amounts due this state under the provisions of this section.” Section 16-10-120, Utah Code Annotated, 1953.

Thus, the Legislature propounding that “A corporation which commences to do business in this state shall upon *incorporation or qualification . . .*” (emphasis added) pay corporate tax did not really intend to infer that a foreign corporation failing to qualify is not liable for the tax. By the same reasoning, the Appellant claims that the Legislature did not mean to shield a de facto corporation from the scope of the franchise tax. Rather, the corporation, foreign or domestic, unqualified or de facto, is subject to the tax if it conducts its business within the State — and that is the sole test.

The position of the Respondent is completely untenable. The Commission’s Decision creates a four-month period during which the Appellant conducted business and realized a taxable income, for which no one, as the Respondent’s position concedes, is subject to the State’s taxing authority. The directors and shareholders cannot be held liable for tax while the entity functions as a de facto corporation. *Marsh v. Mathias, supra.*

If the Corporation is not liable, the shareholders and business enjoy a dispensation relieving them from any obligation for state tax until such time as their procedure of incorporation is perfected. Thus, if the Respondent's position is upheld, it is possible for a group to do as the Appellant did, only with the purpose to avoid the state taxing authority. The Legislature endeavored to preclude such a situation by broadly defining the group subject to the franchise tax as including

“ . . . (E)very corporation, and every company, joint-stock company, joint-stock association, business trust, society, or other association, organized for profit and doing business in this state, wherein interest or ownership is evidenced by certificates or other written instruments or wherein the interests or rights of shareholders, members, associates or beneficiaries are represented or evidenced by units or shares.” Section 59-13-1(3), Utah Code Annotated, 1953.

Thus, there are business entities not even required to “incorporate or qualify” to do business in Utah, or to pay any filing or license fees, who fall within the foregoing definition and are therefore subject to the corporate franchise tax. The Appellant, assuming the privilege of doing business, came within the definition of a “corporation,” even though it had obtained no Certificate of Incorporation. A similar situation exists under federal law where “corporations” subject to the corporate income tax are broadly enough defined as to include the Appellant. Section 7701, Internal Revenue Code.

In the final analysis, whether or not the Vincent Drug Company was a de facto corporation, it satisfied the statutory requirements while doing business within the State. The Court must accede to the obvious legislative intent to tax every entity not specifically exempt, and require the Appellant to pay the franchise tax from the day it began to do business.

POINT IV

THAT THE RESPONDENT ERRED IN ITS COMPUTATION OF TAX AND INTEREST ON THE ASSESSMENT LEVIED.

Without prejudice to the Appellant's contentions hereinbefore stated, it is submitted in the event the Court were to affirm the Commission's Conclusions of Law and Decision, that the Respondent has erred in the computation of the deficiency assessment and in the additional levy for interest.

The Commission held that the return filed by the Appellant for the year ended March 31, 1963 was the first return of the corporation acceptable to it under its interpretation of the taxing statutes. Decision, P. 2, Finding of Fact 9. This return, however, included the period of April 1, 1962 to May 2, 1962 during which the Appellant functioned without benefit of a Certificate.

It would seem, in order to be consistent, that the Respondent should accept only that portion of the return that reflects operations after May 2, 1962, and

should therefore grant the appropriate credit against the deficiency.

Additionally, the Commission decreed that interest on the deficiency should be computed from March 31, 1963. Decision, P. 3, Conclusion of Law 4. As hereinbefore cited, Section 59-13-21 provides that the prepayment of tax due for the second taxable period of the corporation can be made on an installment basis, with the due date of each installment expressly set forth. Thus, interest on any deficiency can only be assessed from the date upon which the quarterly portion of such deficiency became due, and then only upon that portion of the assessment.

CONCLUSION

It is respectfully submitted that the Commission erred in its consideration and interpretation of the statutes and law of this jurisdiction. On the basis of its de facto existence, legislative intent, and a strict construction of applicable statutory provisions, the Appellant must be held as being subject to the corporate franchise tax from its inception, January 2, 1962.

Respectfully submitted,

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