

1965

## Vincent Drug Company, Inc. v. State Tax Commission of Utah : Defendant'S Brief

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### Recommended Citation

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# IN THE SUPREME COURT OF THE STATE OF UTAH

VINCENT DRUG COMPANY, INC.,  
*Plaintiff,*

— vs. —

STATE TAX COMMISSION  
OF UTAH,

*Defendant.*

## DEFENDANT'S

Writ of Review of a Decision of the  
State Tax Commission

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# IN THE SUPREME COURT OF THE STATE OF UTAH

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VINCENT DRUG COMPANY, INC.,  
*Plaintiff,*

— vs. —

STATE TAX COMMISSION  
OF UTAH,

*Defendant.*

Case  
No. 10384

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## DEFENDANT'S BRIEF

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### STATEMENT OF THE NATURE OF THE CASE

On January 2, 1962, articles of incorporation were delivered to the Secretary of State on behalf of the above-entitled corporation. Prior to this time plaintiff did business as an individual proprietorship. The Secretary of State returned the articles because they did not comply with certain statutory requirements without having issued a charter to the corporation. However, the defects were corrected and the Certificate of Incorporation of the plaintiff was subsequently approved and issued by the Secretary of State on May 2, 1962.

During the interim period plaintiff continued to do business. The question presented for consideration is when did the corporation receive its right to exercise its corporate franchise so as to be subject to the Utah corporation franchise tax?

## DISPOSITION BEFORE THE STATE TAX COMMISSION

Upon stipulated facts the Tax Commission concluded that the plaintiff, Vincent Drug Company, commenced to exist as a corporation only when all conditions precedent prescribed by Utah statutes, including the issuance of a corporate charter, had been complied with.

## RELIEF SOUGHT ON REVIEW

The defendant asks that its decision heretofore rendered be sustained, while plaintiff petitions the Court to reverse this decision and hold that its franchise tax returns were properly filed based upon a first fiscal year of February 2, 1962, to March 31, 1962.

## STATEMENT OF FACTS

The facts are entirely stipulated and are included on pages 7 and 8 of the Record herein. To the extent that plaintiff's brief adequately represents the stipulation, it will be adopted by defendant, and no further statement of facts will be set forth. It should be noted, however, that the language of the stipulation is somewhat different than the language used by plaintiff in its brief.

## ARGUMENT

### POINT I.

THE UTAH FRANCHISE TAX IS A TAX UPON THE PRIVILEGE OF EXERCISING A CORPORATE FRANCHISE OR ON THE PRIVILEGE OF DOING BUSINESS.

See *American Investment Corp. v. State Tax Commission*, 101 Utah 189, 120 P. 2d 331, overruled in part by *J. M. and M. S. Browning Co. v. State Tax Commission*, 107 Utah 457, 154 P. 2d 993. The latter case held:

“The tax is not an income tax . . . The tax is imposed upon the privilege of exercising the corporate franchise or on the privilege of doing business in Utah.”

Quoting from the *American Investment Corp. case*, that Court said:

“The corporate franchise tax being one upon the franchise, or the privilege of doing business in this state, it matters not as to the extent to which the franchise is exercised and *the franchise is still taxable if not exercised or if only partially exercised.*” (emphasis supplied)

Section 59-13-3, U.C.A. 1953, imposes a tax of no less than \$10 on all qualified corporations in the State of Utah, whether or not they do business. To the extent that such corporations conduct business or exercise their franchise so as to require a greater tax contribution based upon net income earned, they are accordingly taxable upon the privilege of doing this business; but it is the privilege which is taxed and not the doing of busi-

ness as such. In other words, the defendant disagrees with the plaintiff that the tax is not one upon the right to be a corporation. (Page 6 of plaintiff's brief.) The unmistakable holding of the *American Investment Corp.* and *Browning Co.* cases, *supra*, is that the tax is due whether the corporate franchise is exercised or not.

## POINT II.

### THE PLAINTIFF CORPORATION COMMENCED TO EXIST AS A CORPORATION ONLY AFTER IT HAD RECEIVED ITS CORPORATE CHARTER.

The plaintiff argues that it had the right to conduct business as a corporate entity beginning on January 2, 1962. This argument is based in large part upon the proposition that it was a *de facto* corporation after that date. Plaintiff contends that a *de facto* corporation possesses all the powers of a *de jure* corporation and that its existence cannot be collaterally attacked.

In this regard, Section 16-10-50, 1953, is pertinent and provides as follows:

“Duplicate originals of the articles of incorporation shall be delivered to the secretary of state. If the secretary of state finds that the articles of incorporation conform to law, he shall, when all fees have been paid as in this act prescribed:

“(1) Endorse on each of such duplicate originals the word ‘filed,’ and the month, day and year of the filing thereof.



“(2) File one of such duplicate originals in his office.

“(3) Issue a certificate of incorporation to which he shall affix the other duplicate original.

“The certificate of incorporation, together with the duplicate original of the articles of incorporation affixed thereto by the secretary of state, shall be returned to the incorporators or their representative.”

Section 16-10-51, U. C. A. 1953, then provides:

*“Upon the issuance of the certificate of incorporation, the corporate existence shall begin, and such certificate of incorporation shall be conclusive evidence that all conditions precedent required to be performed by the incorporators have been complied with and that the corporation has been incorporated under this act, except as against this state in a proceeding to cancel or revoke the certificate of incorporation or for involuntary dissolution of the corporation.”* (emphasis supplied)

The Tax Commission's position in this regard is that the corporate existence does not begin until the certificate of incorporation is issued and that it has no legal power to tax an entity as a corporation prior to the time the certificate is issued. This is not to say that the plaintiff would not be subject to tax prior to the date of the issuance of the certificate. It would be taxed, but as a business partnership or individual proprietorship, not a corporation.

There is a plain distinction between acts which are essential steps in the process of incorporation and pre-

requisites to corporate existence and those which are not, and those which, as such, may work a forfeiture of rights after the corporation has been brought into legal existence. Many times, this distinction is characterized as being one between conditions precedent and conditions subsequent. The performance of the first-named acts may be challenged by private parties, when they are not estopped from doing so, whenever the question of corporate existence becomes material to them. The latter acts and prerequisites can only be challenged or taken advantage of by the government itself.

The Tax Commission does not concede that, as a governmental entity, it is not entitled to collaterally attack the corporate existence of plaintiff. But even if the rules available to private parties are applicable to it, it has been held that a failure to file a certificate is a condition precedent which can be questioned by a party having a valid interest therein. *Elgin National Watch Co. v. Loveland*, 132 Fed. 41, app. dism'd 66 C.C.A. 680, 132 Fed. 1021. The Tax Commission submits there is a legal distinction between questioning the right of an organization to do business as a corporation and a collateral attack on such a corporation. It is further submitted that the Tax Commission has the right to question the right of any organization to do business as a corporation.

The following jurisdictions hold that an organization cannot do business as a corporation until the required papers have been filed and that where business is done without filing of papers pursuant to statutory requirements the members of such organizations are liable

for the various business obligations as partners: *Union Pacific R. R. Co. v. Blair*, 48 Utah 38, 156 Pac. 948; *Garnett v. Richardson*, 35 Ark. 144; *Bigelow v. Gregory*, 73 Ill. 197; *Spencer Field & Co. v. Cooks*, 16 La. Ann. 153; *Hurt v. Salisbury*, 55 Mo. 310; *New York National Exchange Bank v. Crowell*, 177 Pa. 313, 35 Atl. 613; *Beracron v. Hobbs*, 96 Wise. 641, 71 N.W. 1056.

If a corporation is organized under general law, the time when the corporate existence commences depends upon the terms of the particular statutes involved. As a general rule corporate existence commences when all conditions precedent prescribed by the statute, as distinguished from conditions subsequent, have been substantially complied with. *Bank of Verona v. Stewart*, 223 Wis. 577, 270 N.W. 534.

It is well established that a corporation cannot exist until its charter has been granted. *Powers v. Brunswick-Balke-Collender Co.*, 19 Ga. App. 706, 91 S.E. 1062.

Plaintiff places reliance on the case of *Nevada Trailer Finance Co. v. State Tax Commission*, 5 Utah 2d 177, 299 P 2d 126. That case does not stand for the proposition that a *de fact corporation* is subject to corporation franchise tax. Rather, it represents this Court's statement that a previously existing corporation could obtain no advantage over other foreign corporations doing business in this state by failing to qualify and that such a corporation could not avoid a lawful tax obligation by violating the Utah statute requiring qualifying to do business. The question of when a foreign corporation becomes

entitled to do business in this state as a corporation was not before the court.

### POINT III.

#### THE ASSESSMENT OF INTEREST ON THE TAX COMMISSION'S DEFICIENCY ASSESSMENT IS PROPER.

The taxpayer contends that an adjustment should be made in the computation of the tax. This is based on the fact that the return which was filed by plaintiff for the year ending March 31, 1963, included income for a period wherein plaintiff functioned without the benefit of a certificate of incorporation. To the extent that this income was included in such tax return, the Tax Commission concedes that an adjustment should be made.

In addition, the plaintiff complains that the Tax Commission's assessment of interest on the deficiency assessment herein is improper. This contention is based upon the taxpayer's interpretation of Section 59-13-21, U.C.A. 1953, which provides for the payment of taxes due under the first return on an installment basis.

The Tax Commission would agree that had the amount due been admitted and reported by the taxpayer, then one-quarter of this amount could have been paid as an installment payment under Section 59-13-21. However, the tax under this section was not paid nor was a quarterly installment payment made. Section 59-13-21, U.C.A. 1953, provides in part:

“If any installment is not paid on the date fixed for its payment, the whole amount of the tax unpaid shall be paid, upon notice and demand of the tax commission.”

The argument presented by the taxpayer here is similar in many respects to the contention of the taxpayer in the *American Smelting & Refining Co. v. State Tax Commission case*, 16 Utah 2d 147, 397 P. 2d 67 (1964). There, this Court held that the privilege of filing and paying franchise taxes on a quarterly basis was dependent upon strict compliance with statute. So, in this case, the taxpayer should not be allowed to fail to pay the tax when due and thereafter, if such tax is determined to be due, request retroactively the privilege of paying tax and interest on an installment basis.

## CONCLUSION

The Tax Commission's right to tax a corporation as a corporation is dependent upon the legal existence of such a corporate entity. Where the charter has not been granted, and the corporation in no way treated as a legal entity by the Secretary of State, or where the corporation has not previously existed as such in another state, a corporation franchise tax should not apply to an organization conducting business activities in the guise of a corporation.

Respectfully submitted,

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