1965

Western Contracting Corporation, An Iowa Corporation v. State Tax Commission : Plaintiff's Reply Brief

IN THE SUPREME COURT OF THE STATE OF UTAH

WESTERN CONTRACTING CORPORATION, an Iowa Corporation,

Plaintiff,

vs.

STATE TAX COMMISSION,

Defendant.

Case No. 10322

PLAINTIFF'S REPLY BRIEF

Original Proceeding for Review of Decision of State Tax Commission

Sanford M. Stoddard
Bryce E. Roe
Kenneth J. Hanni
FABIAN & CLENDENIN
800 Continental Bank Building
Salt Lake City, Utah
Attorneys for Plaintiff

Phil L. Hansen
F. Burton Howard
236 State Capitol
Salt Lake City, Utah
Attorneys for Defendant

TABLE OF CONTENTS

AUTHORITIES CITED

CASES

STATUTES

OTHER AUTHORITIES

IN THE SUPREME COURT OF THE STATE OF UTAH

WESTERN CONTRACTING CORPORATION, an Iowa Corporation,
Plaintiff,

vs.

STATE TAX COMMISSION,
Defendant.

Case No. 10322

PLAINTIFF'S REPLY BRIEF

PLAINTIFF'S REPLY BRIEF

Original proceeding for review of decision of State Tax Commission.

PRELIMINARY STATEMENT

Defendant's reply brief states as facts, and draws conclusions from the Utah Code Annotated 1953

and other sources, matters which are not justified or correct and a reply seems warranted.

On page 4 of defendant's brief the statement is made: "Section 59-13-22, U.C.A. 1953, together with section 59-13-15, U.C.A. 1953, requires the filing of franchise tax returns on an accrual or percentage of completion basis." These sections do not provide for or require the filing of franchise tax returns on an accrual or percentage of completion basis. Rather, the sections provide that the net income of the taxpayers shall be computed upon the basis of the taxpayers' annual accounting period "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." The plaintiff maintains its records on a completed contract basis, which is a generally accepted method of accounting for contractors.

ARGUMENT

I. THE ALLOCATION FORMULA IS THE BASIC METHOD OF DETERMINING INCOME TAXABLE IN UTAH.

Defendant, in its brief, completely misinterprets the preference expressed in the statute and in the regulations of the State Tax Commission concerning the allocation of multi-state corporations' income to the state of Utah. Similarly, defendant's brief quotes cases that have been decided in other jurisdictions where the basic taxing statute is not the same as the Utah statute

and draws analogies that are not warranted. On page 13 of defendant's brief the comment is made:

> "Such allocation is appropriate only where the business within the state is not separable."

Similarly, on page 17, quoting the case of *Fisher v. Standard Oil,* (8th Cir. 1926), 12 F.2d 744, defendant's brief says:

> "Theories of allocation have no place in determining income tax on a corporation if net income within a state can be distinguished from outside business."

And, on page 18,

> "Only where income cannot be ascertained should the allocation formula be used."

Contrast the impression set forth by defendant in its brief from these statements with the following statement from the State Tax Commission's Regulation 8, Subsection 4, Exceptions to Statutory Method:

> "It is the policy of the Tax Commission, based upon court interpretations of the statute, to require that the method set forth in the statute be used for the assignment of net income within and without this state."

Clearly, the preference in the state of Utah is for the use of the allocation formula and not for separate accounting. If the State Tax Commission believes that the use of the allocation formula does not properly allocate taxpayer's income to the state of Utah, then, and only then, can the Commission change the statutory

formula and in so doing it must follow the limits established by the statute and interpreted by the court as follows:

> "If . . . the application of the foregoing rules does not allocate to the state the proportion of net income fairly and equitably attributable to this state, then the Commissioner may make such allocation as is fairly calculated to assign to this state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation." Section 59-13-20, subsection 8, Utah Code Annotated 1953.

The determination is subject to the limitation of the total net income of the taxpayer.

II. THE CONSTITUTIONAL QUESTION IS PROPERLY BEFORE THE COURT.

On page 8 of defendant's brief the comment is made:

> "While the taxpayer herein does not claim constitutional violations, the constitutional provisions explain the reason for Utah legislative insistence that only income attributable to Utah business activities be taxed."

Plaintiff specifically represents that:

> "An attempt by the State Tax Commission to tax more than net income of the corporation, as being properly allocable to Utah, violates the Commerce clause, Article I, Section 8, Clause 3, of the Federal Constitution." (P. 10, Plaintiff's Brief.)

III. THE UTAH CODE ANNOTATED 1953 CONTROLS CORPORATE FRANCHISE TAXES.

It is the Utah statute that is controlling in this case and unless statutes in other jurisdictions are comparable, decisions in those jurisdictions have no bearing on the facts in this case. For example, the Wisconsin statute, as quoted by defendant, provides that "persons engaged in business within and without the state" should "be taxed only on such income as is derived from *business transacted* and property located within the state." (Emphasis added.) (Page 12 of Defendant's Brief.)

Similarly, in *Magnolia Petroleum Co. v. Oklahoma Tax Commission,* 121 P.2d 1008, 190 Okla. 172 (1941), the court said:

> "In our opinion, the intention as expressed in the statute is that direct allocation be made in all cases of this character where practicable, and that indirect allocation be made only in those instances where the same would prove more practicable than direct allocation. *The statute clearly favors direct allocation.*" (Emphasis added.)

In *McWilliams Dredging Co. v. McKeigney,* 227 Miss. 730, 86 So. 2d 672, App. Dism. 352 U.S. 807, 77 S.Ct. 57, 1 L.Ed. 2d 38 (1956), the court, after citing the applicable statute and regulations, said:

> "Our law unquestionably favors the specific accounting by foreign corporations . . . "

The cases cited by defendant from these jurisdictions have no bearing on this case because the statutes in those jurisdictions are substantially different from the Utah statute, in that they favor separate accounting whereas the Utah statute and its interpretations express a strong preference for the statutory allocation formula.

IV. THE DESCRIPTION OF THE PLAINTIFF'S BUSINESS IS NECESSARY TO A PROPER DETERMINATION OF NET INCOME.

Defendant's brief states that plaintiff has asserted certain facts in its brief which are not properly before the court (page 30). This is contrary to the facts. Since these same elements relating to the "unitary" nature of the plaintiff's business were a portion of the memorandum submitted to the State Tax Commission in connection with the formal hearing and were specifically set out in the Writ of Certiorari as a portion of the record to be returned to the court, even though this portion of the record was not returned by the State Tax Commission, they are properly before this court.

Defendant's brief quotes from Altman and Keesling, *Allocation of Income in State Taxation*, page 38, on page 18:

> "A business is unitary if business done in any state benefits the business done elsewhere and is

benefited by the business done elsewhere because of the distributon of processes and operations, centralized management, increased buying power, volume reduction of manufacturing cost, or other factors of the business as a unit."

Plaintiff subscribes completely to this view and the elements of plaintiff's business activities included in plaintiff's brief are those necessary to describe the business activities of plaintiff to indicate that the business is unitary, and that all elements both within and without the state contribute to the success of the various business components or divisions. If the business is "unitary" in nature, the allocation formula should be applied to determine the portion of net income taxable in **Utah.**

V .DEFENDANT'S REASONING AND CITATIONS IN CONNECTION WITH THE DEDUCTION OF FEDERAL INCOME TAXES DO NOT SUPPORT ITS CONCLUSION.

On page 39 of defendant's brief, there is a quotation, again from Altman and Keesling, *Allocation of Income in State Taxation,* in connection with the deduction for federal income taxes. Plaintiff adopts this quotation and points out the result of such determination of federal income tax deductions as is set forth by defendant.

> "The determination is made by applying to the entire amount of federal taxes on income a fraction, the numerator of which is the net income within the scope of the state tax and the

denominator of which is the net income shown by the federal returns."

In this case, if we follow the segregated accounting method required unilaterally by the State Tax Commission, the amount of net income allocated to Utah, as the result of certain assumptions concerning the proration of various expenses of the corportion, is $1,741,237.43. The net income shown on the federal return was $555,088.31. The fraction determined pursuant to the quotation in defendant's brief times the net federal income taxes of $183,215.11 would permit a deduction for federal income taxes to be applied against the income determined in Utah of $574,562.24. Although this is not the same amount claimed as an alternative by the plaintiff, by using the equivalent tax rate, it is certainly substantially in excess of the amount allocated to Utah pursuant to Tax Commission Regulation 13. The defendant's comment that the Regulation "achieved substantially the same result" is certainly not consistent with the result obtained by applying the factors quoted with favor by the defendant in its brief.

The court may be startled, as we have been, by the term "true net income" employed by the defendant on pages 38 and 39 of its brief. Certainly the Utah statutes do not speak in terms of "true net income" nor, to date, have the interpretive regulations of the State Tax Commission. It appears to plaintiff that this is an attempt to introduce a new concept into the

corporation franchise tax law. This is not an administrative function but rather it is a prerogative of the Utah legislature. The statutory concept of "net income" specifically defined in section 59-13-6, Utah Code Annotated 1953 and the methods for determining such net income, found in the accompanying sections, is the concept applicable in this case and the limiting factor in determining the maximum amount of income that may be taxed in Utah.

Section 59-13-7, Utah Code Annotated 1953, provides for the deduction of taxes paid or *accrued.* Where more than one profit-making and operating division is included within an overall corporation, the word "accrued" may properly refer to the amount of income taxes applicable to that division. If defendant is correct in its assertion that the term "net income" does not mean what it is defined to mean as in the Utah Code Annotated 1953, but actually means net income in Utah or some new concept such as "true net income," the provision for the deduction of federal income taxes must be read in the light of proper accounting principles in the determination of net income from an operating division of a corporation. This results in the determination of a federal tax deduction for the division (Utah) consistent with the income for the same division. In other words, the Tax Commission cannot have its cake and eat it too.

CONCLUSION

The points raised in defendant's brief and the conclusions drawn therein are not consistent with the facts, with the Utah statute which controls the imposition of the corporate franchise tax, or with the plain meaning of the words involved.

Respectfully submitted,

Sanford M. Stoddard
Bryce E. Roe
Kenneth J. Hanni
FABIAN & CLENDENIN

800 Continental Bank Building
Salt Lake City, Utah

Attorneys for Plaintiff