1966

Bennett Association v. Utah State Tax Commission : Brief of Defendant

IN THE SUPREME COURT
of the
STATE OF UTAH

BENNETT ASSOCIATION,
a Massachusetts business trust,
Plaintiff,

- vs. -

STATE TAX COMMISSION OF UTAH,
Defendant.

Case No. 10682

BRIEF OF DEFENDANT

Writ of Certiorari to Review an Order of the State Tax Commission of Utah

PHIL L. HANSEN,
Attorney General
F. BURTON HOWARD
Special Asst. Attorney General
336 South Third East
Salt Lake City, Utah
Attorneys for Defendant

Mulliner, Prince & Mangum
F. S. Prince & John K. Mangum
315 East Second South
Salt Lake City, Utah
Attorneys for Plaintiff

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STATEMENT OF THE CASE

This is an original proceeding to review an order and decision of the State Tax Commission upholding a franchise tax deficiency against Bennett Association in the amount of $73,029.02.

STATEMENT OF FACTS

The Plaintiff herein, Bennett Association, is a Massachusetts business trust with its principal place of business in Salt Lake City, Utah. At all times mentioned herein Plaintiff owned more than 95% of the outstanding stock of Bennett Leasing Company, Utah Auto Rentals and Bennett's, a Utah corporation.

On or before April 15, 1965, the Plaintiff filed a consolidated corporation franchise tax return for its

January 1, 1964, to December 31, 1964, calendar year, and included therein the income of Utah Auto Rentals and Bennett Leasing Company. However, it failed to include the income of Bennett's and did not include a consent from the latter corporation to the filing of a consolidated return on its behalf. Had the return been filed in a proper and timely fashion, it would have shown that on March 31, 1964, Bennett's made a liquidating distribution of all of its assets to the Bennett Association in accordance with a plan of liquidation and dissolution. This liquidating distribution was computed on the fair market value of assets transferred from Bennett's to the Plaintiff in the amount of $1,766,362.80. A franchise tax deficiency has been sustained by the State Tax Commission upon this income to Bennett Association in the amount of $70,559.44, together with interest thereon in the amount of $2,469.58 for a total deficiency of $73,029.02.

The Commission held that the Plaintiff was not entitled to claim the benefits of filing a consolidated return with its dissolved subsidiary and ruled that the liquidating distribution which it received from this subsidiary was taxable to the parent corporation. It is this ruling that Plaintiff asks this court to review.

ARGUMENT

POINT I

ONLY AN AFFILIATED CORPORATION HAVING A TAXABLE YEAR OF ITS OWN CAN BE ACCORDED THE PRIVILEGE OF JOINING IN A CONSOLIDATED RETURN FOR THAT YEAR SO AS TO QUALIFY FOR AN INTERCOMPANY TRANSACTION EXEMPTION.

As a general rule the liquidating dividend paid from a subsidiary to a parent in the State of Utah is taxable to the parent. Such a distribution is required to be included in the gross income of the parent and after taking into consideration certain adjustments on the basis of property involved, it is taxable as income to the parent corporation. See Sec. 59-13-5 UCA 1953.

Amounts distributed in complete liquidation of a corporation are treated as full payment in exchange for stock and are taxable to the distributee. See 59-13-14 UCA 1953.

It must be noted that 1964 was not a taxable year for Bennett's under Sec. 59-13-1 (6), UCA 1953. This section provides:

> "The term 'taxable year' means the calendar year or the fiscal year ending during such calendar year upon the basis of which the net income is computed and includes, in the case of a return made for a fractional part of a year under the provisions of this chapter, or under regulations prescribed by the Tax Commission, the period for which such return is made . . ."

The franchise tax in Utah is a tax on the privilege of doing business measured by income and is a prepaid tax. Sec. 59-13-3, UCA 1953, provides that every corporation" for the privilege of exercising its corporate franchise or the privilege of doing business in the state shall annually pay to this state a tax equal to 4% of its net income for the *preceeding taxable year,* computed and allocated to this state in the manner hereinafter pro-

vided . . .'' (Emphasis suppled.) Thus, 1964 was not a taxable year for Bennett's even though it may otherwise be a member of the consolidated group in question.

It should not be allowed to join in a consolidated return for the year 1964 because the privilege of making a consolidated return for any taxable year is only granted to members of an affiliated group in place of the individual returns which the members of that group would otherwise be required to file. A corporation which owes no return cannot participate in the filing of a joint return or a consolidated return with other corporations. And, as Regulation 4 only begins to operate after the existence of a consolidated return privilege is established, it seems clear that a group of corporations not entitled to file a consolidated return under the statute cannot claim a consolidated return exemption under isolated portions of the regulation.

In the year 1964 Bennett's paid to the Bennett Association a liquidating dividend which is taxable under Utah law unless an exemption is available to the parent which would prevent this dividend from being included in the tax return filed for or by the parent.

The only special tax consideration available is that provided by Franchise Tax Regulation No. 4, Article 34, which states:

> "Gain or loss shall not be recognized upon a distribution during a consolidated return period by a member of an affiliated group to another mem-

> ber of such group in cancellation or redemption of stock; and any such distribution shall be considered an intercompany transaction."

Thus, while no statutory exemption is provided, the Plaintiff herein contends that the distribution which it received from its subsidiary should be treated as an intercompany transaction and that it need not report such a liquidating dividend as income.

A determination of the propriety of this contention necessarily involves inquiry into the nature of consolidated returns and affiliated groups as defined by Utah statutes.

Sec. 59-13-23, UCA 1953, defines affiliated group in Utah and under the general definition contained there, it is probable that Bennett's would be a member of an affiliated group in 1964 even though it dissolved in March of that year. However, Sec. 59-13-23, UCA 1953, further provides that an affiliated group shall have the privilege of making a consolidated return *"for any taxable year in lieu of separate returns."* (Emphasis supplied.) Thus, the statute contemplates the filing of one consolidated return in place of many separate returns. These returns would, of course, only be due if the individual corporations had taxable years, the activities of which they were required to report. The statute, therefore, requires a "taxable year" for each member of the affiliated group as a prerequisite for inclusion of that member's activities in the consolidated return filed for that taxable year.

POINT II

THE LIQUIDATING DISTRIBUTION PAID TO PLAINTIFF IS NOT EXEMPT FROM TAXATION UNDER TAX COMMISSION FRANCHISE TAX REGULATION NO. 4.

The Utah franchise tax act does not provide for special tax treatment of intercompany transactions reported on consolidated returns. Any exemption applicable to such transactions must be based on the franchise tax regulations promulgated by the Tax Commission. The question of whether or not the Commission can provide by regulation an exemption from income which is required by statute to be taxed is uncertain, but does not need to be decided in connection with this appeal.

Section 59-13-23, UCA 1953, provides in part:

"By Affiliated Group.

(1) An affiliated group of banks and/or other corporation shall, subject to the provisions of this section, *have the privilege of making a consolidated return for any taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations* under subsection (2) of this section prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. . .

Rules and Regulations.

(2) *The Tax Commission shall prescribe such regulations as it may deem necessary in order that the tax liability of an affiliated group of banks*

and/or corporations making a consolidated return and of each corporation in the group, both during and after the period of affilation, may be determined, computed, assessed, collected and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liabilty. . ." (Emphasis added.)

Thus, the privilege of filing consolidated returns is only granted in lieu of making separate returns and *even then* it is conditioned upon all corporations involved consenting to *all* of the regulations under Subsection (2) prescribed prior to the making of such return.

Therefore, even if Article 34 of Regulation 4 does establish an exemption for intercompany transactions reported on consolidated returns, this exemption cannot be broader than the regulation upon which it is based. The privilege of filing a consolidated return is conditioned upon consent to all of Regulation 4, not just the portion which exempts intercompany transactions.

The term "consolidated return" means any taxable year for which a consolidated return is made. See Article 2, (b), page 43, Franchise Tax Regulations. It has already been pointed out that the year 1964 was not a taxable year for Bennett's even though the consolidated return was made for that year.

In addition, the option to file a consolidated return *must* be exercised at the time of filing the return of the parent. At the time of the filing of the parent's return in this case, the election was not made to have Bennett's income included in the return and, therefore, under the

regulation, it cannot be subsequently included. See Article 10, Regulation 4, page 43, *Ibid.*

A further reason that the Plaintiff cannot prevail under the regulation itself is that the term "affiliated group" is defined by regulation as not including corporations not subject to tax under the act. See Regulation 4, Article 2 (b), page 43, *Ibid.* Bennett's was not subject to tax under the act for the year 1964 because it owed no tax on the activities in the year it dissolved. Therefore, it was not a member of an affiliated group as defined by the regulations during the year in question.

For these reasons, the exemption is unavailable to Plaintiff as it and Bennett's were not members of an affiliated group as defined by the regulation at the time the liquidating dividend was made.

POINT III

THE COURT SHOULD STRICTLY CONSTRUE THE CLAIMED EXEMPTION.

This case presents an unusual situation where the authority purporting to establish a tax exemption is derived, not from a statute, but from an administrative regulation. However, the Commission submits that the general rules regarding the construction of such tax exemptions apply equally herein. It is well established in Utah that where a statute purports to create an exemption from the general application of a revenue law, such exemption provision is to be strictly construed against the one who asserts the claimed exemption. *Norville v. State Tax Commission,* 98 Utah 170, 97 P.2d 937.

The presumption is that all exemptions intended to be granted were granted in express terms and that language relied upon as creating an exemption must be clear so as to not admit reasonable controversy about its meaning. All doubts must be resolved against the exemption, and exemptions will not be aided by judicial interpretation. *Judge v. Spencer,* 15 Utah 242, 48 Pac. 1097; *Parker v. Quinn,* 23 Utah 332, 64 Pac. 961; *Elks v. Grosbeck,* 40 Utah 1, 120 Pac. 192; *Norville v. State Tax Commission,* 98 Utah 170, 97 P.2d 937.

Further support for the proposition of strict construction is found in the statute authorizing the commission to promulgate regulations governing consolidated returns. Sec. 59-13-23 (2) UCA 1953 provides in part as follows:

> "The Tax Commission shall prescribe such regulations as it may deem necessary in order that the tax liability of an affiliated group of . . . corporations making a consolidated return . . . may be determined, computed, assessed, collected and adjusted in such a manner as clearly to reflect the income *and to prevent avoidance of tax liability.*" (Emphasis supplied.)

Thus, in order to comply with the statutory mandate, the regulations should be interpreted in such a manner as to reflect the income of affiliated corporations and to prevent the avoidance of tax liability.

The Commission submits that because of the rule of strict construction an exemption cannot be granted to the Plaintiff in this matter where the entire regulation setting up an exemption has not been complied with.

CONCLUSION

While Regulation No. 4 does purport to exempt certain intercompany transactions, this exemption, if valid, cannot be broader than the regulation creating it. Plaintiff cannot qualify for the exemption because it made no timely election and because the dividend was not made during the consolidated return period from a member of the group affiliated with Plaintiff, all of which are required by the regulation as well as the statute.

Respectfully submitted,

PHIL L. HANSEN,
Attorney General

F. Burton Howard,
Special Assistant Attorney General

Attorneys for Defendant