Dir. of Income for Tax Purposes - K

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1972

KENNECOTT COPPER CORPORATION, a corporation, et al.,

Appellants,

-vs-

STATE TAX COMMISSION OF UTAH,

Appellee.

On Appeal from the Supreme Court of the State of Utah

JURISDICTIONAL STATEMENT

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At this juncture a subject index and tables of authorities cited should be included.

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This is an appeal from a State Court decision by Appellants Kennecott Copper Corporation and various other subsidiary corporations, namely Kennecott Communications Corporation, Bear Creek Mining Company, Kennecott Coal Company, Chase Brass and Copper Company, Inc., and Peabody Coal Company (formerly Kenbody, Inc.). The appeal is from a decision of the Supreme Court of the State of Utah rendered on January 24, 1972. (Rehearing denied April 14, 1972). Appellants submit this statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The opinion of the Supreme Court of the State of Utah affirming a previous decision by the State Tax Commission of Utah is not yet officially reported, is unofficially reported at 493 P.2d 632 and is set forth in Appendix "A". The Order of the Supreme Court of Utah, denying a Petition for Rehearing is not reported and is set forth in Appendix "B". The opinion of the State Tax Commission of Utah, which was reviewed and affirmed by the Utah Supreme Court is unreported. Its decision, consisting of Findings of Fact and Conclusions of Law is set forth in Appendix "C".

JURISDICTION

This proceeding involves the franchise tax liability of appellants in the State of Utah for the years 1967 and 1968. A deficiency was assessed against appellants by the Utah State Tax Commission, and a petition for redetermination of that deficiency was filed by appellants pursuant to Utah Code Annotated, Section 59-13-35 (1953). Following an adverse determination by the State Tax Commission, appellants processed the matter on petition for review to the Supreme Court of Utah pursuant to Utah Code Annotated, Section 59-13-46 (1953).

The judgment of the Supreme Court of Utah sought to be reviewed is dated January 24, 1972 and was entered on January 24, 1972. The Supreme Court of Utah denied a petition for rehearing on April 14, 1972. The notice of appeal to this Court was filed on May 10, 1972 with the Supreme Court of the State of Utah. A copy of that notice is attached hereto as Appendix "D".

The jurisdiction of the Supreme Court to hear this appeal rests upon 28 U.S.C. Section 1257(2) and jurisdiction is supported by the following decisions of this Court: Norfolk and Western Ry. Co., et al. v. Missouri State Tax Commission, 390 U.S. 317 (1968) and Butler Bros. v. McColgan, 315 U.S. 591 (1942). It is submitted that jurisdiction is particularly clear since the State Court ruled expressly on the validity of Utah's Uniform Act as challenged under both the Commerce Clause (Article I, Section 2 of the United States Constitution) and the Due Process Clause (Fourteenth Amendment to the United States Constitution). See Charleston Federal Savings and Loan Assn. v. Alderson, 324 U.S. 182, 185 (1944).

STATUTES, REGULATIONS AND CONSTITUTIONAL PROVISIONS INVOLVED

The Commerce Clause of the Constitution of the United States (Article I, Section 8, Clause 3), and the Due Process Clause of the Fourteenth Amendment are set forth in Appendix "E". The pertinent sections of the Utah Code Annotated are Sections 59-13-78 through 59-13-97 (Utah's enactment of the Uniform Division of Income for Tax Purposes Act), and Section 59-13-23. These are set forth in Appendix "F".

QUESTIONS PRESENTED

Utah has adopted the Uniform Division of Income for Tax Purposes Act (UDITPA) containing a now standard three factor formula (property, payroll and sales) for apportionment of an interstate taxpayer's income. Is this statute as applied to appellants repugnent to or violative of the Commerce Clause or the Due Process Clause of the United States Constitution when, in application of that Act, Utah has administratively deviated from that statutory formula, and devised a multi-form "separate accounting" method of apportionment as to appellants (a consolidated group of corporations conceded by the state to be a unitary business) and when such method of apportionment has the effect of:

(1) Subjecting to Utah tax an amount of income out of all reasonable proportion to the "business activity" of taxpayer in that state.

(2) Taxing extraterritorial values and assigning sales and activities to Utah which are within the jurisdiction of and are taxable by other states, in that for the years 1967 and 1968 taxpayer is being taxed on an approximated 300% of the income justified by the formula now prevalent in other states.

(3) Creating a cumulative tax burden on interstate commerce which exceeds that placed upon local commerce.

(4) Denying to an interstate business the right to file a consolidated tax return which right is enjoyed unrestrictedly by intrastate corporations, and

(5) Determining Utah's portion of the taxpayer's income through separate accounting methods applied to a unitary business, in a manner grossly inconsistent with prevalent methods of apportionment used in other states.

STATEMENT OF THE CASE

A. Material Facts

(1) The Taxpayer

Kennecott Copper Corporation is an interstate business engaged principally in the mining and processing of nonferrous minerals. Its corporate headquarters are in New York, and its principal mining activities are carried out in Utah, Nevada, Arizona and New Mexico. Kennecott has various wholly-owned subsidiaries, including the following, all of which actually conduct business in Utah: Kennecott Communications Corporation (a relatively insignificant company which carries out communications functions for the corporate group); Bear Creek Mining Company (the exploration arm of Kennecott); Chase Brass and Copper Company (a major fabricator and seller of nonferrous metal products); Peabody Coal Company (a major coal producer involved only in 1968); and Kennecott Coal Company (a relatively insignificant coal producer). (Appendix "C", pp.).

Not only is there total ownership by Kennecott of the subsidiaries, but there are strong functional and administrative ties between the various divisions and subsidiaries, both horizontally (e.g., product flow, equipment and personnel interchange) and vertically (e.g., coordinated and strong centralized management, benefits, accounting, etc.). These facts led the Tax Commission below to conclude that the companies constitute a "unitary business". (Appendix "C", pp.).

(2) The Tax Returns

The State of Utah imposes a franchise tax measured by income on corporations for the privilege of conducting business in Utah. Effective for the first time in 1967, Utah adopted the Uniform Division of Income for Tax Purposes Act (hereinafter UDITPA or Uniform Act), which provides for

the apportionment of business income of a multi-state corporation through a three factor formula consisting of property, payroll and sales (Appendix "F", p.). Taxpayer (meaning the affiliated group of corporations) for the years 1967 and 1968 filed its Utah franchise tax returns in admitted compliance with the terms of the UDITPA. The Supreme Court of Utah conceded this by noting:

> "Kennecott filed its franchise tax returns for the years 1967 and 1968 in accordance with the formula set forth in the 1967 Act." (Appendix A, p.).

The returns were consolidated pursuant to state law which creates an unrestricted privilege of consolidation in those corporate affiliates meeting the requirement (essentially 90% stock ownership). (Appendix "F", p.).

Essentially, the method of preparing the returns was to first compute "consolidated net income" (defined in the State regulations as the aggregate of the affiliates' gross income less the aggregate of the affiliates' deductions). Consolidated net income was then apportioned to Utah (after exclusion and specific allocation of passive or non-business income pursuant to the provisions of the Uniform Act) through the three factor formula, with the amount apportioned to Utah being proportionate to Utah's percentage of total property, payroll and sales. Utah's apportioned share of consolidated net income was 28% in 1967 and 23% in 1968.

(3) <u>The Administrative Deviation</u>

The Tax Commission of Utah (first through its Auditing Division and later as a body) determined that the three factor formula did not fairly reflect business activity in Utah and substituted its own method of apportionment pursuant to the "relief provisions" of the Uniform Act. (App. "F", §59-13-95). The method of apportionment adopted by the Commission can best be described as a hybrid form of separate accounting since it involves both separate

accounting features and formulary apportionment features. As to the parent corporation, Kennecott, the Commission in effect determined that the taxable entity was the Utah Copper Division, a division of Kennecott including the Utah mine and reduction facilities. Hence, an income figure for the division was extracted from the depletion schedules (a separate accounting figure) which income was, in turn, subjected to a three factor formula consisting of property, payroll and sales of Utah Copper Division only. Essentially, 100% of both property and payroll of this hypothetical entity were in Utah, but virtually none of its sales were in Utah. Hence, the Commission arrived at an apportionment percentage for Utah Copper Division of approximately 66% (the average of 100% payroll, 100% property and 0% sales). The same hybrid method was employed as to Tintic Division, a lead-zinc operation in Utah. The very substantial operations, property, payroll and sales of the parent in New York, Arizona, New Mexico and Nevada were simply excluded from the computations altogether, even though the Tax Commission held that taxpayer was a unitary business.

As to the other affiliated corporations, all of which had comparatively less significant operations in Utah, the Commission utilized a fairly orthodox three factor formulary approach, but effectuated an "unconsolidation" of the returns by departing from the "consolidated net income" approach and separately computing corporate income allocated to Utah for each of the affiliates on an individual basis. This was justified by the Commission on the ground that the UDITPA was not intended to apply to consolidated returns. (A necessary implication of which is that interstate taxpayers cannot consolidate their returns, whereas intra-state Utah corporations may).

The methodology of the State's apportionment of

income was highly unorthodox as applied to a unitary business, but even more objectionable was the result achieved. Utilizing the three factor formula in admitted compliance with the UDITPA, the taxpayer apportioned some 28% of its consolidated net income to Utah in 1967 and 23% in 1968. The State's method, as affirmed by a majority of the Utah Supreme Court, apportioned some 78% to Utah in 1967 and 69% in 1968.[1]

The majority of the Utah Supreme Court, with little real analysis of the issues presented, affirmed the Tax Commission's decision in a 3-2 decision. The dissent observed that the Tax Commission had administratively created a "new law" which applied "exclusively" to the taxpayer (Appendix A).

B. The Federal Questions Were Raised and Decided

The Utah Supreme Court, in its final decision in this matter, expressly considered the validity of the Uniform Act (as adopted in Utah, see Appendix F), as against the contention that said Act, as applied, was unconstitutional under the Constitution of the United States. This portion of the majority opinion is as follows:

> "Kennecott contends that the decision of the Tax Commission violated the provisions of the commerce clause (Article I, Sec. 8, Cl. 3) and the Fourteenth Amendment to the United States Constitution. The Utah act we are here dealing with does not seek to impose a tax upon income or business done outside the state of Utah. The act only seeks to impose a tax upon that portion of Kennecott's income which is derived from its business activity in this State. We

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[1]These percentages have been computed after eliminating all disputes between the parties as to the amount of total income. In the Court below, there were two such disputes involving the depletion deduction and federal income tax deduction. These disputes were resolved in the State's favor and, as they do not involve constitutional issues, they are not pressed further here. The percentages reported have been determined after giving full benefit to the State on these items.

> are of the opinion that the statute and the decision of the Commission do not infringe constitutional rights of Kennecott." .(App. A, p.)

The decision dealt expressly with both the validity of the Uniform Act itself and the decision of the Tax Commission in applying the Act, both as tested on federal constitutional grounds. In view of the applicable presumption under these circumstances [Charleston Federal Savings and Loan Assn. v. Alderson, 324 U.S. 183, 185 (1944)] we will only add briefly that these constitutional issues were raised at all stages before both the Tax Commission and the Utah Supreme Court including arguments that the Uniform Act, as applied here, was unconstitutional under the Commerce Clause of Article I, Section 2 of the United States Constitution (see page 41 of taxpayer's original brief before the Utah Supreme Court), and that the assessment itself was violative of the Commerce Clause and the Due Process Clause of the Fourteenth Amendment (see page 88 of taxpayer's original brief before the Utah Supreme Court). The federal constitutional questions were also ruled upon expressly by the Tax Commission (see Conclusion of Law No. 12, Appendix C).

THE QUESTIONS ARE SUBSTANTIAL

The instant case clearly and squarely presents extremely important constitutional issues regarding the taxation of a multistate taxpayer. The following argument will discuss, first, the merits of appellant's position (in Section 1 dealing with the apportionment issues and Section 2 dealing with the consolidated return issues), and will conclude with a discussion regarding the substantiality and national importance of the issues presented.

Section 1 -- The Uniform Act as applied by the State Tax Commission and approved by the Utah Supreme Court is unconstitutional.

While this Court has historically been hesitant to interfere in matters of state taxation, it has had periodic occasion to demonstrate its "concern. . . that state taxes imposed on income from interstate commerce be fairly apportioned." [General Motors Corp v. District of Columbia, 380 U.S. 553, 560 (1965)]. While the test has not been stringent, at a bare minimum a state has been required to use an apportionment method which has a "modicum of reasonable relation to corporate activities within the state." [General Motors Corp. v. District of Columbia, 380 U.S. 553, 561 (1965)]. The method of determining Utah's share of taxable income, approved by the Court below, is in conflict with this Court's decisions both in terms of the method used and the result reached.

(a) Methodology - The critical facts which are not in dispute are that Kennecott and its affiliated corporations doing business in the State of Utah constitute a "unitary business". It is also undisputed that the taxpayer (referring to the consolidated group) filed its tax return in admitted compliance with the three factor formula as specified in the UDITPA. The state deviated from its own "uniform" statutory formula and imposed a separate accounting method as to the parent corporation, resulting in approximately three times as much apportioned income as would have been justified by the formula.

It is recognized that this Court has never attempted to specify any single appropriate method for apportionment and such relief is not here requested. It would seem apparent, however, that a business held to be unitary has the right to be taxed in a way which recognizes the unitary characteristics of the business since the imposition of separate accounting on such a business is both economically unsound and completely inconsistent with the

methods of apportionment utilized by other states.

It is clear that a method of apportionment must be "fairly calculated" to assign to the taxing state a percentage of income "reasonable attributable" to the taxpayer's activities in the state. Butler Bros. v. McColgan, 315 U.S. 501, 503 (1942). Separate accounting as applied to a unitary business cannot be depended upon or expected to produce a fair result. As noted in Hans Rees' Sons, v. North Carolina, 283 U.S. 123, 133 (1931):

> "Undoubtedly, the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." (Emphasis added)

This concept was further developed in Butler Bros. v. McColgan, 315 U.S. 501 (1942), wherein it was held that a state may use formulary apportionment to reach a share of the total corporate income of a unitary business, even though on a separate accounting basis the taxpayer demonstrated a loss in the taxing state. In so holding, this Court recognized that separate accounting is an inherently unrealistic method to determine the income of a unitary business.

> "In either aspect of the matter, the results of the accounting system employed by appellant [a separate accounting method] do not impeach the validity or propriety of the formula which California has applied here [an apportionment formula]." (315 U.S. at 508)

Since Butler Bros., it has been clear that a unitary business had no right to insist that its income be determined through a separate accounting method. We seek here to establish the converse proposition -- that a state may not impose separate accounting on an admittedly unitary business. This Court has never directly ruled on the question, although numerous state courts have so held, primarily relying upon Butler

Bros v. McColgan., e.g., Crawford Manufacturing Co. v. State Commission of Revenue and Taxation, 180 Kan, 352, 304 P.2d 504 (1956); Superior Oil Co. v. Franchise Tax Board, 34 Cal.Rptr. 545, 386 P.2d 33 (1963); Western Contracting v. State Tax Commission, 18 Utah 2d 23, 414 P.2d 579 (1966).[1]

The State of Utah here has forced an admittedly unitary business on to a separate accounting method of taxation. Since the taxpayer has been held to be unitary and by definition "all the factors in that enterprise are essential to the realization of profits", it can be soundly concluded that the method of apportionment utilized here was not "reasonably calculated" to assign to the State of Utah that portion of the net income "reasonably attributable" to the business done there.

In terms of the values protected by the Commerce Clause, the simple matter of consistency among states requires that a unitary business be taxed as such. As noted in the Willis Subcommittee Report:

> "State tax administrators differ somewhat in their conclusions as to what kinds of business are unitary and what kinds are not, but it is almost universally true that they are extremely reluctant to permit the use of separate accounting in the case of a business deemed 'unitary'".[2]

Utah is obviously out of step with this national treatment of multi-state taxpayers, and this sheer inconsistency

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[1]The Supreme Court of Utah in Western Contracting completely embraced the proposition that separate accounting cannot be applied to a unitary business only to hold, in the instant case involving the largest taxpayer in the state, that the administration was free to impose separate accounting on a unitary business.

[2]Special Subcommittee on State Taxation of Interstate Commerce, House Committee on the Judiciary, 88th Cong., 2d Sess., State Taxation of Interstate Commerce, H.R. Rep. No. 1480 at p. 167. Cited and referred to hereinafter as "Willis Report".

raises prominent constitutional ramifications, as noted in General Motors v. District of Columbia, 380 U.S. 553, 560 (1965).

> "In any case, the sheer inconsistency of the District formula with that generally prevailing may tend to result in the unhealthy fragmentation of enterprise and an uneconomic pattern of plant location, and so presents an added reason why this Court must give proper meaning to the relevant provisions of the District Code."

The inconsistency of Utah's method is more than academic as may readily be seen by comparing the instant decision with that in Chase Brass and Copper Company v. Franchise Tax Board, 7 Cal.App.3d 99, 86 Cal.Rptr. 350 (1970), appeal dismissed and cert. denied, 400 U.S. 961 (1970). There, the California Court of Appeals extended the unitary business-combined return approach to reach Kennecott's earnings through its subsidiary, Chase Brass. It is obvious that this is completely inconsistent with Utah's separate accounting approach, and a comparison of the two cases will demonstrate a classic case of a single taxpayer being whipsawed by two states, each in its desire to maximize revenues.

As clearly illustrated in the instant case and Butler Bros. (where separate accounting showed a loss in California of $82,000 and the unitary formula approach apportioned a $95,000 profit), the two methods will produce widely disparate and completely contradictory results. Hence, for even a modicum of consistency to exist the ruling in Butler Bros. must have bilateral application and either a state or a taxpayer should be precluded from using separate accounting as applied to a unitary business in the absence of "clear and cogent" reasons. Otherwise, the unitary taxpayer will be taxed inconsistently resulting in inequities, multiple taxation, and gross disparities in

the overall pattern of state taxation.

(b) Result - Not only is separate accounting, per se, unreasonable here but the use of that method has produced an entirely unsupportable result.

It is fundamentally clear that under both the Commerce Clause and the Due Process Clause an apportionment or allocation of a multistate taxpayer's income for tax purposes must be reasonably proportionate to the "business activity" of the taxpayer in the taxing state and the income so apportioned must be "reasonably attributable" to the business done there. Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931), Butler Bros. v. McColgan, 315 U.S. 501 (1942). It has been further suggested, but not held in a constitutional context by this Court, that a method of taxation which is grossly inconsistent with those prevailing in other states is of dubious validity, General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965). The method of apportionment imposed by Utah here is completely disproportionate and unrelated to the taxpayer's business activities in Utah, and moreover, it is irreconciliably inconsistent with the prevalent methods of allocation or apportionment used by other states.

As to the mechanics of measuring business activity, there is compelling reason to conclude that the appropriate ingredients in this case are the traditional factors of property, payroll and sales. Not only are these almost universally recognized by other states, but in addition, the Utah State Tax Commission itself has conceded their relevance by utilizing these three factors (as applied to a separate accounting figure) itself. No claim has been made below that these three factors were not appropriate or that additional factors should be added.

If these factors are used, it is clear that the

net result of Utah's assessment here reaches far beyond its borders and taxes extraterritorial values. In admitted compliance with the UDITPA, taxpayer arrived at an apportionment percentage of 28% for the year 1967 and in accordance with the UDITPA, 28% of the consolidated net income was apportioned to Utah. In stark contrast, the State of Utah is seeking to tax 78% of consolidated net income for the same year. The state has arrived at this absurdly higher percentage primarily through use of its separate accounting approach to the parent corporation. The figures for 1968 are equally disparate: 23% of the taxpayer's property, payroll and sales were located in Utah, but the State has claimed the right and jurisdiction to tax 69% of taxpayer's total income. Disparities of equal or lesser magnitude have been completely condemned by this Court in Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, and Norfolk and Western Ry. Co. v. Missouri State Tax Commission, 390 U.S. 317 (1968).

The concept that the taxation here far exceeds business activity in Utah was not seriously questioned below but has simply been ignored by both the Tax Commission and the Supreme Court of Utah. The Tax Commission itself made a finding that even if gross receipts from products mined in Utah were apportioned to Utah (contrary to the UDITPA, but the maximum conceivable apportionment to Utah), it would result in "business activity" in Utah of 41.7% in 1967 and 33% in 1968 (App. p.). The Commission neglected to mention how, then, it was justified in taxing 78% and 69% of the taxpayer's income for the same years. Its decision, and that of the Supreme Court as well, can only be interpreted to mean that business activity in Utah is irrelevant in apportioning income.

At a minimum, if a state is going to apportion income to itself which equals 300% of the actual business

activity in the state, it should demonstrate by "clear and cogent evidence" why it should be permitted to do so. (See Western Contracting v. State Tax Commission, 18 Utah 2d 23, 414 P.2d 569 (1966); Butler Bros. v. McColgan, 315 U.S. 501 (1942). Particularly is this true where the state itself has deviated from its own "uniform" statutory method of apportionment. One will search the record in vain for such explanation here. The Tax Commission's decision below attempted to excuse the state's overreaching by pointing to two items -- first, it was claimed that sales of copper and other minerals, mined in Utah but sold and delivered elsewhere, should be apportioned to Utah, whereas under the Uniform Act, the sales were apportioned on a destination basis. This rationale is wholly inappropriate (as it ignores the legislative attribution of sales to destination states which have clear jurisdiction to tax those sales), but even were it an appropriate rationale, it would not justify the State's method. (If the sales of all taxpayer's Utah products were reallocated to Utah in the sales factor, it would only result in an average apportionment to Utah of 41% in 1967 and 33% in 1968 -- still not near enough to justify taxation of 78% and 69%, respectively, of taxpayer's income in those years.) The only other "justification" claimed was that the depletion computation of "net income from the property" was much higher than taxpayer's allocated income and that this somehow justified abandonment of the formula. This is simply a case of saying that separate accounting (the depletion figure) would produce more revenue in Utah than does the formula, -- an obviously irrelevant argument as applied to a unitary business. [Butler Bros. v. McColgan, 315 U.S. 501 (1942)]. Moreover, the very depletion figures relied upon in this analysis were rejected by both the Tax Commission and the Utah Supreme Court (a decision which is now final).

Although the Utah Tax Commission and Supreme Court seemed clearly inclined to view Utah as a sovereign nation, unbridled by constitutional limitations on its taxing power, this Court has had occasion to condemn methods of taxation, such as that here, which are seriously at variance with those prevalent in the "overall pattern of taxation of income derived from interstate commerce." General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965). If, as admitted, the Uniform Act would allocate but 28% of taxpayer's income to Utah in 1967, it follows that 72% of the income is attributable to other states which have every right and full jurisdiction to tax the income so apportioned, since such states can lay claim to property, payroll and sales in their respective jurisdictional spheres. In other words, if Utah is taxing 300% of its fair share of income, as determined by the factors of property, payroll and sales, it follows, almost by definition, that the 200% overage is also taxable by other states, which almost universally use the same factors for apportionment. We know of no valid argument which this taxpayer could make in those other states to persuade them that they should somehow defer to Utah's bizzare method of apportionment. Utah's answer to this dilemma was typified by a question posed from the bench during oral argument before the Supreme Court -- Justice Ellett inquired of counsel:

> "How do we know it is Utah, rather than the other states, which is taxing more than its share?"

The answer, implicit in the foregoing discussion, is the same to the question "How do we know it is Johnny, rather than the other 49 soldiers, who is out of step?"

Section 2 -- Consolidation

The other facet of the case is the matter of consolidated returns. Ordinarily, whether or not a group of affiliated corporations may file a consolidated return would

simply be a matter of state law with no federal constitutional ramifications. Here, however, because of the peculiar treatment of an interstate taxpayer, a serious commerce clause question is raised.

Utah law grants a privilege to affiliated corporations to file consolidated returns. (See Utah Code Annotated 59-13-23, in Appendix). There is no dispute that the taxpayer met the requirements of the statute (90% stock ownership). The regulations of the Tax Commission defined "consolidated net income" as:

> "The aggregate of the gross income of each of the includable corporations less the aggregate of the allowable deductions of... such corporations...."

Taxpayer filed in accordance with the consolidated return provisions and computed consolidated net income as required by the regulations. This income, as a unit, was then apportioned through the three factor formula to Utah. The Tax Commission refused to allow apportionment of consolidated income and, in effect, deprived taxpayer of the benefit of consolidation by separately computing corporate income for each affiliate and separately apportioning the income of each corporation to Utah.

The explanation for this "unconsolidation" is contained in Conclusion of Law No. 8 (Appendix) which says:

> "The Uniform Division of Income for Tax Purposes Act contemplates apportionment by a single taxpayer and not a group of taxpayers. Apportionment must occur separately for each taxpayer or else the Act would have allowed group aggregation or spoken of taxpayers in a plural sense."

Not only is this patently incorrect,[1] but it evokes a clear

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[1]The official comments to the Uniform Act under Section 16 expressly and approvingly refer to the use of consolidated returns.

discrimination against multistate businesses. Since the UDITPA applies only to those businesses in interstate commerce, this finding necessarily results in a discriminatory treatment of interstate taxpayers (who are effectively denied the benefits of a consolidated return) and in favor of strictly intrastate affiliated corporations which are free to consolidate since the Uniform Act has no application to them whatsoever. We contend that the act, so interpreted, is in patent violation of the Commerce Clause.

The matter of consolidated returns has additional significance on a broader scale. Just as the states have had to cope with the unitary business -- separate accounting dichotomy on a single corporate level, so now are they coming to grips with the problems presented by multi-corporate affiliates. Thus, as the unitary business concept was used in Butler Bros. to cross state lines to reach "unitary profits", so now corporate lines too have been crossed using the unitary business concept. This is exemplified by the Chase Brass case, 7 Cal.App.3d 99, 86 Cal.Rptr. 350 (1970), app. dis. cert. den. 400 U.S. 961 (1970) in which the income of Kennecott Copper (which did not conduct business in California) was taxed by applying an extension of the unitary business concept through Chase Brass and Copper, a subsidiary held to be unitary with the parent. If California has a right to tax affiliated corporations as a unitary business, do not those same corporations also held in Utah to be unitary, have a clear right to be taxed as such in Utah? We need not, and do not argue that a unitary taxpayer has the right to force a state to tax it on a combined return method, but we do submit that, at least where there is a state statute clearly allowing consolidation and the state itself has held the corporate affiliates are a unitary business, it is completely illogical for the state to refuse to tax the affiliates as such.

Although this Court has never had occasion to deal with this problem specifically, it would seem clear that the values of consistency [as set forth in General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965)] the economic realities of a unitary business (as spelled out in Butler Bros. v. McColgan), and the avoidance of disparate treatment of the same taxpayer (compare the instant case with Chase Brass and Copper Company v. Franchise Tax Board, 400 U.S. 961 (1970)), would all lead to the conclusion that both the Due Process Clause and the Commerce Clause should prevent the actions here taken by Utah. Particularly is this true where the state's justification for denying the privileges of consolidation so obviously results in discriminatory treatment of an interstate taxpayer.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL AND NATIONAL IN IMPORT

(1) This case is presented at a time and in a context which creates considerable national concern. For many years, there has been a great hue and cry in this country for uniformity in methods of state taxation of interstate commerce. A congressional report on the subject in 1964 stressed the need for federal legislation and concluded that the situation then was "chaotic".[1] As a result, there have been various bills introduced in Congress to regulate this area and simultaneously strip the states of much of their sovereignty in matters of taxation.[2]

But the situation has changed markedly since 1964, and the states have taken widespread and responsible actions to achieve uniformity. The keystone of this effort has been the UDITPA. In 1964, when the Willis Subcommittee professed such pessimism, there were only 3 states of 38 having a corporate income tax which had enacted the Uniform Act.

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[1] Willis Subcommittee report, p.

[2]

(Willis Subcommittee Report, p. 133). Today, and largely in an effort to prevent federal interference in the area, 24 states and the District of Columbia have now substantially adopted the provisions of the UDITPA. (P-H All States Tax Reporter ¶1046). Virtually all states use the three factor formula of property, payroll and sales in one form or another (of 46 states reported, all but 5 use those three factors -- P-H ¶1046). This trend toward uniformity was given considerable weight by this Court in General Motors Corp. v. District of Columbia in 1965, when the trend was yet embryonic as compared with the present situation.

Congress has yet to enact any law dealing with state taxation of interstate commerce, except for Public Law 86-272 (15 U.S.C. §381-84) which does not deal with apportionment, and there is sound reason to conclude that Congress will not act in view of the considerable improvements which have been made by the states themselves in enacting uniform apportionment statutes.

Thus, it now appears that the Uniform Act will play a central role in resolving the inequities, inconsistencies and dangers of over and under taxation which were observed to exist in 1964. It can only have that beneficial result, however, if it is administered fairly and uniformly. As noted by certain commentators:

> "The great attractiveness of the UDITPA is in the 'U'. It is a uniform statute. It is widely adopted. Any state deciding to adopt an income tax law or to change an existing tax law could use UDITPA as a model and then avoid any of its alleged pitfalls by adopting clear regulations. It would have to find remarkably strong reasons for not following the UDITPA approach."[1]

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[1] Sarver and Hynes, Proposal for a Uniform Regulation on Business Income under IDITPA, 22 Hastings, L.J. 31 (1970).

The instant case could well be crucial in this situation since it is the first case to reach a state's highest court involving an interpretation of the so-called "relief provisions" of the UDITPA (which allow deviation from the formula in the event it does not "fairly reflect business activity" in the taxing state.)[1] Knowledgeable authorities have urged that these provisions must be applied narrowly and only in highly exceptional cases:

> "There are completely compelling reasons for giving the relief provisions a narrow construction. Under a broad construction the purposes of obtaining uniformity through the adoption of the Uniform Act would be defeated. If a choice of methods is permitted, different administrators in different states inevitably will choose different methods. As a result, even if all the states imposing taxes on or measured by income should adopt the Uniform Act, the chaotic condition heretofore existing would continue to exist."[2]

The dissent in the instant case agreed with this approach and observed:

> "...to achieve uniformity and to prevent taxation of extraterritorial income the relief provisions of the act should be narrowly construed."

Notwithstanding the foregoing and the stated purpose of the Uniform Act, the majority of the Utah Supreme Court have seemingly given the tax administrator a carte blanche to disregard the "uniform" formula and impose, in its stead, a highly unorthodox method of apportionment. If this decision is allowed to stand, it will become a precedent which could significantly and completely emasculate the benefits of the uniform legislation in this field. Thus, we submit that the case has ramifications echoing far beyond the taxpayer's pocketbook and Utah's coffers. It serves as an open

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[2] Keesling and Warren, California' Uniform Division of Income for Tax Purposes Act, 15 UCLA L.Rev. 156 at 171 (1967).

invitation for tax administrators to deviate from the Uniform Act, and will certainly "chill" the enthusiasm of taxpayers in challenging such deviations.

(2) It is time for a current pronouncement by this Court on the subject of multistate taxation of corporate income. Even though the matter of fair apportionment of multistate income is clearly of central importance in our federal system and this Court has had occasion to express its "continuing concern for fair apportionment" (General Motors v. District of Columbia, 380 U.S. 553), the decisions dealing with the subject have been few and far between. Not since 1931 (in Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123,) has this Court stricken an apportionment method in an income tax case on constitutional grounds. Butler Bros. v. McColgan, 315 U.S. 501, was announced in 1942 and was the last apportionment case on income taxation to be decided on constitutional grounds by this Court. General Motors v. District of Columbia, 380 U.S. 553), although stating some new and extremely significant approaches to the problem is not clear precedent on the constitutional issues as it was decided on statutory grounds only. Its import is hence unclear as is further evidenced by the fact that the majority decision of the Supreme Court of Utah cited the case in support of its holding that the federal Constitution was not violated here.

General Motors v. District of Columbia, 380 U.S. 553, expressly recognized, for the first time, that in measuring the validity of an apportionment method the method in question must be compared with those prevailing elsewhere to determine its impact on the overall pattern of taxation. The precise issue, i.e., total and sheer inconsistency, is before the Court in this case in a clear constitutional setting, and it is plainly desirable in view of the values to be preserved

by the Commerce Clause that this issue be dealt with in this context by the Court so that the precedential impact of General Motors will be made abundantly clear to the states.

(3) There is an inconsistency between the decisions of the lower courts. The inconsistency is more dramatic than most as it involves disparate treatment of the same taxpayer by two states -- California and Utah. In the case under consideration, Utah, although holding Kennecott, Chase Brass and other affiliates to be unitary, has imposed a separate accounting approach on the parent corporation, and has required separate taxation of the affiliates. In stark contrast, California in Chase Brass and Copper Company v. Franchise Tax Board, 400 U.S. 961 (1970), has accomplished exactly the opposite result. California has ruled that Chase and Kennecott are unitary, and even though the parent, as such, does not conduct business in California, that state has taxed the parent's income through the combined return, unitary business approach.

The resultant inconsistency is a classic reason why this Court should give plenary consideration to the case, having declined to do so in the California litigation. The taxpayer, held to be a unitary business, is being whipsawed between two states' desires to extract more revenues. California claims that it is justified in pushing the unitary business concept to a point where it taxes the income of Kennecott (some of which is earned in Utah), and yet Utah, in order to enhance its revenues, declines to tax the same taxpayer as a unitary business, imposes separate accounting on the parent, and refuses to allow consolidation of the returns, even though California, in effect, requires it. The only appropriate forum for relief is this Court.

In a microcosmic manner, the California-Utah disparity demonstrates clearly the need for a current and strong

pronouncement by this Court on the subject of multistate taxation. If the Utah decision is allowed to stand and becomes viable precedent for others to follow -- there will exist a situation which attacks the very raison d'etre of the Commerce Clause. In these times when state revenues are thinly stretched to provide governmental services, there is a clear temptation for the States to push constitutional niceties aside in order to maximize revenues. Juggling methods of apportionment is one obvious way that states may accomplish this expedient result since, as seen in both the instant case and Butler Bros., the difference between separate accounting and formulary apportionment often may mean a multifold difference in tax revenues.

CONCLUSION

Jurisdiction exists and substantial questions are presented; probable jurisdiction should be noted and the case should be given plenary consideration.

Respectfully submitted,

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