Allocation of Business Income for State Income Tax Purposes

William W. Watson

Follow this and additional works at: https://scholarship.law.umn.edu/mlr
Part of the Law Commons

Recommended Citation
https://scholarship.law.umn.edu/mlr/2532

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
ALLOCATION OF BUSINESS INCOME FOR STATE INCOME TAX PURPOSES

By William W. Watson*

A manufacturing company incorporated in one state has its factory in another. It purchases all its raw materials in a third state. Its officers live in a fourth state, from which the business is controlled and managed. The company's only sales office, from which all deliveries are made, is in a fifth, in which all customers reside and all sales are consummated. The company operates as an integral unit. By reason of the location of the factory within its borders one state claims the net income of the company is taxable by it. Another claims the net income taxable by it because purchases of raw materials are made there. A third claims that the management of the business from within the state also justifies taxation of the company's net income. A fourth claims that the sales activities within the state justify income taxation by it.¹ The manufacturing company claims that it is not tax-

¹The first state claims the company's entire net income also taxable by it because of the company's incorporation under its laws. With respect to this claim no question of allocation is raised. Instead there is that of the power to tax income from extra-state sources. Whether there is such power over domestic corporations or resident individuals is not within the scope of this article. For cases which uphold the power of the state of incorporation to tax income earned in business outside the state see Crescent Manufacturing Co. v. South Carolina Tax Comm'n, (1924) 129 S. C. 480, 124 S. E. 761 and State v. Gulf, M. & N. R. Co., (1925) 138 Miss. 70, 108, 104 So. 689, 693 (income from business done both within and without the state taxed); Porto Rico Coal Co. v. Edwards, (S.D.N.Y. 1921) 275 Fed. 104 (U. S. corporation taxed by federal government on income from business done exclusively in Porto Rico); Porto Rico Mercantile Co. v. Gallardo (C.C.A. 1st Cir. 1925) 6 F. (2d) 526, 529 (dictum); and Montag Bros. v. State Revenue Comm'n, (1935) 50 Ga. App. 660, 664, 179 S. E. 563, 565. The United States Supreme Court apparently has not, as yet, finally passed upon this question. Residents have been taxed on income from business outside of the state. Lawrence v. State Tax Comm'n of Miss., (1932) 286 U. S. 276, 52 Sup. Ct. 556, 76 L. Ed. 1102, 87 A. L. R. 374 (resident of Mississippi taxed on income from construction business in Tennessee); Head v. Maxwell, (1939) 60 Ga. App. 488, 4 S. E. (2d) 45 (resident partner taxed on income from firm business carried on entirely outside the state); State v. Weil, (1936) 232 Ala. 578, 168 So. 679, affirmed on rehearing in (1939) 237 Ala. 293, 186 So. 467 (resident partner taxed on income from business carried on partly outside the state); People ex rel. Woolworth v. State Tax Comm'n, (1922) 200 App. Div. 287, 192 N. Y. S. 772. In other states the right to tax residents on extra-state income has, as a matter of construction, been denied: State ex rel. Arpin v. Eberhardt, (1914) 158 Wis. 20, 147 N. W.
able in any of the states mentioned. It contends that it is entitled to a separate accounting, that such accounting shows that its operations are carried on at a loss in all states except the fifth state; that the constitution of that state prohibits income taxation; that, should a separate accounting be denied by any of the other states, then a meritorious case is presented for the application of an "equitable" apportionment; and that an apportionment formula, if applied by these states, would be unconstitutional as taking property without due process of law.

This dispute between the taxpayer and its sovereign involves statutes which in the states mentioned might impose a tax with respect to foreign corporations upon net income from "business transacted," "carried on," or "done," within the state, or from "sources within the state." Where the business is conducted in more than one state a method of allocation is usually set forth in these statutes for determining the portion of net income attributable to business within the state. This allocation may be by apportionment formula, by separate accounting, or by "equitable" apportionment. If the business is located entirely within the

1a See subdivision II, C of this article entitled, "Allocation by Equitable Apportionment."

2To St. Augustine who, in De Civitate Dei, said, "If there be no justice, what are kingdoms but great robber bands?" the taxpayer would argue there was no justice. Clapp v. Heiner, (C.C.A. 3rd Cir. 1931) 51 F. (2d) 224, 226 might be quoted in the argument: "The appeal to conscience made by the taxpayer might be answered generally by saying that in taxation that guide has little if any place."

3Some states permit an allocation where income is from "business transacted in part within and in part without" the state. Colorado, Laws 1937, ch. 175, sec. 16; Kansas, Gen. Stat. 1935, sec. 79-3202; see New
state or entirely without the state, no problem of allocation is raised. The entire income would be taxed or none. Likewise no problem of allocation would have been raised had the company carried on a separate business in each of the states or had the company’s activities been of a type which could not be described as a business or trade.

I. ALLOCABLE INCOME

Primarily the problem of allocation is to attribute to one or more of several business functions a portion of that net income which results from the integrated conduct of them all. Thus, 

Mexico, Laws 1933, ch. 85, sec. 31(b). A few use the phraseology trade or business "carried on partly within and partly without" the state. Iowa, Code 1939, sec. 6943.065(1); Kentucky Statutes (Carroll 1936) sec. 4281b-32(2); Maryland, Laws 1939, ch. 277, sec. 12-246(b); Minnesota, Mason’s 1940 Supplement, sec. 2394-25(A); North Dakota, Compiled Laws, Supp. 1925, sec. 2346a(2). Others refer to "business done" within and without the state. Georgia, Code, sec. 92, 3113(a) as amended in 1937; Oklahoma, Statutes Supp. 1936, sec. 12498(a); Vermont, Public Laws, 1933, sec. 888. The statutes in still another group of states refer to taxpayers "engaged in business within and without" the state. Arizona, Rev. Code Supp., sec. 3182x; South Dakota, Code 1939, sec. 57.2707; Wisconsin, Statutes 1939, sec. 71.02(3) (d). Finally a number of states permit an allocation of income if derived "from sources (partly) within and (partly) without" the state. Arkansas, Statutes (Pope 1937) sec. 14038; California, General Laws (Deering 1937) sec. 8494(7)(f); Idaho, Code 1932, sec. 61-2416; Louisiana, Gen. Stat., Supp. 1938, sec. 888.34(b); Mississippi, Code, Supp. 1938, sec. 1614(c).

In the following states statutes provide for the taxation of the entire net income of businesses conducted wholly within the state: Arkansas, Statutes (Pope 1937) sec. 14038; Georgia, Code 1933, sec. 92.3113(b), as amended in 1935; Iowa, Code 1939, sec. 6943.065(1); Kentucky, Statutes (Carroll 1936), sec. 4281b-32 (2); Maryland, Laws 1939, ch. 277, sec. 12-246(b); Massachusetts, General Laws, ch. 63, sec. 41(d); Minnesota, Mason’s 1940 Supplement, sec. 2394-23(c); New Mexico, Laws 1933, ch. 85, sec. 31(a); North Dakota, Compiled Laws, Supp. 1925, sec. 2346a(2); Pennsylvania, Purdon’s Statutes supp., tit. 72, sec. 3420b; Vermont, Public Laws 1933, sec. 888; Virginia, Tax Code, sec. 54.

The statutes referred to in note 8 above use the words “business” or “trade” in the singular, and thus permit an allocation only of the income from a single business. The few states which use the word “sources” may be construed as having a similar meaning. But see Interstate Bond Co. v. State Revenue Comm’n of Ga., (1935) 50 Ga. App. 744, 179 S. E. 559. A single business is referred to hereafter as a unitary or integral one.

The great majority of statutes in note 8 above refer to income from “business” or “trade and business,” thus limiting an allocation to such types of income. Those statutes which refer to income from “sources” within and without the state may be construed to have an equivalent meaning. But see Interstate Bond Co. v. State Rev. Comm’n of Ga., (1935) 50 Ga. App. 744, 179 S. E. 559.
the income of the manufacturing company may be said to result from its combined manufacturing, selling, buying and managing activities. For tax purposes this income must be split up and a portion assigned to factory operations, a portion to selling activities, a portion to buying activities and a portion to management. Obviously, there are no a priori rules for making this segregation. The legislatures and the courts are guided principally by ideas of fairness. The application of these ideas is restricted to the allocation of income from an integral multi-state business. Income, if not derived from business, or if from a business within one state or if from dissociated businesses in separate states, is not subject to allocation. These three limitations are clear in principle. They deserve consideration in greater detail.

A. Business Income.—Only business income may be allocated. Income from personal services, from isolated sales, rentals, royalties, interest, and dividends is assigned a taxable situs under principles different from those controlling with respect to business income. Distinctions of definition are of consequent importance.

1Gorham Manufacturing Co. v. State Tax Comm’n, (S.D.N.Y. 1921) 274 Fed. 975. At page 978 Judge Learned Hand said: “The case in this aspect presents the not wholly unfamiliar difficulty of trying to apportion quantitatively the effect of a number of factors each of which is an absolute condition of the result. In such a case there is no rational solution which will bear scrutiny, and one must proceed by a more or less rough division not too shocking to preconceived assumptions.” Pertinent to add is a statement of Mr. Justice Holmes, “In the law we only occasionally can reach an absolutely final and quantitative determination. . . . But it is the essence of improvement that we should be as accurate as we can.”

The income of a taxpayer, for example, engaged in the garage business in one state and in the grocery business in another is not subject to allocation although the taxpayer is, in fact, engaged in business in both states.

Income from personal services may, for example, be taxed in various states. The domiciliary state may tax. State ex rel. Lerner v. Wisconsin Tax Comm’n, (1933) 213 Wis. 267, 251 N. W. 456; Colchensky v. Oklahoma Tax Comm’n, (1939) 184 Okla. 207, 86 P. (2d) 329; see Lawrence v. State Tax Comm’n, (1932) 286 U. S. 276, 52 Sup. Ct. 556, 76 L. Ed. 1102, 87 A. L. R. 374 (state may tax person domiciled therein on income earned in the construction of highways outside the state). Income from personal services may also be taxed by the state in which they are earned. Travis v. Yale and Towne Mfg. Co., (1919) 252 U. S. 60, 40 Sup. Ct. 228, 64 L. Ed. 460; People ex rel. Troy v. Graves, (1937) 275 N. Y. 599, 11 N. E. (2d) 773; Hughes v. Spaeth, (1940) 207 Minn. 577, 292 N. W. 194; see Atkinson v. State Tax Comm’n, (1937) 156 Or. 461, 67 P. (2d) 161. A taxpayer residing in one state and working in another has been taxed on the same income by both states. Hughes v. Wisconsin Tax Comm’n, (1938) 227 Wis. 274, 278 N. W. 403; Dromey v. Wisconsin Tax Comm’n, (1938) 227 Wis. 267, 278 N. W. 400. If the taxpayer neither resides within the state nor earns any income within the state during the taxable year, he is not subject to income taxes. See
ALLOCATE OF BUSINESS INCOME

Generally the sale of an individual’s time, effort or ability produces income which may be described as that from personal services. If merchandise is regularly being sold, a business income may be said to be earned. If “services” are performed by the operation of a plant, business income may likewise be said to result.

A stock or real estate broker who limits his activities to the solicitations of buy or sell orders is rendering personal services. On the other hand, a dealer engaged in buying and selling stock or real estate is in business. An accounting firm which employs several assistants on a salary basis is not engaged in business.


People ex rel. Stafford v. Travis, (1921) 231 N. Y. 339, 132 N. E. 109, 15 A. L. R. 1319 (commission merchant engaged in the buying and selling on his own credit of cotton goods assumed to be earning a business income).

Jorgenson-Bennett Manufacturing Co v. Knight, (1928) 156 Tenn. 579, 3 S. W. (2d) 668, 60 A. L. R. 393. (That income from “services rendered . . . in kiln-drying, surfaced and resawing lumber” was from business was assumed without discussion.)

Wisconsin Tax Commission in 1924 ruled that a resident broker was there taxable on income from his Chicago “business.” Wisconsin C. C. H. and P. H. Tax Services, pars. 10-809.19 and 11,119. Compare Appeal of Kenly, (Wisconsin Tax Comm’n, March 24, 1932) Wis. C. C. H. Tax Service, par. 10-813.03.

In a ruling of the Wisconsin Tax Comm’n, (1926) in par. 11,157 of P. H. Wis. Tax Service it was held there must be an allocation of the income of a taxpayer engaged in the business of selling and underwriting bonds. See Art. 23-1 of 1940 Minnesota Regulations in Minn. C. C. H. Tax Service, par. 14-725.

See Yalden v. Commissioner, (1930) 20 B.T.A. 372, involving the earned income credit of an accountant under sub-sections (3) and (4) of sec. 25(a) of the Revenue Act of 1938 and prior years (capital
On the other hand, the commissions of a general sales agent who employs sub-agents and maintains an office constitute business income, notwithstanding the fact that the commissions of agents are generally considered income from personal services. The income of a general agent of a life insurance company probably also may be considered to be from business rather than from personal services. In some states income, to be from personal services, must not only be derived from the performance of services, but also must be from services with respect to which neither capital nor labor are material income producing factors. In held not a material income producing factor where $22,062.56 of $44,838.00 gross receipts was expended for salaries. The accountant employed four auditors, an assistant auditor, typist and other office help. See also IX-1 C. B. 121 reaching the same result with respect to physicians and attorneys employing assistants. In Appeal of Tower, Jr., (Nov. 9, 1938) the Wisconsin Tax Commission ruled that a patent attorney employing assistants on a salary or per diem basis was earning income from personal services and not from business. Wisconsin P. H. and C. C. H. Tax Services, pars. 13,333 and 14-547 respectively. In these cases there is an emphasis on the fact that the senior members, and not assistants, attract clients. Consequently, the work of assistants is not income producing. Compare, however, (Wis. Tax Comm'n, Feb. 27, 1924) Wis. C. C. H. Tax Service, par. 10-809.18. Under the New York statute, taxing income from a trade, business, profession or occupation the income of an accounting firm may be allocated. Op. Atty. Gen. Sept. 23, 1920 P. H. Tax Service par. 57,596. Likewise a non-resident attorney may be taxed on his New York practice. Ruling (St. Comp. May 25, 1920) P. H. Tax Service par. 57,577. 2

People ex rel. Lummis v. Graves, (1937) 251 App. Div. 591, 297 N. Y. S. 967. 2

See California Personal Income Tax Regulations of 1937, art. 7(f) 5, note 16 above; Iowa Regulations of 1938, art. 18c in Iowa C. C. H. Tax Service, par. 1469-3; Minnesota Regulations of 1940, art. 23-1, note 16 above; and Regulations of other states. 2

Cerf v. Lynch, (1932) 237 App. Div. 283, 261 N. Y. S. 231; Matter of Recht and Kutcher, (1939) 257 App. Div. 489, 12 N. Y. S. (2d) 158. (Both cases under special New York statute.) Contra: Appeal of McMillan, (Wis. Tax Comm'n, June 11, 1936) P. H. Tax Service par. 13,220. Compare Sanborn v. Commissioner, (1930) 19 B. T. A. 495. In State ex rel. Lerner v. Wisconsin Tax Comm'n, (1933) 213 Wis. 267, 251 N. W. 456, the court held that a taxpayer engaged in the solicitation of advertising and other activities in connection with the publication and distribution of year books was earning income from personal services. The court indicated that the employment on a commission basis of sub-agents did not involve “the material aid of capital.” 2

The Wisconsin Regulations of 1932, art. 601.2 in Wisconsin C. C. H. Tax Service, par. 10-813, provide in part, “Income from personal services as used in our income tax law applies to income received from performing mental or physical labor, and the fact that the capital or labor of others is employed as an incident to rendering such services, where such capital and labor is not a material income producing factor, will not be sufficient to result in the classification of such income as income from business within the meaning of the statute.” Under this regulation capital has been held to be a material income producing factor in the case of “broker” who had capital invested in a stock exchange seat and in carrying customers on margin. Appeal of Perry
other states income from personal services is treated as non-allocable notwithstanding the fact that a business in rendering personal services may be involved in the sense that the employment of labor or capital may be material income producing factors. Because of the tendency under the first rule to consider the employment of labor or capital to be merely incidental, the same result is usually achieved under either rule. This result is that income from personal service is not allocable.

The making of isolated sales does not constitute a business. Gains therefrom are assigned a situs for taxation under rules different from those for the allocation of business income. Some states exclude from allocation "compensation for labor or personal services, or from a business consisting principally of the performance of personal or professional services." Mason's 1940 Minnesota Supplement, sec. 2394-23(a). Compare art. 412 and 415 of New York Personal Income Tax Regulations for 1935 in N. Y. C. C. H. Tax Service, pars. 15-913 and 15-916 respectively.

28Business income, as indicated hereafter, may be allocated by a separate accounting or by apportionment formulas. Capital gains from isolated sales are assigned a situs for taxation by other rules which vary with respect to the tangible or intangible nature of the property in question. Capital gains from the sale or exchange of tangible property, may be taxed by the state in which such property is situated. Mason's 1940 Minnesota Supplement, sec. 2394-23(b); Wisconsin Statutes 1939, sec. 71.02 (3) (c). Or they may be taxed by the state of the domicile of the owner. People of the State of New York ex rel. Pierson v. Lynch, (1933) 237 App. Div. 763, 263 N. Y. S. 259. Whether both the state of the domicile of the owner and the situs of the property may tax the same gains is, as yet, an undecided question. Capital gains from isolated sales of intangible property are generally taxed by the state of the domicile of the owner. Osgood v. Tax Comm'n, (1920) 235 Mass. 88, 126 N. E. 371; Stone v. Tax Comm'n, (1930) 235 Mass. 93, 126 N. E. 373; Bryant v. Tax Comm'n, (1935) 291 Mass. 498, 197 N. E. 509, 102 A. L. R. 1; Zimmers v. City of Milwaukee, (1925) 189 Wis. 269, 206 N. W. 178; Stone v. State Tax Comm'n, (1928) 197 Wis. 212 N. W. 376; Appeal of Wisconsin Michigan Power Co., (Wis. Tax Comm'n, Dec. 22, 1936) P. H. Tax Service, par. 13,239. Sometimes the state of the business situs of such intangibles imposes an income tax. See People ex rel. Whitney v. Graves, (1937) 299 U. S. 366, 57 Sup. Ct. 237, 81 L. Ed. 285 and Hutchins v. Commission of Corp. and Tax., (1930) 272 Mass. 422, 172 N. E. 605, 71 A. L. R. 605. Whether the state of the domicile of the obligor may tax is apparently an undecided question. Gains on securities held by a foreign corporation which have no business situs in
rived from sales continuously and regularly made by a person who may be considered gainfully occupied in such activities.20

Business income is also to be distinguished from financial and investment income such as rentals, royalties, interest and dividends which are not generally allocable.20 A person may, however, the state may not be taxed. Newport Co. v. Wisconsin Tax Comm'n, (1935) 219 Wis. 293, 261 N. W. 884, 100 A. L. R. 1204. It has been held that where a taxpayer is a resident for a fraction of a year he is taxable only on the gains realized while a resident and not on the portion of the annual taxable net income apportioned on a time ratio basis. Greene v. Wisconsin Tax Comm'n, (1936) 221 Wis. 531, 266 N. W. 270. Compare Scoble v. Wisconsin Tax Comm'n, (1937) 225 Wis. 529, 275 N. W. 531, which holds that the time apportionment ratio is applicable in the absence of proof by the taxpayer as to the actual time of earning the income.

20The making of ninety-one transactions on the stock market during one year has been held not to constitute doing business. People ex rel. Whitney v. Loughman, (1927) 220 App. Div. 30, 220 N. Y. S. 405 (statute allowed deduction of losses “incurred in trade or business”). See also sec. 23 (a) of the federal revenue acts which allow as a deductible expense “the ordinary and necessary expenses paid in carrying on a trade or business,” and compare Kenan v. Bowers (C.C.A. 2d Cir. 1931) 50 F. (2d) 112 and Kane v. Commissioner (C.C.A. 2d Cir. 1938) 100 F. (2d) 382 with Roebing v. Commissioner, (1938) 37 B. T. A. 82. In the latter case the taxpayer was allowed to deduct expenses with respect to the management of properties under her personal supervision. She owned $9,000,000 worth of securities, purchased $517,080 worth during the taxable year, and in the same period sold securities of the value of $38,363. In People ex rel. General Alliance Corp. v. State Tax Comm'n, (1938) 253 App. Div. 413, 2 N. Y. S. (2d) 994, the court held the purchase by a parent company of shares of stock in the 47 per cent owned subsidiary did not constitute doing business under the New York act. The same court reached the opposite result in People ex rel. Tobacco and Allied Stocks, Inc. v. Graves, (1937) 250 App. Div. 149, 294 N. Y. S. 995, aff'd 277 N. Y. 723, 14 N. E. (2d) 821 where the taxpayer made gross purchases of securities in 1929 in the sum of $2,500,000, and during 1930, 1931, and 1932 made purchases of thirty-one different issues of stock and sales of twenty-one other issues, realizing capital gains in the amount of $225,000 and losses of $450,000; loaned money on call in the aggregate of $300,000; had bank deposits within the state; and maintained a principal office in New York at a yearly expense of $6,500.

20Rentals may be taxed by the state in which the rental producing property is situated. This principle was apparently assumed by the court in Chicago and Northwestern Ry. Co. v. Wisconsin Tax Comm'n, (1929) 199 Wis. 368, 226 N. W. 293, and in Byram v. Wisconsin Tax Comm'n, (1929) 199 Wis. 378, 226 N. W. 296. See Shaffer v. Carter, (1920) 252 U. S. 37, 40 Sup. Ct. 221, 64 L. Ed. 445. Sometimes, the state of the domicile of the rent recipient imposes a tax. New York ex rel. Cohn v. Graves, (1937) 300 U. S. 306, 57 Sup. Ct. 466, 81 L. Ed. 666; 108 A. L. R. 721, Palmer v. State Board of Assessment and Revue, (1939) 226 Iowa 92, 283 N. W. 415, Compare People ex rel. Beck v. Graves, (1939) 280 N. Y. 405, 21 N. E. (2d) 371. Whether both states may tax the identical income has not, as yet, been directly the subject of decision. As to what constitutes tangible or intangible property interests seen Senior v. Braden, (1935) 295 U. S. 422, 55 Sup. Ct. 800, 79 L. Ed. 1520, 100 A. L. R. 794 (beneficial interest in real estate held to be an interest in realty for property tax purposes).

Royalties derived from tangible property such as mines or oil wells
are generally taxed by the state of the location of the royalty producing
property. For example, see sec. 71.02 (3) (c) of the Wisconsin Statutes
which provides in part, “Income derived from rentals and royalties from
real estate or tangible personal property . . . shall follow the situs of
the property from which derived.” Under an earlier Wisconsin law
royalties from leases to mines outside the state were taxed to residents. Pfister
Land Co. v. City of Milwaukee, (1917) 166 Wis. 223, 165 N. W. 23.
Compare the cases above involving the situs of rents. Royalties derived
from intangibles such as patents and copyrights are assigned a situs for
income taxation under rules similar to those with respect to dividends and
interest which are discussed below. Such royalties have been taxed by the
state of the royalty recipient. People ex rel. Rice v. Graves, (1936) 242
App. Div. 128, 273 N. Y. S. 582, aff’d without opinion 270 N. Y. 498,
200 N. E. 288; Lasba v. Wisconsin Tax Comm’n, (1933) 218 Wis. 414,
261 N. W. 404. The state of the source may also tax. See Fox Film
1010 (motion picture royalties taxed by state in which pictures were ex-
hibited) and Rafael Sabatini v. Commission (C.C.A. 1938) 98 F. (2d)
753 (copyright royalties taxed by state in which royalty payor sold books).
The state of the business situs of the patents may tax royalties therefrom.
Appeal of Aluminum Manufacturing Co., (Wis. Tax Comm’n, Aug. 21,
1939) P. H. Wis. Tax Service, par. 13,428. Whether both the state of
the source and of the domicile may tax the same income has not, as yet,
been expressly decided.

Interest is generally taxed by the state of the domicile of the recipient.
578, 168 So. 679, aff’d on second appeal 237 Ala. 293, 186 So. 467. Taxa-
tion by the state of the obligor has been disallowed as a matter of statutory
construction in State ex rel. Manitowoc Gas Co. v. Wisconsin Tax
Comm’n, (1915) 161 Wis. 111, 152 N. W. 848, and as a matter of due
process in Domenegh v. United Porto Rican Sugar Co., (C.C.A. 1st Cir.
1932) 62 F. (2d) 552, but in Mississippi Cottonseed Products Co. v.
Stone, (1939) 184 Miss. 409, 184 So. 428 such taxation was allowed, both
as a matter of construction and presumably as a matter of due process.
It has been allowed as a matter of jurisdictional power. United States
Stockholm Enskilda Bank, (1934) 293 U. S. 84, 55 Sup. Ct. 50, 79
L. Ed. 211. Taxation by the state of the business situs has long been
recognized. DeGanay v. Lederer, (1919) 250 U. S. 376, 39 Sup. Ct. 524,
63 L. Ed. 1042; Hill v. Carter, (C.C.A. 9th Cir. 1931) 47 F. (2d) 869,
cert. den. 284 U. S. 625, 52 Sup. Ct 10, 76 L. Ed. 532. A taxpayer
domiciled within a state for only a fraction of the taxable year may be
taxed on the portion received while so domiciled. Ewa Plantation v.
Wildor, (C.C.A. 9th Cir. 1923) 289 F. 664; Martin v. Gage, (1934) 281
Ky. 95, 134 S. W. (2d) 966; Kennedy v. Commission of Corp. and Tax.,
(1926) 255 Mass. 426, 152 N. E. 747. The portion may be computed on
a time ratio basis. McCarty v. Conway, (1934) 215 Wis. 645, 255 N. W.
913, 93 A. L. R. 1196.

Dividends are generally taxed by the state of the domicile of the
dividend recipient. Conner v. State, (1925) 82 N. H. 125, 130 Atl. 355;
Lasba v. Tax Comm’n, (1933) 244 Mass. 40, 138 N. E. 708; State v.
293, 186 So. 467; State ex rel. Dulanev v. Nygaard, (1921) 174 Wis. 597,
183 N. W. 884; Wiseman v. Interstate Public Service Co., (1935) 191
Ark. 255, 85 S. W. (2d) 700. The state of the business situs of the
dividend producing securities may tax. DeGanay v. Lederer, (1919) 250
U. S. 376, 39 Sup. Ct. 524, 63 L. Ed. 1042; see First Bank Stock Corpora-

Dimensions: Width: 652.8 Height: 431.0
sidered to be in a business in which both capital and labor are material income producing factors. Frequently the same tax-


ports to tax such income. Arkansas, Statutes (Pope 1937) secs. 14026(b) and 14026(b). The state of incorporation of the dividend payor has juris-
volved, and in Lord Forres v. Commission, (1932) 25 B. T. A. 154 where the jurisdictional power of the United States was involved. The power was denied as a matter of due process in Newport Co. v. Wis-


Rentals: Compare Flint v. Stone Tracy Co., (1910) 220 U. S. 107, 31 Sup. Ct. 342, 55 L. Ed. 389, Ann. Cas. 1912B 1312 (various taxpayers "engaged in such activities as leasing property, collecting rents, managing office buildings, making investments of profits, or leasing ore lands and collecting royalties, managing wharves, dividing profits, and in some cases investing the surplus" held to be "engaged in business" within the meaning of an excise tax on the doing of business measured by net income—p. 171) and Frothingham Buildings v. Commonwealth, (1924) 249 Mass. 290, 144 N. E. 229 (the leasing of a building, collecting of rents, management of the properties and investment of certain securities held "doing business" for excise tax purposes) with Zonne v. Minneapolis Syndicate, (1911) 220 U. S. 187, 31 Sup. Ct. 361, 55 L. Ed. 428 (a corporation, divested of all power to manage or control properties held not to be doing business by receiving rentals from lessee and distributing them to shareholders) and Standard Lumber Co. v. Pierce, (1924) 112 Or. 314, 228 Pac. 812 (receipts of rentals from property outside the state held not to constitute doing business for income tax purposes).

Royalties: With respect to the Clark Iron Co. in Flint v. Stone Tracy
payer may earn both a business and an investment income. Operating statements often reflect this in segregating operating and non-operating income. In these situations that portion of the taxpayer’s income which is derived from investments not employed in connection with business\(^2\) and not allocable\(^3\) must be separated from business income allocable by apportionment or

\(\text{Co.}, (1910) 220 \text{ U. S. 107, 170, 171, 31 Sup. Ct. 342, 55 L. Ed. 389, and in Von Baumbach v. Sargent Land Co., (1917) 242 U. S. 503, 37 Sup. Ct. 201, 61 L. Ed. 460, the court held that the leasing and management of ore lands and collection of royalties therefrom constituted doing business under business excise tax acts. In Quicksafe Mfg. Corp. v. Graham, (1930) 161 Tenn. 46, 29 S. W. (2d) 253, the court held, in part, that the receipt of patent royalties did not constitute doing business for excise tax purposes.}

Interest: State v. Weil, (1936) 232 Ala. 578, 168 So. 679, aff’d on second appeal 237 Ala. 293, 186 So. 467 (interest income held non-allocable); Beneficial Loan Society of Oregon v. State Tax Comm’n, (1939) 163 Or. 211, 95 P. (2d) 429 (interest income from a small loan company held to be from business and allocable by apportionment formula); and Interstate Bond Co. v. State Revenue Comm’n, (1935) 50 Ga. App. 744, 179 S. E. 559 (interest income held earned from business carried on entirely within the state). The interest income of a finance company has been held to be allocable by apportionment. In the Matter of the Appeal of Marcus-Lisome, Inc., (Cal. St. Bd. of Equal., Nov. 15, 1939) in Cal. C. C. H. Tax Service, par. 5-801.005.

Dividends: Compare Edwards v. Chile Copper Co., (1925) 270 U. S. 452, 46 Sup. Ct. 345, 70 L. Ed. 678 and Phillips v. International Salt Company, (1927) 274 U. S. 718, 47 Sup. Ct. 589, 71 L. Ed. 1323 reversing (C.C.A. 3d Cir. 1925) 9 F. (2d) 389 (on particular facts of each case the holding of stock and receipt of dividends was held to constitute doing business for purposes of business excise tax) with Rose v. Nunnally Investment Co., (C.C.A. 5th Cir. 1927) 22 F. (2d) 102; and Eaton v. Phoenix Securities Co., (C.C.A. 2d Cir. 1927) 22 F. (2d) 497 (reaching opposite result on slightly different facts); with Welch Holding Co. v. Gallaway, (1939) 161 Or. 515, 89 P. (2d) 559 (taxpayer held “merely a conduit” for passing the profits of the operating companies to the shareholders of the taxpayer); and with People ex rel. Butterick Co. v. Gilchrist, (1928) 213 App. Div. 535, 211 N. Y. S. 75. See also note 34 below.

3\(^2\)Section 23 of the Minnesota Act (note 8 above) uses the phrase “employed in business” and sec. 17 of the Colorado Act (note 8 above), the phrase “received in connection with business.” Other statutes are of purport. See like note 33 below.

3\(^3\)In Union Pacific Railroad Co. v. State Tax Comm’n, (1937) 145 Kan. 715, 68 P. (2d) 1 the court held that no part of a $16,007,413.71 dividend and interest income was “received in connection with business” in Kansas. The stocks and bonds from which the income in question was derived were not controlled or managed from Kansas nor were they physically situated there. Accord: California Packing Corp. v. State Tax Comm’n, (1939) 97 Utah 367, 93 P. (2d) 463; Appeal of the Great Northern Railway Co., (Cal. Bd. of Equal., Nov. 15, 1939) Cal. C. C. H. Tax Service, par. 5-553.04. See Atlantic Coast Line R. Co. v. Doughton, (1923) 262 U. S. 413, 43 Sup. Ct. 620, 67 L. Ed. 1051, where a North Carolina statute levying a three per cent tax on “net operating income” was upheld against constitutional objections that the statute failed to take into account both non-operating income in the form of dividends, interest and rentals received and non-operating expenses in the form of interest and rentals paid.
separate accounting. Converely, income from securities or properties employed in connection with business must be considered part of business income and allocated therewith.

B. An Integral Business.—Income derived from business activities carried on in more than one state may be allocated only if these activities are parts of an integral whole. If any part, confined to the limits of one state, should be considered a dissociated unit the income therefrom would not be subject to allocation. Or if this dissociated business is carried on in several states there is an allocation, but only of the separate income. Definition is thus necessary in order, in some instances, to determine whether or not an allocation is to be made and in others to determine the unit of income subject thereto.

An integral business is not subject to precise definition. Mr. Justice Holmes has suggested that its chief characteristic is that value attributable to combination. A familiar example of this

34 A situation in which there may be a conflict of authority with respect to the distinction between operating and financial income is that in which a parent company holds stock of and receives income from its subsidiary or subsidiaries. See State v. National Cash Credit Association, (1932) 224 Ala. 629, 141 So. 541, where it was held that the ownership by a parent company of stock and bonds in its subsidiaries did not constitute doing business; and compare National Leather Co. v. Massachusetts, (1928) 277 U. S. 413, 48 Sup. Ct. 534, 72 L. Ed. 935 where it was held that the stock of subsidiaries owned by the parent company were "employed in... business within the Commonwealth." See also Atlantic Lumber Co. v. Commission of Corp. and Tax., (1934) 2 Mass. B. T. A. 67, aff'd on other grounds 292 Mass. 51, 197 N. E. 525, and 298 U. S. 553, 56 Sup. Ct. 887, 80 L. Ed. 1328, where a different result was reached, apparently because the subsidiaries were outside rather than inside the state as in the earlier case. In Stanley Works v. Hackett, (1937) 122 Conn. 547, 190 Atl. 743, the court held that shares in Canadian subsidiaries owned by a Delaware corporation with its principal office in Connecticut were employed in connection with the Canadian business. Compare also Fargo v. Hart, (1903) 193 U. S. 490, 24 Sup. Ct. 498, 48 L. Ed. 791 (holding that ownership of bonds and real estate by an express company was not an integral part of its business) with Illinois Central Railway v. Green, (1917) 244 U. S. 555, 37 Sup. Ct. 697, 61 L. Ed. 1309 (holding that stock of subsidiary railways kept in the treasury of the parent company was, in the absence of proof by the taxpayer to the contrary, part of the business properties of the parent company.)


36 In Fargo v. Hart, (1903) 193 U. S. 490, 24 Sup. Ct. 498, 48 L. Ed. 791, Mr. Justice Holmes first stated at page 501 that "The express business added nothing to the value of the bonds in New York" and then went on to show that the bonds added nothing to the value of the express business in Indiana.
ALLOCATION OF BUSINESS INCOME

occurs in those business enterprises which possess, above the actual value of their properties, a going concern value attributable to the high rate of return earned by reason of central ownership and management. 37 Under the rule of value business properties and

37 The history of the "unit rule" presents an interesting development. It was first formulated with respect and applied to businesses in which there was present a physical unity of contiguous property. Chief examples of such businesses have been railroads; (State Railroad Tax Cases, (1875) 92 U. S. 575, 608, 23 L. Ed. 663, 671. "The track of the road is but one track from one end of it to the other, and except in its use as a track, is of little value;" Pittsburgh, etc., Ry. Co. v. Backus, (1894) 154 U. S. 421, 14 Sup. Ct. 1114, 38 L. Ed. 1031. Both cases upheld an apportionment of total going concern value on a mileage ratio. Wallace v. Hines, (1920) 253 U. S. 66, 40 Sup. Ct. 435, 64 L. Ed. 782 voided a mileage ratio as applied to the particular facts of the case. The mileage ratio was approved with respect to income taxes in Norfolk and Western Ry. Co. v. State, (1935) 297 U. S. 682, 56 Sup. Ct. 625, 80 L. Ed. 977; telegraph companies (Western Union Telegraph Co. v. Massachusetts, (1888) 125 U. S. 530, 8 Sup. Ct. 961, 31 L. Ed. 790; Western Union Telegraph Co. v. Taggart, (1896) 163 U. S. 1, 16 Sup. Ct. 1054, 41 L. Ed. 49. The statutes in both cases taxed a mileage proportion of total going concern value); telephone companies (see 2 Cooley, Taxation (4th ed. 1924) secs. 811 and 813); pipe line companies (see Tide Water Pipe Co. v. State Bd., (1895) 57 N. J. L. 516, 31 Atl. 220, 27 L. R. A. 684 aff'd on op'n below, 59 N. J. L. 269, 39 Atl. 1114, gross receipts tax); interstate toll bridge companies (Henderson Bridge Co. v. Kentucky, (1897) 166 U. S. 150, 17 Sup. Ct. 326, 41 L. Ed. 953—value of going concern apportioned on ratio of length of bridge within the state to total length of bridge); power companies (State ex rel. Union Electric Light & Power Co. v. Baker, (1927) 316 Mo. 853, 293 S. W. 399, total property was apportioned on wire mileage basis); and water companies (Berger Aqueduct Co. v. State Board of Taxes, (1921) 95 N. J. L. 486, 112 Atl. 881—business excise tax measured on a water main mileage proportion of gross receipts).

Later a unity of use became the standard. Under this rule the principal taxpayers were express companies (Adams Express Co. v. Ohio State Auditor, (1897) 165 U. S. 194, 222, 17 Sup. Ct. 305, 41 L. Ed. 683. "The unit is a unit of use and management, and the horses, wagons, sales, pouches and furniture—possessed a value in combination—") ; refrigerator car companies; (see American Refrigerator Transit Co. v. Hall, (1899) 174 U. S. 70, 19 Sup. Ct. 599, 43 L. Ed. 899 and Union Refrigerator Transit Co. v. Lynch, (1900) 177 U. S. 149, 20 Sup. Ct. 631, 44 L. Ed. 708); tank car companies (Union Tank Line Co. v. Wright, (1919) 249 U. S. 275, 39 Sup. Ct. 276, 63 L. Ed. 602—ratio of total miles of track within the state over which cars ran to total mileage everywhere held unconstitutional. Later car mileage ratios were adopted); sleeping car companies (Pullman's Palace Car Co. v. Pennsylvania, (1891) 141 U. S. 18, 11 Sup. Ct. 876, 35 L. Ed. 613); and steamship lines (Schwab v. Richardson, (1923) 263 U. S. 88, 44 Sup. Ct. 60, 68 L. Ed. 183 and Commissioners v. Old Dominion S. S. Co., (1901) 128 N. C. 555, 39 S. E. 18). The rule of unity of use was not held to include manufacturing concerns. Adams Express Co. v. Ohio State Auditor, (1897) 165 U. S. 194, 17 Sup. Ct. 305, 41 L. Ed. 683. The court said at page 222 "The same party may own a manufacturing establishment in one state and a store in another, and make profit by operating the two, but the worth of each is separate." See Utah-Idaho Sugar Co. v. Salt Lake County, (1922) 60 Utah 491, 210 Pac. 106, 27 A. L. R. 874. Later, however, the rule finally emerged as one of value and was applied to manufacturing concerns by the United States Supreme Court in the series of decisions cited in notes 38 through 43 below. The above dictum may, therefore, be considered overruled.
organizations having a value in combination in excess of the total of separate values would be considered to be integral. Thus it has been held that a glue company with sales activities and offices without the taxing state together with a factory and principal office within the taxing state was engaged in an integral business. The same result has been reached in the case of a typewriter company, the principal office of which, together with its sales organization and branches, was outside the taxing state and its factory within the taxing state; in the case of a leather tanning business the warehouse of which, together with its branch and principal sales offices, was located outside the taxing state and its tanning factory within the taxing state; and in the case of a coffee company 99.8 per cent of sales of which were made outside the taxing state and the production plant of which was within the taxing state. Similarly, when the question of taxation has arisen in the state of the location of the branch sales and import offices of an ale company, the brewery, situated outside the taxing state, has been considered an integral part of the entire enterprise. Also a company with factories located in several different states, as well as with multi-state sales branches, has been considered to be engaged in an integral enterprise. On the other hand, silverware and munitions businesses owned and managed by the same taxpayer have been considered to be dissociated enterprises. Here, apparently, neither business would enhance the value of the other. Under certain circumstances oil wells

44Gorham Manufacturing Co. v. Travis, (S.D. N.Y. 1921) 274 Fed. 975, aff'd (1924) 266 U. S. 265, 45 Sup. Ct. 80, 69 L. Ed. 279 (dictum at page 979 by Judge Hand that "the taxpayer must have the right to show that parts of the foreign assets are not functionally connected with the local business.") A more obvious situation might be that of a taxpayer engaged in both the grocery and garage businesses. If these were each carried in different states there would be no allocation of the combined income. The separate incomes would be separately taxed in each state.
ALLOCATION OF BUSINESS INCOME

separately operated in separate states by the same taxpayer have been held separate, integral units. Also, a taxpayer engaged both in the business of operating its plant and of managing its investments may perhaps be considered to be engaged in two separate businesses.

Although the presence of a common ownership is one of the factors to be considered in ascertaining whether or not an integral business is being carried on, it is not of itself determinative. Sometimes diversity of ownership may be ignored if there is a unity of value. Likewise, a unity of management is not determinative

45State ex rel. Attorney General v. Lion Oil Refining Co., (1926) 171 Ark. 209, 284 S. W. 33, involving a property tax on corporate excess, indicated there was no organic unity between the taxpayer’s operations in Arkansas in drilling for and refining oil, and its similar operations carried on in other states. The court said, “Each one would be separately operated and might be shut down without any impairment of the operating power of its plants in the other two states.” See Utah-Idaho Sugar Co. v. Salt Lake County, (1928) 60 Utah 491, 210 Pac. 106, 27 A. L. R. 874, involving a property tax on the corporate excess of a beet sugar company engaged “in the production, manufacture and sale of beet sugar.” It had sugar factories in several states.

46Fargo v. Hart, (1903) 193 U. S. 490, 24 Sup. Ct. 498, 48 L. Ed. 791. This case involved a tax upon the property within Indiana of the American Express Company. The value of the property was taken to be a mileage proportion of the going concern value of the total assets of the company. The Express Co. had real estate of a market value of $2,000,000 and securities of a worth of $15,000,000, neither of which was employed in its express business. The securities were apparently employed in its banking business. The assessment was held improper to the extent that the value of dissociated properties was included. Coulter v. Weir, (C.C.A. 6th Cir. 1904) 127 Fed. 899 reached the same result on almost identical facts involving the Adams Express Co., a taxpayer similarly situated. It should be noted that under income tax laws a result similar to that in the last two cases above might sometimes be reached on the theory that income from real estate and securities was investment rather than business income. See notes 30 through 33 above.

47Sometimes this is done by looking through the “corporate fiction;” or under anti-evasion sections of income tax statutes; or under consolidated return provisions thereof. Palmolive Co. v. Conway, (C.C.A. 7th Cir. 1932) 56 F. (2d) 83; Buick Motor Co. v. City of Milwaukee, (C.C.A. 7th Cir. 1931) 48 F. (2d) 801; Cliffs Chemical Co. v. Wisconsin Tax Comm’n, (1927) 193 Wis. 295, 214 N. W. 447; Singer Mfg. Co. v. Gilpatrick, (1922) 98 Conn. 192, 118 Atl. 919; In re Morton Salt Co., (1939) 150 Kan. 650, 95 P. (2d) 335. Cf. Studebaker Corp. v. Gilchrist, (1920) 244 N. Y. 114, 155 N. E. 68; Curtis Companies Inc. v. Wisconsin Tax Comm’n, (1933) 214 Wis. 85, 251 N. W. 497, 92 A. L. R. 1065; Procter and Gamble Co. v. Newton, (S.D. N.Y. 1923) 289 Fed. 1013; Application of Marke & Hammacher, (1940) 288 App. Div. 363, 16 N. Y. S. (2d) 774, and McCrory Co. v. Commission of Corp. and Taxation, (1932) 280 Mass. 273, 182 N. E. 481. In Palmolive Co. v. Conway, (C.C.A. 7th Cir. 1932) 56 F. (2d) 83, the fact that an advertising agency was separately incorporated apparently persuaded the court that the placing of advertising was not part of an integral business. Prima facie, it would seem that the placing of advertising would add value to the rest of the business in increased sales. See In re Kansas City Star Co., (Mo. 1940) 142 S. W. (2d) 1029. For a lucid article concerning the effect of intercorporate organization on allocation see
even in those cases in which it is coupled with a unity of ownership.\textsuperscript{48} The fact that separate divisions of the same business are operated as independent accounting units does not conclusively show that separate businesses are involved,\textsuperscript{49} even though such accounting methods may be determinative of the unit of business for which a separate accounting may be had. Although there was some uncertainty in the early cases\textsuperscript{50} between the concept of the


\textsuperscript{48}Piedmont & N. Ry. Co. v. Query, (E.D. S.C. 1932) 56 F. (2d) 172 held two unconnected railroad lines, separately located in two different states, to be separate integral units even though owned and managed by the same taxpayer. On the facts, the operation of the railroad in South Carolina might not have added any appreciable value to the railway operated in North Carolina. There was no showing that a single management of the two lines effected any appreciable saving. See also Burkhart Manufacturing Co. v. Coale, (1940) 345 Mo. 1131, 139 S. W. 2 (2d) 502, holding that a company with separate factories and sales forces in three different states all subject to a central "directory control" did not, with respect to sales from out of state factories, make transactions partly within the state. A sales ratio allocation of the company's income from all sources was made. Compare McCrary Co. v. Commission, (1932) 280 Mass. 273, 182 N. E. 481, where the retail stores of the chain taxpayer were separately incorporated, being subsidiaries of the parent which acted as the general purchasing agent for all its branches. Each retail store was charged a 10 per cent commission for such services. A unity of value might here seem to be present. The court decided to the contrary, however, on the grounds of separate ownership.

\textsuperscript{49}See Chicago I. & L. Ry. Co. v. Lewis, (E.D. Ky. 1925) 12 F. (2d) 802 and cases cited in notes 38 to 43 inclusive above.

\textsuperscript{50}Fisher v. Standard Oil Co., (C.C.A. 8th Cir. 1926) 12 F. (2d) 744; Standard Oil Co. v. Thoresen, (C.C.A. 8th Cir. 1928) 29 F. (2d) 708. Both cases involved North Dakota income taxes on the same taxpayer, which was engaged in the production, refining, transportation and sale of petroleum and its by-products in various states of the Union. The taxpayer in each case had "sales outlets" in North Dakota. In the first case the court said at page 747: "Theories of allocation can have no place in the inquiry, if net income from within the state stands on its own footing unmixed with outside business." It concludes, however, at page 747, "We think appellee's business within the state is easily separable from its other business by charging it with the wholesale price of its products which it sells in North Dakota. That would put it on an equality there with those who sell and do not produce and refine." In the later case on the other hand, the court disallowed the additional assessments in question on the ground that the sales business was of "different character" from the businesses of producing and refining oil, and quoted with approval the dictum in Adams Express Co. v. Ohio, (1897) 165 U. S. 194, 17 Sup. Ct. 305, 41 L. Ed. 683, set forth at the end of note 37 above. It added: "It is conceded to be a very easy matter for the state to determine the market value of refined oils within its borders at any time and place, and on this, having ascertained the selling price, to determine the tax necessary to be paid." The dictum of Chief Justice Fuller in Adams Express Co. v. Ohio, (1897) 165 U. S. 194, 17 Sup. Ct. 305, 41 L. Ed. 683, was also the basis, perhaps unfortunately, of another decision involving the "unit rule" in Standard Oil Co. v. Howe,
integral business unit and the concept of a separate accounting unit, recent cases all take cognizance of the fact that there may be various accounting units of the same integral enterprise.51

C. A Multi-State Business.—Sometimes a taxpayer may carry on an integral business in more than one state. A multi-state business52 is then done and an allocation is to be made.52a Or a taxpayer may carry on an integral business within one state. Here there is no problem of allocation but a preliminary one of determining whether the entire business is done within the state.53 More specifically, there must be decision with respect to whether or not the operation of a factory outside the state, or the conduct

(C.C.A. 9th Cir. 1919) 257 F. 481. The North Dakota supreme court recently has construed the North Dakota statute in question as one probably involving a separate accounting unit rather than a unit of integral business. Ford Motor Co. v. State, (1935) 65 N. D. 316, 258 N. W. 596.

52Standard Oil Co. of Indiana v. Wisconsin Tax Comm’n, (1929) 197 Wis. 630, 223 N. W. 85 (on facts practically identical with those involved in the North Dakota taxes in the note above, the court held the taxpayer entitled to a separate accounting) and cases cited in notes 219 to 249 below.

52The distinction here made between a multi-state business on the one hand and business within one state on the other is not the same as that between interstate and intrastate commerce within the meaning of the federal constitution. An interstate business may, for the purpose of allocation, be considered to be carried on entirely within one state. See Hump Hairpin Mfg. Co. v. Emmerison, (1922) 258 U. S. 290, 42 Sup. Ct. 805, 66 L. Ed. 622. Conversely, there may be a multi-state business where, for the purposes of the commerce clause, an intrastate business would be carried on in each of several states. Save for one or two early decisions commerce clause precedent has not been followed in allocation cases. See cases collected in the footnotes. In Converse v. Northern Pacific Ry. Co., (C.C.A. 8th Cir. 1924) 2 F. (2d) 959, the court construed the phrase “within the state” to include only intrastate business. Contrast Matson Navigation Co. v. State Board of Equalization, (1935) 3 Cal. (2d) 1, 43 P. (2d) 805, aff’d 297 U. S. 441, 56 Sup. Ct. 753, 80 L. Ed. 622 (on facts practically identical with those involved in the North Dakota taxes in the note above, the court held the taxpayer entitled to a separate accounting); Norfolk and Western R. Co. v. N. C. ex rel. Maxwell, (1935) 208 N. C. 397, 181 S. E. 248, aff’d 297 U. S. 682, 56 Sup. Ct. 625, 80 L. Ed. 977 (detailed statutory provision); and Op. Tenn. Att. Gen. Feb. 25, 1939 in Tenn. C. C. H. Tax Service, par. 14-502. In Temple v. Gates, (1933) 186 Ark. 820, 56 S. W. (2d) 417, the court said: “The transaction between it [the taxpayer] and the citizens of this state were interstate in nature and character” and held the business in question not to be “carried on in this state.” Other grounds for decision were presented on the facts. The limitation should be borne in mind, however, that a franchise tax upon the doing of business measured by net income may be, generally speaking, subject to the usual commerce clause restrictions upon franchise taxes. With respect to interstate commerce see note 103 below.


53Economically, the problem is to decide whether the income of the business is earned in its entirety within the state. If the economic and legal problems are to coincide, the statutory phrase “doing business” and the economic phrase “earning business income,” must be considered to be equivalent. For statutory provisions see notes 4 through 11 above and text.
of buying activities outside the state, or the location of management outside the state, or the solicitation of sales through agents or branches outside the state, or the performance of any one of several other business functions\textsuperscript{54} constitute doing business or, in economic terms, the performance of an income producing function outside the state. If in any instance it does, an allocation is to be made. If it does not, there is none.

It is generally accepted that the operation of a manufacturing plant constitutes doing business, and that some portion of the final net income may be attributed to the factory.\textsuperscript{55} There capital and labor are employed in combination for profit. Apparently some stress is laid on this fact of combination, for the presence outside the state of property alone\textsuperscript{56} or the employment outside the state of labor alone\textsuperscript{57} have not either, as yet, been considered doing business. This result, perhaps, would not seem fully accurate to an economist who, quite probably,\textsuperscript{58} would attribute some portion, however small, of the business income to each of the two separate factors. Should a case arise on stronger facts, the

---

\textsuperscript{54}The October 1939 Report of the Committee of the National Tax Association on Allocation of Income at page 29 suggests the following additional functions in earning manufacturing income: Extracting, assembling, storing, research and design, credits, collecting, transporting, accounting, financing, and general administration.

\textsuperscript{55}Cases cited in notes 38 to 43 inclusive.

\textsuperscript{56}Appeal of California Despatch Line, (Cal. St. Bd. of Equal., Mar. 10, 1938) Cal. C. C. H. Tax Service, par. 5-801a.03 (business of renting tank cars held to be done in its entirety within California notwithstanding presence of cars outside the state there operated by lessees); Appeal of Kasser Egg Process Co., (Cal. St. Bd. of Equal., Mar. 14, 1933) Cal. C. C. H. Tax Service, par. 5-802.05 (business of renting machines held to be done in its entirety within California notwithstanding the presence outside the state of the machines there controlled by the lessees.) On the facts of these cases it would not seem that the taxpayer, if a foreign corporation, would find it necessary to qualify to do business in the outside states nor would it find itself subject to process there. Possibly, if the property outside the state was subject to the taxpayer’s control and operation, a different result would be reached.

\textsuperscript{57}The employment of labor outside the state in making deliveries there has been held not to constitute doing extra-state business. Ruling (Wis. Tax Comm’n, Jan. 25, 1926) 411, Wis. C. C. H. Tax Service, par. 10-809.07; see Op. Tenn. Att. Gen. March 1, 1939. Tenn. C. C. H. Tax Service, par. 4-010. Labor of travelling salesmen expended outside the state does not there localize the sales income resulting from their efforts. See cases note 90 below. There would probably be no jurisdictional power to impose or collect the tax. See note 59 below.

\textsuperscript{58}Not the least of the difficulties facing the courts in this field of allocation is the apparent absence of well established principles of economics or accounting determining the place at which specific items of income are earned. See report of the Committee of the National Tax Association on Allocation of Income (October 1939) at pages 13 and 16.
law may accord the economist's position legal recognition. To date it has not.\(^6\)

Processing and assembling also constitute doing business at the location of the respective processing\(^6\) or assembly\(^6\) plants, and part of the final net income is there earned. A transportation company is doing business and earning income where its facilities are located.\(^6\) So again a business is done and income earned at the well\(^6\) or mine\(^6\) from which oil or minerals are extracted.

Economically speaking, some portion of the income of a business should probably be attributed to the performance of the accounting function, to the financing of the business, to collections, to research and design and to storage. Here again legal recognition of the economist's probable position is lacking, as are also decisions with respect to factual situations in which that viewpoint might more forcefully be presented. It has been held that where a "business is transacted and located without the state, excepting incidental management from and accounting" within the state, the income therefrom is earned in its entirety without

\(^{60}\)A taxpayer should be considered to be doing business where, economically speaking, it earns income subject to the limitation that a situs for taxation of income should not be assigned to a state without power to tax that income. Compare Union Refrigerator Transit Co. v. Kentucky, (1905) 199 U. S. 194, 26 Sup. Ct. 36, 50 L. Ed. 150 (holding that Kentucky could not tax to a domestic corporation property outside the state) with Southern Pacific Company v. Kentucky, (1911) 222 U. S. 63, 32 Sup. Ct. 13, 56 L. Ed. 96 (holding the reverse where property outside the state could not be taxed elsewhere and would escape taxation unless Kentucky could tax).


\(^{65}\)State ex rel. Mariner v. Hampel, (1920) 172 Wis. 67, 178 N. W. 244; Cottonwood Coal Co. v. Junod, (1935) 73 Mont. 392, 236 Pac. 1080.
the state; that the maintenance of a bank account outside the state does not constitute doing business outside the state; that making collections outside the state does not constitute doing business there; that the employment of research men in science or design does not constitute doing business; and that the maintenance of warehouses outside the state does not constitute doing business, as well as the reverse. In this last situation those


66Cottonwood Coal Co. v. Junod, (1935) 73 Mont. 392, 236 Pac. 1080. Here argument was made to the court that the taxpayer by "sending money for deposit in banks in St. Paul, receiving interest on its bank balances and interest on Liberty bonds, and disbursing these funds in that city, . . . was 'engaged in business' within the state of Minnesota." The Montana court held it was not. In a ruling of the Wis. Tax Comm'n of Jan. 2, 1924, 888 (Wis. C.C.H. Tax Service, par. 10-809.01) it was held that a foreign corporation doing nothing in Wisconsin other than the keeping of money on deposit in banks in the state and paying its bills by check thereon was not doing business nor earning income in Wisconsin. Where, however, the taxpayer is engaged in several activities within the state the presence of a bank account may, as one factor among several, be taken into consideration in determining whether or not the taxpayer is engaged in business. Laurentide Co. v. Durey, (N.D. N.Y. 1916) 231 Fed. 223 (". . . it collected such checks in the United States and deposited the proceeds to its own credit in its own bank account in the United States. . ." at p. 228); People ex rel. Stafford v. Travis, (1921) 195 App. Div. 635, 187 N. Y. S. 311, rev'd on other grounds 231 N. Y. 339, 132 N. E. 109, 15 A. L. R. 1319 ("all of his activities, his banking and capital, are in New York.") Carlos Ruggles Lumber Co. v. Commonwealth, (1927) 261 Mass. 450, 158 N. E. 899 ("The petitioner deposited money in banks here and received interest on the same.")

67See Op. Tenn. Att. Gen. March 1, 1939, Tenn. C. C. H. Tax Service, par. 4-010. However, if the making of collections is only one of several functions carried on outside the state it may be taken into consideration in deciding whether business is done outside the state. Appeal of Spicer & Co., (Cal. St. Bd. of Equal., April 20, 1932) Cal. C. C. H. Tax Service, par. 5-802.02.

68See general discussion concerning business situs of patents in Newport Co. v. Wisconsin Tax Comm'n, (1935) 219 Wis. 293, 310-312, 261 N. W. 884, 891, 100 A. L. R. 1204. See also note 72 below.

69Appeal of Green Spot, (Cal. St. Bd. of Equal., Nov. 15, 1939) Cal. C. C. H. Tax Service, par. 5-801a.05 ("appellant alleges that it maintains warehouses in other states and that many deliveries [through independent brokers] are made therefrom. The mere ownership of property outside the state, however, does not constitute doing business outside the state;") Appeal of Great Western Electro Chemical Co., (Cal. St. Bd. of Equal., April 24, 1934) Cal. C. C. H. Tax Service, par. 5-802.3 (company's entire net income was taxed in California even though a few of its sales were made from warehouses outside the state).

70See Walter H. Frick, (Wis. Tax Comm'n, Feb. 8, 1924) (warehouse within the state) and A. W. Kimball in re Chequamegon Ice Co., Ruling, Sept. 8, 1923 (warehouse without the state) in Wis. C. C. H. Tax Service, pars. 10-809.09 and 10-809.17, respectively. In California, the maintenance of a warehouse outside the state together with an office constitutes doing business outside the state. Appeal of Apex Rotarex Manufacturing Co., (Cal. St. Bd. of Equal., Nov. 9, 1935) Cal. C. C. H. Tax Service, par.
cases which hold that the maintenance of a warehouse or storage facilities constitutes doing business would appear, perhaps, the more accurate. The same conflict of authority will probably also arise with respect to the accounting and other functions mentioned should the courts be presented with situations in which, instead of "incidental" accounting, there was involved a regular accounting office outside the state at which a permanent staff was continuously employed; in which, instead of a bank account, there was the taxpayer's principal financial office;\textsuperscript{71} in which, instead of collectors, there was a collection office; and in which, instead of a few research employees, there was a permanent research department and laboratories outside the state.\textsuperscript{72}

A taxpayer is likewise engaged in business outside the state if its purchases made there or its management located there give that outside state jurisdiction to impose the tax, provided, of course, that economically speaking the income is there earned. The few court decisions involving the buying function have been made in situations in which the taxpayer, in conjunction with making purchases, was engaged in other business activities. Thus

\begin{itemize}
  \item In Laurentide v. Durey, (N.D. N.Y. 1916) 231 Fed. 223 above, the court in deciding that the taxpayer was doing business in the United States considered the fact among others that "it hired and paid for storage or warehouse room and had them [goods] delivered to itself at such rooms where it stored them." (p. 228).
  \item In International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 192, the taxpayer was engaged in buying and storing grain in North Dakota and selling it elsewhere. The court held it was doing business in North Dakota.
  \item In Porto Rico Mercantile Co. v. Gallardo, (C.C.A. 1st Cir. 1925) 6 F. (2d) 526 the taxpayer was engaged in buying and storing molasses in Porto Rico. At page 529, the court said, "If it can be said to be probable that the storing of molasses in Porto Rico increased its value there, it is impossible to determine the amount of profit" and noted that the statute omitted any allocation factor (which would be the usual device for measuring such profit).
  \item In Montgomery Ward & Co. v. State Tax Comm'n, (1940) 151 Kan. 159, 98 P. (2d) 143 the court took into consideration, among other things, the presence of a warehouse outside the state in attributing a portion of income to extra-state activities. The effect of the California Rule would be to recognize the storage function only in those cases in which the taxpayer engaged in sufficient additional activities to make qualification necessary, if a foreign corporation, or service of process effectual. The Wisconsin rule would seem to be more accurate for it gives recognition to the economic income from storage, assuming storage to be an income producing factor.
\end{itemize}


\textsuperscript{72}See Newport Co. v. Wisconsin Tax Comm'n, (1935) 219 Wis. 293, 261 N. W. 884, 100 A. L. R. 1204, where laboratories and a permanent research staff were apparently under consideration. See Montgomery Ward & Co. v. State Tax Comm'n, (1940) 151 Kan. 159, 98 Pac. (2d) 143, with respect to recognition accorded banking and accounting services, advertising, window displays, training schools and other activities conducted from without the state.
it has been held, that a taxpayer is engaged in business and is
taxable on the income attributable thereto where it concurrently
engages in the making of purchases and the storage of goods;\textsuperscript{73}
where it makes purchases and shipments and stores goods;\textsuperscript{74}
and where it engages in both buying and selling.\textsuperscript{75} On the other hand,
the making of isolated purchases outside of the state does not
constitute doing business there.\textsuperscript{76} Whether the continuous making
of purchases outside the state constitutes doing business will prob-
ably be answered in the affirmative in some situations\textsuperscript{77} and in the
negative in others.\textsuperscript{78} The maintenance of a purchasing office in
a state constitutes doing business.\textsuperscript{79} In a few cases there has been
some discussion of the allocation of buying profit by a separate
accounting.\textsuperscript{80} The few court decisions involving the management
of a business from without the state have been made in situations
in which there was involved a rather passive power of control
rather than the active and detailed conduct of business. The
management of Oklahoma oil fields by an owner and operator
in Illinois "exerted from his place of business" there does not
constitute doing business outside Oklahoma.\textsuperscript{81} The "formulating

\textsuperscript{73} Porto Rico Mercantile Co. v. Gallardo, (C.C.A. 1st Cir. 1925)
6 Fed. (2d) 526, and International Elevator Co. v. Thoresen, (1929) 58
N. D. 776, 228 N. W. 192.

\textsuperscript{74} Village of Westby v. Bekkedal, (1920) 172 Wis. 114, 178 N. W. 461.

\textsuperscript{75} Appeal of Yokohama Ki-Sto Kwaisha, Ltd., (1927) 5 B. t. A.
1, 217 N. Y. S. 669; Carlos Ruggles Lumber Co. v. Commonwealth,
'(1927) 261 Mass. 450, 158 N. E. 899.

\textsuperscript{76} People ex rel. Gaston & Co. v. Gilchrist, (1925) 214 App. Div. 750,
209 N. Y. S. 900 (Memorandum decision stated in Tenn. C. H. Tax
Service, par. 10-501.03 as holding that the making of casual and isolated
purchases and sales outside the state did not constitute doing business
there.) See with respect to service of process on foreign corporations, 18
Fletcher, Cyclopedia of Corporations, (1933) 406, sec. 8729 and with re-

\textsuperscript{77} If the buyer, as agent, has authority to pass the purchase price
and close the transaction and also operates in such way as to subject his
employer to the jurisdiction of the state in which to make the purchases
there is authority, by way of analogy with sales, that business is being
done. See note 90 below.

\textsuperscript{78} If the buyer, as agent, is restricted to the solicitation of offers of
sale, business, by analogy with sales, would not be done. See note 91 below.
As to mail order purchases, see by way of analogy notes 87 and 88 below.
Sales subject to the buyer's confirmation were involved in Montag Bros. v.

\textsuperscript{79} Appeal of El Dorado Oil Works, (Cal. St. Bd. of Equal., Nov. 15,
1939) Cal. C. C. H. Tax Service, par. 5-803.017. See Montgomery Ward

\textsuperscript{80} Hans Rees v. North Carolina, (1930) 283 U. S. 123, 135, 51
Sup. Ct. 385, 75 L. Ed. 879, and S. S. Kresge Co. v. Bennett, (S.D.N.Y.

\textsuperscript{81} Shaffer v. Carter, (E.D. Okl. 1920) 252 U. S. 37, 40 Sup. Ct. 221,
64 L. Ed. 445.
of plans and policies" and the holding of directors' meetings outside the state also do not constitute doing extra-state business. Conversely, the presence of "incidental management," of business trustees or of a partner within the state does not bring a business, otherwise carried on without the state, within the state. On the other hand, a company which maintains outside the state an office from which the business is actively conducted in a detailed and continuous manner will probably be held to be doing a multi-state business. The difference between these two types of situations may be justified upon the jurisdictional considerations already mentioned.

The problem most frequently raised does not concern the management of a business, the making of its purchases, the operation of its factory or the performance of any one of the other business functions already mentioned. It concerns the securing of sales. Determination of the place at which sales profit may legally be said to be earned involves both the economic problem of localizing the income and the legal problem of the state's power to tax it. A taxpayer is not engaged in business outside the state and is not considered to be earning income there by virtue of mail order sales made to extra-state customers. Nor

---


83United States Glue Co. v. Town of Oak Creek, (1915) 161 Wis. 211, 219, 153 N. W. 241, 244 aff'd 249 U. S. 32, 38 Sup. Ct. 499, 62 L. Ed. 1135.

84State ex rel. Mariner v. Hampel, (1920) 172 Wis. 67, 178 N. W. 244 (land and mines in Michigan were owned by Wisconsin trustees who "had practically the same powers with respect to the control and management" as their predecessor corporation from which the properties had been conveyed to them.)

85State v. Eberhardt, (1914) 158 Wis. 20, 147 N. W. 1016 (partnership income from a dredging business in Texas held not taxable to resident partner in Wisconsin).


87Montag Bros. v. State Revenue Comm'n, (1935) 50 Ga. App. 660, 179 S. E. 563, aff'd 182 Ga. 568, 186 S. E. 558. Here the court held that the busi-
is a taxpayer engaged in business within the state by reason of correspondence with customers there residing. Although there may be some inaccuracy from the economic aspect, the result seems sound, for a contrary rule would assign sales income a situs for taxation in a state which, under the usual circumstances, would not have power to impose the tax. Where sales are solicited outside the state by salesmen whose authority is limited to the solicitation of offers of purchase, the same rule obtains and, although subject to some doubt as to its economic accuracy, seems sound for the reasons stated. However, it has been held that a business is done outside the state and a sales income there earned where sales are consummated by salesmen or agencies outside the

ness of the taxpayer was "carried on entirely within the state" saying: "... that in its several kinds of sales, ... some to mail order customers out of the state ... there is no contention. ..." In Hump Hairpin Mfg. Co. v. Emmerson, (1922) 258 U. S. 290, 42 Sup. Ct. 305, 66 L. Ed. 622, the court held all business was done within the state. The case involved a tax on the privilege of doing business measured by the value of capital stock represented by property and business within the state. In a dictum the court stated that an income tax would be valid under similar circumstances. Accord: Appeal of K. Hovden Company, (Cal. St. Bd. of Equal., April 24, 1934) Cal. C. C. H. Tax Service, par. 5-801.01; Appeal of Great Western Electro Chemical Co. and Appeal of American Engraving & Color Plate Co., (Cal. St. Bd. of Equal., Dec. 14, 1931) Cal. C. C. H. Tax Service, par. 5-802.03.

Ruling of Wisconsin Tax Comm'n, Wis. C. C. H. Tax Service, par. 10-809.15.

The economist might have reason to contend that some small portion of the sales profit should be attributed to the state in which the customer resides, where the decision to purchase is made, from which the price is paid and within which the goods are delivered.

state with authority to close them there.\textsuperscript{91} It has also been held, under a different rule, that such part of a company's sales business as involved the shipment of goods from origins without the state to destinations without the state constitutes extra-state business.\textsuperscript{92} This latter rule is subject to some doubt both with respect to its theory\textsuperscript{93} and present authority.\textsuperscript{94}

\textsuperscript{91}In People ex rel. Stafford v. Travis, (1921) 231 N. Y. 339, 132 N. E. 109, 15 A. L. R. 1319, some of the orders taken by the field representatives outside the state “there became consummated agreements of purchase and sale between relator and such customers” (p. 114). The taxpayer also “employed travelling salesmen in different places in Europe, South America, and Australia, some of whom maintained offices where the name of G. A. Stafford & Co., under which the relator did business, may have been displayed.” (p. 113). The court held income from such sales earned outside New York. Accord: People ex rel. Monjo v. State Tax Comm'n, (1926) 218 App. Div. 1, 217 N. Y. S. 669. Note, however, special New York statute stated in note 95 below. See Appeal of Howard Auto Co., (Cal. St. Bd. of Equal., May 15, 1931) Cal. C. C. H. Tax Service, par. 5-802.06. For cases which involve the rule which assigns sales a situs in the state in which the last act necessary to pass title occurred, see note 150 below and text. For cases involving the confirmation of sales see notes 159 and 160 below and text.

\textsuperscript{92}United States Glue Co. v. Town of Oak Creek, (1915) 161 Wis. 211, 153 N. W. 241, aff'd 249 U. S. 32, 38 Sup. Ct. 499, 62 L. Ed. 1135; Appeal of Great Western Electro Chemical Co., (Cal. St. Bd. of Equal., April 24, 1934) Cal. C. C. H. Tax Service, par. 5-802.03; Appeal of Charles Harley Co., (Dec. 14, 1931) Cal. C. C. H. Tax Service, par. 5-802.03. A third rule under the particular wording of the Missouri statute may be that the presence of salesmen outside the state is alone sufficient to make sales those “which are transactions partly within this state and partly without this state” and permit allocation. Artophone Corp. v. Coale, (1939) 345 Mo. 344, 133 S. W. (2d) 343. For statute see note 145 below.

\textsuperscript{93}It assigns sales a taxable situs in a state which might not have jurisdiction to tax. Additional questions are raised with respect to the construction of the Wisconsin statute, for the United States Glue Co. had its principal sales office in Wisconsin and branch sales offices in many of the larger cities of the United States. If, in fact, sales were consummated through the home office they would not under the rule be Wisconsin sales if shipment took place entirely outside the state; and if, in fact, the sales were consummated at branches outside the state they would not under the rule be extra-state sales if the goods originated in Wisconsin. Compare Trane Co. v. Wisconsin Tax Comm’n, (1940) 235 Wis. 516, 292 N. W. 897.

\textsuperscript{94}Buick Motor Co. v. City of Milwaukee, (E.D. Wis. 1930) 43 F. (2d) 385, aff’d (C.C.A. 7th Cir.) 48 F. (2d) 801, held that sales of the taxpayer’s Wisconsin branch of goods shipped from the Michigan factory to Michigan customers were Wisconsin sales. The Wisconsin court in Trane Co. v. Wisconsin Tax Comm’n, (1940) 235 Wis. 516, 292 N. W. 897, held the taxpayer’s entire income taxable in Wisconsin and that no business was done outside the state. In so doing it emphasized the fact that sales were consummated in the Wisconsin office and that salesmen outside the state were limited in their authority to the solicitation and formulation of “proposals” for final action at the home office. Compare however, California Packing Corp. v. State Tax Comm’n, (1939) 97 Utah 367, 93 F. (2d) 463. In Carlos Ruggles Lumber Co. v. Commonwealth, (1927) 261 Mass. 450, 158 N. E. 899, an allocation was permitted where goods were both purchased and sold without the state. Apparently, in the United States Glue Co., (1917) 247 U. S. 321, 38 Sup. Ct. 499, 62 L. Ed. 1135, no allocation was allowed in respect to this type of sale.
Where the taxpayer maintains branch sales offices outside the state and operates them under such circumstances as would subject it, if a foreign corporation, to the jurisdiction of the extra-state courts or to the duty of qualification, no conflict of authority exists. The decisions are that the taxpayer is engaged in a multi-state business.85 Where, however, some doubt on the facts exists

with respect to whether or not a business office is actually maintained outside the state, the results are not so clear. Whether the making of brokerage sales outside the state or sales on such public exchanges as those for stock and grain outside the state constitute doing business are questions also subject to jurisdictional considerations. The activities of brokers outside the state probably would neither subject the taxpayer, if a foreign corporation, to the service of process nor make qualification necessary. If so, a situs for taxation of the income from brokerage sales would not be assigned to the state of the location of the brokers and the taxpayer would not be considered to be doing business there. To the extent that exchange sales are made through

---

Footnotes:

96 In Trane Co. v. Wisconsin Tax Comm’n, (1940) 235 Wis. 516, 292 N. W. 897, the standard agency contract provided that the agent should maintain at his expense a suitably equipped sales and service office with the company’s name appearing on the entrance, in the telephone book and other directories. It did not appear whether these agreements were complied with. The court held that no business was being done outside the state. In People ex rel. Stafford v. Travis, (1921) 231 N. Y. 339, 132 N. E. 109, 15 A. L. R. 1319, the court noted among other facts that the company’s name appeared on the doors of sales offices. If a stock of goods is maintained at the branch office from which sales are made a business is, of course, being done. Ruling (Wis. Tax Comm’n, May 26, 1925) C. C. H. Tax Service, par. 10-809.06; Appeal of Apex Rotarex Manufacturing Co., (Cal. St. Bd. of Equal., Nov. 9, 1936) Cal. C. C. H. Tax Service, par. 5-802.01. However, the maintenance of a mailing headquarters for salesmen, listing in the telephone directory, the placing of a name on an office door and the keeping of samples for the inspection of prospective customers does not necessarily constitute doing business within the state. Ruling Wis. Tax Comm’n Ibid. Compare ruling (Wis. Tax Comm’n, March 10, 1924) Wis. C. C. H. Tax Service, par. 10-809.14. The maintenance of an office for the forwarding of mail and telegrams, for the direction of customers, and for occasional calls by salesmen does not constitute doing business. People ex rel. Brighton Mills v. Knapp, (1920) 192 App. Div. 740, 183 N. Y. S. 480. Where, in addition to samples on display, a stock of goods is maintained for sale, business is done. Gorham Manufacturing Co. v. Travis, (S.D. N.Y. 1921) 274 F. 975, aff’d (1924) 266 U. S. 265, 45 Sup. Ct. 80, 69 L. Ed. 279. In Baseball Publishing Co. v. Commission, (1933) Mass. B. T. A. 717 the court held that a billboard advertising company was doing business in New York. It occupied a New York office jointly with an affiliated company; paid no rent; salesmen and officers visited the New York office; the treasurer was permanently employed in New York; a bank account was kept in New York; and its name was in the telephone directory. No allocation however was allowed under the Massachusetts statute. See note 137 below and text. In Appeal of Great Western Electro Chemical Co., (Cal. St. Bd. of Equal., Dec. 14, 1931) Cal. C. C. H. Tax Service, par. 5-802.03, the board held that the entire income was earned in California notwithstanding sales made from a Washington office. The nature of the Washington office was not stated. As to a statutory office see Appeal of California Despatch Line, (Cal. St. Bd. of Equal., Mar. 10, 1938) Cal. C. C. H. Tax Service, par. 5-801a.03.

97 Appeal of K. Hovden Co., (Cal. St. Bd. of Equal., April 24, 1934) Cal. C. C. H. Tax Service, par. 5-801.01 (company with brokers on commission basis outside the state with authority there to consummate the sales, to make deliveries from warehouses outside state and to make collections held to be doing its entire business in California); Appeal of Green
brokers they should be similarly treated.\textsuperscript{98} With respect to warehouse and consignment sales there is, in addition to the economic and jurisdictional factors, another involving the storage function. To date the decisions have localized warehouse sales upon principles not primarily concerned with the place of storage of the goods sold.\textsuperscript{99} They have been assigned a situs where made, either at the home office\textsuperscript{100} or at the field office.\textsuperscript{101} By analogy a taxpayer with merchandise in the possession of consignees outside the state would not be considered to be doing business there merely by reason of such storage of goods but by reason of other considerations relating to jurisdiction and the manner in which the sales are made.\textsuperscript{102}

\textsuperscript{98}In Appeal of Henry Investment Co., (Cal. St. Bd. of Equal., Mar. 15, 1933) Cal. C. C. H. Tax Service, par. 5-802.08, it was held that a California firm trading on margin through its brokers on the New York stock exchange was not doing business in New York. Possibly under other and different circumstances the relationship between the taxpayer and its representative on the exchange might be such that the seller would be considered doing business outside the state. See International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 192, where it was stipulated that sales on the Minneapolis grain exchanges were Minnesota sales. As to independent contractors, see Appeal of Filtrol Co. of California, (Cal. St. Bd. of Equal., Nov. 15, 1939) Cal. C. C. H. Tax Service, par. 5-801a.02.

\textsuperscript{99}It might be argued that a warehouse sale is the result of three factors, namely, the activities of the home office, the activities of the field representative, whether employee or broker, and quick delivery effected by the proximate location of the warehouse. The decisions to date have considered the first two factors only (as well as the question of jurisdiction). Apparently, warehouse sales will be considered without reference to the place from which delivery is made. Storage will probably be considered a separate function. See notes 69, 70 and text.


\textsuperscript{101}Appeal of Apex Rotarex Co., (Cal. St. Bd. of Equal., Nov. 9, 1936) Cal. C. C. H. Tax Service, par. 5-802.01; Ruling (Wisconsin Tax Comm’n, May 26, 1925), Gorham Manufacturing Company v. Travis, (S.D. N.Y. 1921) 274 F. 975, aff’d (1924) 266 U. S. 265, 45 Sup. Ct. 80, 69 L. Ed. 279, and other authorities cited in note 96 above where the presence of the goods at the branch was stressed as an additional factor.

\textsuperscript{102}In Trane Company v. Wisconsin Tax Comm’n, (1940) 235 Wis. 516, 292 N. W. 897, the court held that no extra-state business was done, notwithstanding the fact that "consigned stocks were maintained" outside
II. Allocation of Income

Only that income is subject to allocation which is from an integral, multi-state business. This allocation may be made by a statutory apportionment fraction, by an equitable apportionment or by a separate accounting. Under the first method the intrastate portion of the income from a multi-state business is determined by applying a statutory fraction to the entire income. By a separate accounting the same determination is made but by an application and use of accounting records, principles and practices. In an equitable apportionment an administrative selection and application of apportionment fractions is made. The various methods of allocation may be separately considered.

A. Allocation by Statutory Fraction.—The principal constitutional limitations upon statutory apportionment fractions are with respect to their structure and the results of their application. Structural deficiency may invalidate the formula; inequity in results, the particular application.

These fractions generally contain in the numerator some income producing factor which may be assigned a situs within the state, such as property, payroll or sales. The dominator includes similar factors everywhere. The factor or factors in the denominator must correspond to those in the numerator. The legislature...

Sixteen different fractions are listed as having been adopted in various states at page 5 of the 1939 Report of the Committee of the National Tax Association on Allocation of Income. They are as follows:

<table>
<thead>
<tr>
<th>Income Factors</th>
<th>Number of States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, Payroll, Sales</td>
<td>10</td>
</tr>
<tr>
<td>Property, Manufacturing Costs, Sales</td>
<td>7</td>
</tr>
<tr>
<td>Property, Sales</td>
<td>8</td>
</tr>
<tr>
<td>Sales</td>
<td>8</td>
</tr>
<tr>
<td>Property, Manufacturing Costs</td>
<td>1</td>
</tr>
<tr>
<td>Property, Costs of Sales, Sales</td>
<td>1</td>
</tr>
<tr>
<td>Property, Payroll</td>
<td>2</td>
</tr>
<tr>
<td>Property, Shares of other Corporations, Accounts Receivable</td>
<td>1</td>
</tr>
<tr>
<td>Property, Payroll, Sales, Purchases</td>
<td>1</td>
</tr>
<tr>
<td>Property</td>
<td>1</td>
</tr>
<tr>
<td>Manufacturing Costs</td>
<td>1</td>
</tr>
<tr>
<td>Marketing Costs</td>
<td>1</td>
</tr>
<tr>
<td>Property, Payroll, Sales, Manufacturing Costs</td>
<td>1</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>1</td>
</tr>
<tr>
<td>Property, Payroll, Purchases</td>
<td>1</td>
</tr>
<tr>
<td>Loans, Wages, Interest</td>
<td>1</td>
</tr>
</tbody>
</table>

The statute selected as a base the income upon which the taxpayer paid a tax to the United States. This would apparently include dividend and interest income.
failed to take into consideration the value of the interest producing bonds and ninety per cent of the value of the dividend paying stocks.\textsuperscript{108} The court held the formula unconstitutional as applied to the types of income involved, but after reconstruction approved the formula as revised.\textsuperscript{109} The effect of this case would be, in one aspect to exclude from apportionable income earnings of a type which bear no reasonable relationship to any of the factors in the fraction, and in another, to require the inclusion in the fraction of at least one factor which bears some reasonable relationship to the income allocated.\textsuperscript{110} A compound or multiple fraction may include factors, one or more, yet less than all, of which are not related to the income being apportioned.\textsuperscript{111} The reasoning of the \textit{Alpha Portland Cement Case} would require exclusion of the unrelated factor or factors.\textsuperscript{112} The converse of this is not true, however. An allocation fraction is not required to include as

\begin{align*}
\text{Real and Tangible Personal Property in N. Y.} & + \text{Bills and Accounts Receivable in N. Y.} + 10 \text{ per cent of Stock in N. Y.} \\
\text{Real and Tangible Personal Property Everywhere} & + \text{Bills and Accounts Receivable Everywhere} + 10 \text{ per cent of Stock Everywhere}
\end{align*}

The statute included provisions specifying the situs of bills and accounts receivable and stock.

\textsuperscript{108}The formula was as follows:

\textsuperscript{109}The court indicated that the entire amount of interest income should be omitted from the basic income to be allocated and that the entire value of stock should be included in the formula.

\textsuperscript{110}There are many instances in which this rule might find application. For example, apportioning business income by a fraction including only stock, bonds or other property not used in business; or apportioning business income by a fraction including only sales not made in the business; or apportioning business income by a fraction including only payroll of persons not employed in the business; or apportioning dividend income solely on a tangible property, sales or payroll basis; or apportioning interest income on similar bases solely. These principles may here have some application in those cases in which it is uncertain whether the court considered the selling and distribution activities of oil companies to be an integral business separate from production and refining. If the “sales” profit is to be apportioned among the states in which the sales offices are located then only assets used in the sales end of the business may be used in the formula. If, on the other hand, the entire income is being allocated, then all assets should be included. Cf. Fisher v. Standard Oil Co., (C.C.A. 8th Cir. 1926) 12 F. (2d) 744 with Standard Oil Co. v. Thoresen, (C.C.A. 8th Cir. 1928) 29 F. (2d) 708.

\textsuperscript{111}For example a formula may include tangible property and bond factors. The taxpayer earns a business income, but no interest although it owns bonds. The effect of the application of the formula would be to give bonds a fifty per cent weight in apportioning business income. Or take, for example, a formula containing property and sales factors. The taxpayer is engaged in renting and selling properties. He makes no profit on his sales. The effect of the application of the formula would be to give unrelated sales a fifty per cent weight in allocating income from the rental business.

\textsuperscript{112}It would seem as easy an operation to omit a factor as add one. See statutory provisions cited in notes 251 and 252 below and text.
many functional factors as there are corresponding functions in the business. Such a rule would present a practically impossible administrative task. It has been held that the income of a manufacturing concern may be apportioned on the basis of a property factor alone\(^{112}\) notwithstanding the fact that numerous other business functions such as selling and management\(^{114}\) are also involved in the earning of the final net income. The same decision has been made with respect to a mercantile concern.\(^{115}\) A single gross receipts factor has also been approved as applied to manufacturing,\(^{116a}\) automobile assembling,\(^{116}\) and newspaper businesses.\(^{118}\) Under these cases an apportionment formula would be prima facie valid with respect to the allocation of income if there is present therein any one factor reflecting a material function of the business. Although a single factor fraction may be valid, multiple fractions frequently reach a more accurate result and are commonly used.\(^{119}\) A two-way formula of property and

---


\(^{114}\) See cases in preceding note. In Underwood Typewriter Co. v. Chamberlain, (1920) 254 U. S. 113, 41 Sup. Ct. 45, 65 L. Ed. 165, the state court (94 Conn. 47, 108 Atl. 154) said: "The plaintiff’s theory is that the real producing elements of net income depend on the executive management of the corporation, rather than its plant. But . . . it is not unjust to allocate its net income . . . with reference to the value of its tangible property in this and other jurisdictions."

\(^{116a}\) Decision of the court of the state of the main office). Carlos Ruggles Lumber Co. v. Commonwealth, (1927) 261 Mass. 450, 158 N. E. 899 (decision of the court of the state of the main office).


\(^{117}\) In re Kansas City Star Co., (Mo. 1940) 142 S. W. (2d) 1029. (The fraction applied was Missouri circulation over circulation everywhere. Advertising receipts were not included.)

\(^{119}\) See note 105 above. Even a multiple fraction may fail to reflect each of all the various functions in the business such as accounting, buying,
sales has received judicial approval. So also have three-way formulas of property, sales and manufacturing costs, and sales, property and payroll. Multiple formulas of other types have also been approved.

The legislature may not create irrational fractions. Neither may the tax authority apply one which results in obvious inequity. The taxpayer's burden of proof, however, is not easily sustained. The presumption is that a formula of proper structure is prima facie correct. In Hans Rees' Sons v. State of North Carolina, the taxpayer showed that only 17 to 21.7 per cent of its income for the years in question was actually earned in North Carolina whereas the statute apportioned from 66 to 85 per cent of it to that state. The tax as applied was held unconstitutional. On the other hand, proof of a three or four per cent error in the apportionment of a taxpayer's income does not demonstrate inequity.

financing, research, sales, plant, storing, credits, collections, transporting and extracting.


Union Pacific Railway v. State Tax Comm'n, (1937) 145 Kan. 715, 68 P. (2d) 1, approved a three way formula of tangible property, gross revenue, and expense. See also New York formula stated in note 108 above, and considered in cases cited in notes 42, 95 and 106 above.


(1930) 283 U. S. 123, 51 Sup. Ct. 385, 75 L. Ed. 879.

The place at which inaccuracy becomes so gross as to constitute inequity has not as yet been precisely delineated by decision.\textsuperscript{127} Generally, however, the taxpayer has failed to sustain the burden of proof and the formula has been upheld.\textsuperscript{128} In one unusual case the court, in voiding an allocation fraction, took judicial notice of facts tending to show that the results of its application would be unfair.\textsuperscript{129} It has been held that the taxpayer must not only prove "unfairness," but its exact amount.\textsuperscript{130} With respect to this second constitutional limitation, economic and accounting proofs are of decisive importance. Prerequisite to the demonstration of error is proof of the actual amount of income earned within the state. This means, in effect, that the taxpayer must have available the data for a separate accounting.\textsuperscript{131} Possibly this second limitation upon statutory apportionment may, not altogether too

\textsuperscript{127}In this situation the phrase, "Damnum absque injuria," might seem more apt than, "A little wrong is no injustice."


\textsuperscript{129}Wallace v. Hines, (1920) 253 U. S. 66, 40 Sup. Ct. 435, 64 L. Ed. 782 (railway mileage ratio invalidated, the court judicially noting that North Dakota was "a state of plains, very different from other states" and that consequently terminal facilities would be preponderantly out of the state without regard to mileage. The tax was one on corporate excess).

\textsuperscript{130}See People ex rel. Charles Kohlman & Sons v. Law, (1925) 239 N. Y. 386, 146 N. E. 622. In this case the question arose as to the situs of the accounts-receivable-from-orders-accepted-in-the-state factor, note 108 above, of the New York apportionment formula. The taxpayer failed to indicate in its return or show the commission at the hearing how many sales were accepted outside the state. The tax commission assessed the tax on the assumption that all sales were accepted in New York. In affirming the commission's order and reversing the appellate division Mr. Justice Cardozo, speaking for the court said: "In the absence of evidence fixing with reasonable certainty the quantum of error, the board should not be required to roam about in search of information impeaching its own action. The assessment stands as ordered till the taxpayer has shown to what extent it is excessive." In Hans Rees' Sons v. State of North Carolina, (1930) 283 U. S. 123, 51 Sup. Ct. 385, 75 L. Ed. 879, the taxpayer proved the exact quantum of error.

\textsuperscript{131}The statutory right to a separate accounting is discussed below.
inaccurately, be described as the taxpayer's constitutional "right" to a separate accounting. Whether the state has a "right" analogous to that of the taxpayer has not yet been directly decided.\textsuperscript{32} However, it would seem just as inaccurate to impose a tax for less than is due as to impose one for more.\textsuperscript{33} Possibly the burden of proof would make any so-called "right" on the part of the state an illusory one.\textsuperscript{34}

More specific than questions of constitutional limitation are those with respect to the localization and valuation of apportionment factors. The application of sales, property and payroll factors raises problems of both fact and statutory construction.

1. The Sales Ratio.—The lack of uniformity which obtains with respect to the selection of statutory allocation factors by the various state legislatures obtains also with respect to their wording and interpretation. The sales factor is no exception. The statutes or regulations of many states assign sales a situs in the state in which the business activity chiefly conducing to such sales may be said to be localized. Thus, sales are often considered to have a situs within the state if "made through or by offices, agencies or branches" located within the state.\textsuperscript{35} Another common statutory provision of similar purport is that which localizes receipts from sales at "the office, agency, or place of business . . . at or from which the transactions giving rise to such receipts are chiefly handled and attended to with respect to nego-

\textsuperscript{32} See note 219 below and text.
\textsuperscript{33} Whether, as a matter of popular psychology, it would be thought just as unfair is, perhaps, another question.
\textsuperscript{34} Generally, the taxpayer's books are the principal, if not the only, source of information. See Ford Motor Co. v. State, (1935) 65 N. D. 316, 238 N. W. 596.
\textsuperscript{35} Arizona, sec. 3182x, 3 Revised Code Supp. 1934; North Carolina, Code 1935, sec. 7880 (128) II, 2, (b), as reenacted in 1939 Laws, ch. 158, art. IV, Schedule D; South Dakota, Code 1939, sec. 57.2707 (3); Wisconsin, Statutes 1939, sec. 71.02, (3) (d) 3; Oregon, Art. 307-2 of 1940 Regulations, par. 14-536 of Or. C. C. H. Tax Service, (sales from stock not taxpayer's). Minnesota, Mason's 1940 Supp., sec. 2394-25 (A) (1) (a) includes as Minnesota sales those "made through, from or by offices, agencies, branches or stores" within this state as well as those "made within this state." Iowa in Art. 11(d) (Iowa, C.C.H. Tax Service, par. 1461-4) of the 1937 Regulations to the personal income tax law adopts the language of the first quoted provision of the Minnesota statute. The 1935 New York Unincorporated Business Tax Act in McKinley's Consolidated Laws of New York, Book 59, Art. 16-A, sec. 386 (g), provides in part for the inclusion of sales "by or through an agency located within the state." Louisiana in art. 216 of its Regulations (Louisiana C.C.H. Tax Service, par. 14-716) provides, in part, for the inclusion of sales "by or through any branch, agency, office or other place of business within the state."
tiation and execution."

Other states localize all sales of doubtful situs within the state by assigning to the taxing jurisdiction all sales "except those negotiated or effected in behalf of the corporation by agents or agencies chiefly situated at, connected with or sent out from premises for the transaction of business" owned or rented (maintained) by the corporation outside the state. A few states, in addition to localizing sales at the place of the agency, office, branch or other center of business activity producing such sales, provide for localization at the place of the residence of the agent. Thus, sales have been given a local situs if "principally secured, negotiated or effected by employees, agents, offices, or branches of the taxpayer's business resident or located" within the state. It may be observed that the statutory provisions of this majority of states are essentially similar in that they localize sales at an office or agency from which emanate the activities producing the sales. This localization may be described as that of office situs.

To be compared with this majority rule are the various minority rules in other states. One rule assigns sales a situs at the place at which the goods sold are delivered. Another

---

136Kentucky, Statutes, (Carroll 1936) sec. 4281b-32 (1) (c) (D); North Dakota Compiled Laws, 1925 Supplement, sec. 2346a6, 2, (c) (2). The New York Unincorporated Business Tax Act, provides in addition to the part quoted in note 135 above that "all sales negotiated or consummated by salesmen 'attached to or sent from offices, or other agencies situated within the state' shall constitute local sales."

137Massachusetts, General Laws 1932, ch. 63, sec. 38, 6; Pennsylvania, Purdon's Statutes Supp., Tit. 72, sec. 3420b, "Net Income" 2, (c), (3); Utah, Revised Statutes 1933, 80-13-21(6) (e) (1st). The Utah supreme court in California Packing Corporation v. State Tax Comm'n, (1939) 97 Utah 367, 93 P. (2d) 463, redrafted the statute so as to include as local sales those "sales (within the state), except those negotiated or effected in behalf of the corporation by agents or agencies chiefly situated at, connected with or sent out from premises (within the state) for the transaction of business owned or rented by the corporation outside this state. . . ." Utah may now be considered to have a statute similar to those in other states assigning a local situs to sales made "within the state." For facts of this case see note 163 below. Apparently the court was apprehensive of manipulation by the taxpayer.


139The statutes of 18 states are cited in the footnotes above.

140Colorado, Laws 1937, ch. 175, sec. 17 includes "sales delivered within this state excluding deliveries for transportation out of the state"—see art. 17 of 1937 Regulations in Col. C. C. H. Tax Service, par. 10-806; Iowa, Code 1939, sec. 6943.065, 1, b provides, "sales of the corporation within the state shall be taken to be gross sales from goods sold and delivered within the state, excluding deliveries for transportation out of the state." See also Art. 248 Regulations No. 5 Miss. 1937 and 1940 pocket Supp. to Williams Tennessee Code, sec. 1316 (1) (c).
assigns sales a situs within the state from which shipment is made. A considerable number of other statutes refer generally to "sales within the state" without further specification. These last statutes establish what may be fairly described as a "constructional" situs for the statutory phrase has no definite meaning without the aid of judicial interpretation. Some other jurisdictions assign sales a situs in the state in which the last act necessary to pass title occurred. This suggests the conflict of laws rule and will be so described hereafter.

It may be observed that under each of these five rules the

143 New Mexico, Laws 1933, ch. 85, sec. 31 (see sec. 21) and Virginia, Tax Code sec. 54 in Appendix to Virginia, Code 1936, "gross receipts in this state..." shall include... all receipts from sales, wherever made, of products, goods, wares, and merchandise manufactured, or which originated in this state." Oregon, 1938 Regulations, Art. 186 (a) C. C. H. Or. Tax Service, page 1587-91 with respect to sales from stock of goods of taxpayer provides: "The place of sales made... is the location of the stock from which the goods are shipped, regardless of the destination... or the place where the contract of sales was consummated." See Vermont, Public Laws 1933, ch. 40, sec. 894.

144 Arkansas, Regulations 7 (1927) art. 362; California, Reg. to Personal Income Tax Act of 1935, art. 7 (f)-4 and see Act 8494a, sec. 13 of California, Codes Supp. (Deering 1939) providing for allocation "on the basis of sales..." and District of Columbia, art. 3 (b) (1) of Reg. (Par. 10-802 C.C.H. Tax Service). Minnesota, Mason's 1940 Supp. sec. 2594-25 (A) (1) (a) includes "sales made within the state" as well as sales having an "office situs" therein. See Kansas, Laws 1937, ch. 370, sec. 3 amending sec. 79-3218 of Gen. Statutes of 1935 and West Virginia, Laws 1939, sec. 25 (11) with art. 25-60 of Regulations thereunder ("business done within the state"-W.Va. C.C.H. Tax Service, par. 14-637). The Utah statute in effect now contains the phrase "sales (within the state)." California Packing Corp. v. State Tax Comm'n, (1939) 97 Utah 367, 93 P. (2d) 463.

145 See note 156 below.

146 Campania General de Tabacos de Filipinas v. Collector of Internal Revenue, (1929) 279 U. S. 306, 49 Sup. Ct. 304, 73 L. Ed. 704 (holding sales profit taxable in Philippines where the "final acts... making effective the sales occurred"); Commissioner of Internal Revenue v. East Coast Oil Co., (C.C.A. 5th Cir. 1936) 85 F. (2d) 322. ("The title passed to the buyer in Mexico. When title passed, the profit was earned in Mexico. Collection of the price in the United States was incidental, and did not earn the profit.") Briskey Co. v. Commissioner, (1934) 29 B. T. A. 987 (sales income held to be from sources outside United States since title passed in India).

147 Statutes in a few additional states contain phraseology peculiar to the particular enactment. Section 10, Missouri, Rev. Stat. 1929 provides "The amount of sales which are transactions wholly in this state shall be added to one-half of the amount of sales which are transactions partly within this state, and... shall be divided by the total sales... and the net income shall be multiplied by the fraction...;" Section 2297.1 of the Montana, Rev. Laws 1935 provides that consideration shall be given the "sales, property and payroll and such other factors as may be deemed applicable;" Oklahoma in sec. 2 of art. 10 of ch. 60 of its 1939 Laws amending sec. 12498h of Okla. Statutes 1936 Supp. in subsection (e) (3) assigns a situs within the state to sales "in connection with the business transacted partly within and partly without this state." The Missouri law
legislature has selected one or more of the economic incidents to a sale and enacted that they determine its situs. Under the office situs rule those activities of a seller customarily centered at the sales office, which are designed to induce customers to purchase, are selected and made the criterion. These activities are obviously material economic factors in the making of a sale. At the place of delivery the decision to buy is generally made. There purchasing power is found and the purchase price acquired. Material economic factors are also operative here. The place of origin may play some part in the making of a sale, for quick delivery may frequently attract customers. Of some purport also is the place of passing title, for there the seller first acquires legal power to compel the buyer to remit the purchase price. Finally, under the constructional rule, the court may select any one or more of these or other factors as dominant and assign the sale a situs where these factors may be said to be localized. The application of these frequently conflicting rules furnishes a fruitful source of double taxation. They may be considered in greater detail in connection with various types of sales.

Mail order sales, solicited sales, branch office sales, warehouse sales, consignment sales, brokerage sales and sales on exchanges have already been discussed in connection with multi-state businesses. A recurrent problem is whether the rules there discussed apply here. There is some authority that they do. Argument may be made to the contrary on the ground that the jurisdictional considerations present in connection with the former problem are absent here. No general answer may be made. It depends in each state upon the construction as a whole of a particular state income tax statute.

Mail orders may be received, accepted and filled from the same office. In this situation all except the destination rule would assign such sales a situs at the office. It is still an undecided question whether the same result would be reached where the

---

146 See notes 86 through 102 above, and text.
148 Op. Tenn. Att. Gen. March 1, 1939 in Tenn. C. C. H. Tax Service, par. 4-010 holds that receipts from mail order sales to extra-state customers were "gross receipts in Tennessee" within the meaning of the Tennessee apportionment factor. See in accord cases cited in notes 87 and 88 above.
economic incidents of the mail order sale become more widely dispersed.\textsuperscript{149} Probably it would.

The overlapping of rules is especially marked with respect to solicited sales. The destination rule would assign these sales a situs in the state of delivery. The origin rule would consistently assign the same sales a different situs except in those instances in which shipment took place within one state. Under the conflict of laws rule the same sales might be localized in other states. It would depend on where the act which passed title occurred.\textsuperscript{150} Under the office situs rule the salesman who induced the customer to purchase might be connected with an office located in yet another and different state. Thus, it has been held under the Massachusetts statute\textsuperscript{51} that sales solicited in other New England states by salesmen travelling out of a Boston office were Massachusetts sales, notwithstanding the fact that the goods were shipped directly from the Pennsylvania factory to the New England customer.\textsuperscript{162} In another situation under the Wisconsin statute\textsuperscript{53} the order may be accepted by a branch office in one state and the goods shipped from a main office or warehouse in another state; or there may be various inter-branch arrangements which involve sales activities in several states.

\textsuperscript{149}The order may be accepted by a branch office in one state and the goods shipped from a main office or warehouse in another state; or there may be various inter-branch arrangements which involve sales activities in several states.

\textsuperscript{150}In Compania General v. Collector, (1929) 279 U. S. 306, 49 Sup. Ct. 304, 73 L. Ed. 704, the sales, the income from which was in question, were localized at the place of the taxpayer's "principal office" in the Philippines, where the sales were "subject to confirmation and absolute control as to price and other terms" even though the goods were sold through an "agency" in the United States to which country they were shipped. In Commissioner v. East Oil Co., (C.C.A. 5th Cir. 1936) 85 Fed. (2d) 322, the products were sold through agents in United States to customers there who made payment there. The goods were delivered to common carriers in Mexico although "ultimate delivery" was in the United States. They were produced in Mexico where title passed. On this latter ground, the court held them Mexican sales. In Briskey Co. v. Commissioner, (1934) 29 B. T. A. 987, the taxpayer had its principal place of business in the United States, a branch office in India from which goods were shipped to the home office or direct to customers to fill orders given orally at the home office and transmitted by cable to India. The home office charged its "branch" a commission for making sales. Title passed in India. For that reason, the court held the sales to be localized there.

\textsuperscript{151}Note 137 above and text.

\textsuperscript{152}Alpha Portland Cement Co. v. Commonwealth, (1923) 244 Mass. 530, 139 N. E. 158 and (1923) 248 Mass. 156, 142 N. E. 762 reversed on other grounds in 268 U. S. 203, 45 Sup. Ct. 477, 69 L. Ed. 916. There a N. J. corporation engaged in the manufacture and sale of cement had its principal office in Easton, Pa., and a branch office in Boston, Mass., which was in charge of a district sales manager. It was also the headquarters for travelling salesmen who solicited orders in Massachusetts and the other New England states. Orders so taken were transmitted at the Boston office by mail to the principal office where exclusively they were passed upon, and, if accepted, the goods were shipped and invoices sent directly to the customer. Remittances were generally made directly to Easton, Pa. There was a clerk in the Boston office in charge of the company's correspondence.
was held that purchase orders taken in the field by a non-resident agent which were forwarded to the Wisconsin office for acceptance or rejection constituted Wisconsin sales.\textsuperscript{154} Under the constructional situs rule the phrase “sales within the state”\textsuperscript{155} may receive an interpretation similar to that of the phrase “business within the state.”\textsuperscript{156} If so, there may be the same distinction between sales made by salesmen authorized only to solicit orders\textsuperscript{157}

Its office furniture was valued at $573. On these facts, $424,982.70 of the company’s gross receipts were assigned a situs in Massachusetts. Compare Baseball Publishing Co. v. Comm’n, (1933) 1 Mass. B. T. A. 717, where in addition to the facts there stated it appeared that, “Many of the appellant’s contracts (were) negotiated in New York...” The board at page 721 held on the facts, however, “that no employee, except Birch (the treasurer), was chiefly situated at, connected with or sent out from any premises outside the Commonwealth, and that no sales were negotiated or effected in behalf of the appellant by agents or agencies chiefly situated at, connected with or sent out from any such premises or were attributed to business conducted on such premises.” Compare with these two cases California Packing Corp. v. State Tax Comm’n, (1939) 97 Utah 367, 93 P. (2d) 463, which construes the Utah provision similarly worded.

\textsuperscript{155}Note 135 above and text.

\textsuperscript{154}Twin Disc Clutch Co. v. Wisconsin Dept. of Taxation, (Wis. B.T.A., Jan. 12, 1940) Wis. C. C. H. and P. H. Tax Services, pars. 10-827,015 and 13,458 respectively. Accord with respect to question of multi-state business: Trane Co. v. Wisconsin Tax Comm’n, (1940) 235 Wis. 516, 292 N. W. 897. Here orders were secured by extra-state representatives who apparently were connected with “offices” outside the state. All sales were subject to approval at the home office with respect to price, credit, materials and time of delivery. Billings were usually made from the home office. All sales were held to be Wisconsin business.

\textsuperscript{155}This is the phrase used in constructional situs statutes. See note 142 above.

\textsuperscript{156}This is the phrase used in statutes involving the multi-state business. See notes 9 and 23 above. Doing business within the state may in some situations be equivalent to continuously making sales within the state. See note 86 above.

\textsuperscript{157}In Curlee Clothing Co. v. Oklahoma Tax Comm’n, (1937) 180 Okla. 116, 68 P. (2d) 834, sales of the Aluminum Cooking Utensil Co. were also involved. The salesmen had power to get orders and in addition authority to show samples and collect 20 per cent of the purchase price as a down payment. In holding that these additional powers were insufficient to create a binding agreement in Oklahoma, the court said: “The fact that advance collections were authorized did not serve to complete the sale in Oklahoma.” In People ex rel. Stafford v. Travis (1921) 231 N. Y. 339, 132 N. E. 109, 15 A. L. R. 1319 the court said: “He (Stafford) would not be subject to an income tax in a foreign country, in which his travelling men work.” In both of the above cases, the question was whether income was derived from “business, trade, profession, of occupation carried on (with)in this state” under the respective statutes of Oklahoma and New York. In People ex rel. Lummis v. Graves, (1937) 231 App. Div. 591, 297 N. Y. S. 967, the court held the business of the taxpayer to be carried on entirely within the state even though travelling salesmen solicited orders outside the state. In Cerf v. Lynch, (1932) 237 App. Div. 283, 261 N. Y. S. 231, the general agent of a life insurance company was held to be carrying on his business entirely within the state. In Montag Bros. v. State Revenue Commission, (1935) 50 Ga. App. 660, 179 S. E. 563, it was held that sales solicited by salesmen outside the state and subject to buyers’ confirmation...
and those by salesmen authorized to enter into consummated agreements of purchase and sale.\(^{158}\) The effect upon the situs of sales of the power of confirmation at the home office has varied from case to case. Sales have been held to have a situs at the place of confirmation\(^{160}\) and the reverse.\(^{160}\) A distinction might be predicated from the constituted business carried on entirely in the state of the home office. In 

Hump Hairpin Mfg. Co. v. Emmerson, (1922) 258 U. S. 290, 42 Sup. Ct. 305, 66 L. Ed. 622, there was involved a tax upon the proportion of the taxpayer's "capital stock represented by its property and business in Illinois." One of the factors in the proportion was "total business" in Illinois over total business everywhere. The taxpayer's plant, principal office, and "storeroom" were in Chicago. It had travelling salesmen in many of the states of the union soliciting orders. The court held all the company's business was located in Chicago.


\(^{160}\) By tribunals of the state of confirmation: Twin Disc Clutch Co. v. Wisconsin Dept. of Taxation, Wis. B. T. A. Jan. 12, 1940, note 154 above, ("Purchase orders taken in the field by the nonresident agent ... which are forwarded to the Wisconsin office for acceptance or rejection" are Wisconsin sales), Trane Co. v. Wisconsin Tax Comm'n, (1940) 235 Wis. 516, 292 N. W. 897 (holding entire business done in Wisconsin), Appeal of Combined Locks Paper Co., (Wis. Tax Comm'n, Feb. 1, 1939), Wis. C. C. H. and P. H. Tax Services, pars. 14-562 and 13,348, accord, Hump Hairpin Mfg. Co. v. Emmerson, (1920) 293 Ill. 387, 127 N. E. 746, aff'd 258 U. S. 290, 42 Sup. Ct. 305, 66 L. Ed. 622. ("These orders are mailed to ... Chicago and upon acceptance its products are shipped") and see Montag Bros. v. State Rev. Comm'n, (1935) 50 Ga. App. 660, 179 S. E. 563 (Buyers' confirmation also involved) and People ex rel. Charles Kohlman & Co., (1925) 239 N. Y. 346, 146 N. E. 622 (New York accounts receivable factor); by tribunals of a state other than that of confirmation: Curlee Clothing Co. v. Oklahoma Tax Comm'n, (1937) 180 Okla. 116, 68 P. (2d) 834. The court said: "This court has repeatedly held that the sales of goods by a foreign corporation through soliciting agents, who take orders subject to approval of the company at its home office, does not constitute doing business within this state.") Where confirmation passes title the conflict of laws rule (note 150 above) coincides with the rule of the above cases. The distinction between the rules is noted, however, in Montag Bros. v. State Revenue Comm'n, above where the court said: "The fact that . . . the title to some of the goods may have passed to purchasers outside the state, . . . would not relieve the seller from tax. . . ."

\(^{158}\) By tribunals of the state of confirmation: Carlos Ruggles Lumber Co. v. Commonwealth, (1927) 261 Mass. 450, 158 N. E. 899 ("all sales were made subject to confirmation at the home office in Springfield." Held: the taxpayer was doing business both within and without the state). By tribunals of states other than that of confirmation: Laurentide Co. v. Dury, (N.D. N.Y. 1916) 231 Fed. 223 (orders solicited in the U. S. were sent "to the home office of the company in Canada for acceptance or approval"—P. 226. Held: the taxpayer was doing business in the United States), People ex rel. Lummis v. Graves, (1937) 251 App. Div. 591, 297 N. Y. S. 967 ("His duties were to solicit orders, all of which were subject to confirmation or rejection by the employer") in Ohio. Held: the taxpayer-employee was
cated on the basis that some decisions were with respect to situations in which confirmation was merely a formal and unexercised power, and some were with respect to situations in which the power was actually availed of to check credit, price, terms and conditions of sale. This possible distinction will not, however, reconcile all the cases. No all inclusive rule may be stated with respect to the effect of the power of confirmation upon the situs of sales.

Branch office sales made without solicitation through local retail stores are commonly considered to be localized at the store. Ordinarily, goods sold at such a branch are from stock to local customers. Under such circumstances title would generally pass at the store. Consequently, the origin, destination and conflict rules would in the usual case reach the same result as would also, quite clearly, the office situs rule. Since practically all the economic incidents of the sale occur at the store, the constructional rule would create no exception. It has been ruled under the sales ratio provision of the Wisconsin allocation fraction that sales from a Wisconsin branch have a situs within Wisconsin. In accord are the decisions involving the corresponding problem with respect to a multi-state business.

With respect to warehouse sales the decisions, as well as the statutes, are not in harmony. One court, applying the constructional rule, has localized these sales at the warehouse. On the other hand, a court of the state of the factory and home engaged in business in New York), Alpha Portland Cement Co. v. Commonwealth, (1923) 244 Mass. 530, 130 N. E. 158 and (1923) 248 Mass. 156, 142 N. E. 762. See American Mfg. Co. v. City of St. Louis, (1917) 270 Mo. 40, 192 S. W. 402 aff'd on second appeal 198 S. W. 1183 and 250 U. S. 459, 39 Sup. Ct. 522, 63 L. Ed. 1084 ("substantially all . . . sales, though negotiated here, of merchandise stored in this and other cities are confirmed by and are not effective until they are confirmed by the home office in New York.") Held: sales of all goods manufactured in St. Louis were properly included in the "sales made" measure of the tax imposed upon the privilege of manufacturing).

In a ruling of the Wisconsin Tax Comm'n, (1926) in par. 11,157 of P. H. Wis. Tax Service it was held there must be an allocation of the income of a taxpayer engaged in the business of selling and underwriting bonds.

Cases cited note 95 above.

California Packing Corporation v. State Tax Comm'n, (1939) 97 Utah 367, 93 P. (2d) 463, involved a packing company with its principal office in California. It made "sales of goods which were stored in Utah at the time of the sale although such sales were made by agents sent out from California offices." The tax commission held that the "sales of goods which were stored in Utah at the time of sale regardless of whether the sales were made in Utah to Utah concerns or concerns in other states" were to be included in the numerator of the sales ratio of the apportionment fraction. The court affirmed the greater part of the commission's order.
office has held that sales to extra-state customers of goods warehoused outside the state were "made" locally in so far as inclusion within the measure of the manufacturers' privilege tax in question was involved. Taxpayers have also not been considered to be doing business outside the state solely by reason of warehouses there located. This rule has some merit. It avoids some degree of manipulation by reason of change in location of the warehouse. It avoids undue emphasis upon an economic incident of a sale relatively unimportant in the usual case, as compared with the activities of the seller and the contribution of the buyer. Furthermore, warehousing may be considered as the performance of a separate business function of storage and considered independently of sales. Whether this will be the final rule of the courts awaits, however, their decision.

It has been ruled that a brokerage sale does not, for the purpose of the sales ratio, necessarily have a situs where the broker is. This ruling involved a taxpayer which had its principal office in California with customers outside the state to whom sales were made through extra-state brokers. The same board reached a similar result in cases raising the corresponding question with respect to a multi-state business. The reasoning of these cases is not explicit. Possibly the broker's activities on behalf of the buyer were considered dominant and the broker regarded more as the buyer's agent than the seller's. Possibly

---

164 American Manufacturing Co. v. City of St. Louis, (1917) 270 Mo. 40, 192 S. W. 402, aff'd 250 U. S. 459, 39 Sup. Ct. 522, 63 L. Ed. 1084. The case should probably be restricted to its facts although it has been cited with approval in some recent decisions of the United States Supreme Court.

165 See notes 99 through 101, text and cases cited.

166 In McGoldrick v. Berwind-White Coal Co., (1940) 309 U. S. 33, 60 Sup. Ct. 388, 84 L. Ed. 565, the court sustained a sales tax imposed by the state of the location of the purchaser and branch sales office even though the goods were situated outside the state.

167 See notes 69, 70 above and text.

168 Section 1 of Brokers in 12 C. J. S. at page 5 defines a broker as "one who is engaged for others, on a commission, to negotiate contracts relative to property with the custody of which he has no concern." The Restatement of Agency in comment b to sec. 2 refers to a "broker who contracts to sell goods for his principal" as "an independent contractor" defined in sec. 2 (3) as "a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of his undertaking."


170 See cases cited note 97 above, and text.

171 In this aspect a brokerage sale would resemble a mail order sale: in one the buyer sends a mail order to the seller who then ships the goods; in the other the buyer sends a mail order through a broker to the seller who then ships the goods.
viewed as controlling were those authorities to the effect that a foreign corporation is not subject to service or qualification within a foreign state merely by reason of its brokers there. Some economic factors might appear to be to the contrary. In this situation, however, they are probably of less weight than the legal ones.

Consignment sales resemble in some aspects both brokerage and warehouse sales. Generally, brokers and consignees are both considered to be independent contractors. Moreover, consignment sales, like warehouse sales, involve merchandise in storage. If consignment sales are regarded as brokerage sales, the place of the consignee would not alone determine their situs; if they are treated as warehouse sales, the place of consignment would not alone be determinative. The courts may give some recognition to these conclusions. In one decision in which reference was made in passing to “consigned stocks” located outside the state, it was held that no sales business was there carried on. It has been ruled that goods on consignment outside the state are to be included in the numerator of the property ratio of an apportionment fraction. A state regulation is in accord.

Footnotes:

172 Abramovich v. Continental Can Co., (1926) 166 Minn. 151, 207 N. W. 201 and see 18 Fletcher, Cyclopedia of Corporations (1933) 373, sec. 8718.

173 See 17 Fletcher, Cyclopedia of Corporations, (1933) 512, secs. 8482 and 8483.

174 The broker, in reality, may among other things be the active solicitor of sales, may have power to enter binding contracts of sale in behalf of the seller, may have power to make immediate delivery from local warehouses. The purchaser's economic contribution to the sale may also be localized at the place of the broker. Much might be said that the real economic increment is earned at that place.

175 It is often a difficult question of fact to determine whether there is a consignment or sale as between consignor and consignee. 1 Williston, Sales (2d Ed. 1924) sec. 338. In a general way, the term consignment sales is here used to include sales made by a factor of goods in his possession as bailee.

176 See notes 164, 165, 189, 170 and text above.

177 Trane Co. v. Wisconsin Tax Comm'n, (1940) 235 Wis. 516, 292 N. W. 897.

178 Appeal of Heil Company, (Wis. Tax Comm'n, Oct. 20, 1933) Wis. C. C. H. Tax Service, par. 10-827.09. “. . . consignment stocks in the hands of dealer located outside Wisconsin must be treated for apportionment purposes as property owned and used in connection with the taxpayer's Wisconsin business when such goods are shipped on consignment pursuant to orders taken through the taxpayer's Milwaukee office and when sold the sales are treated as sales by that office.”

179 Art. 23-4 of the 1939 Regulations to the Income and Franchise Tax Act of Minnesota in Minn. C. C. H. Tax Service, par. 14-728: "Where a Minnesota concern ships goods on consignment to a factor in another state, such goods to be sold by the factor, who pays the consignor after the goods are sold, such transaction is considered as Minnesota business.”
poration qualification statutes present an analogy which should be noted, together with its limitation.

The few available authorities with respect to sales on exchanges have reached conflicting conclusions. It has been held that a California company was not doing business in New York by virtue of its trading on margin there. On the other hand it was stipulated in one case that sales of a North Dakota concern on Minnesota grain exchanges were Minnesota sales. A stock exchange seat has been held to have a situs at the exchange. To the extent that exchange sales resemble brokerage sales there is further authority in support of the California rule. Under constructional situs statutes it is conceivable that in exceptional factual situations sales might be localized at the exchange. The whole situation awaits further clarification by the courts.

2. The Property Ratio.—It has already been observed that the property ratio is prima facie valid. It has also been sustained against the contention that it discriminates between businesses which own their properties and businesses which hold their properties as lessees. The same accounts receivable may not twice be included in the numerator of this factor.

18017 Fletcher, Cyclopedia of Corporations (1933) 520, sec. 8484.
181It has been held that a foreign corporation may so closely supervise the activities of its consignee-agent that it may be considered to be doing business within the meaning of foreign corporation qualification statutes. 17 Fletcher, Cyclopedia of Corporations (1933) sec. 8484. Note 23 and text.
183International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 192. The company was selling grain "outside of North Dakota, principally on the grain exchanges in Minneapolis, St. Paul, and Duluth." "It is further stipulated that at least 90 per cent of the plaintiff's gross sale . . . was made in states other than North Dakota." The taxpayer's home office was probably in Minnesota.
185See note 169, 170 above and text.
186See note 181 above.
187See note 124 above and text. In International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 192, the court said: "Ownership of property is only one of the factors to be taken into consideration in apportioning income, and there can be no doubt that it has legitimate bearing in effecting a fair distribution of the profits or income . . . ."
188At least in the absence of proof of specific discrimination. International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 192. The court said: "It is next said that the plaintiff is denied the equal protection of the law, in that the method . . . works discrimination in favor of those doing a similar business who lease, rather than own, elevators within the state. It was not proved upon the trial that there were any concerns doing similar business who made it a practice to lease elevators within this state while owning them elsewhere."
189People ex rel. Societe Anonyme Des Anciens Etablissements, E. & E.
The statutory provisions incorporating the property ratio vary considerably with respect both to the method and time of valuation of the properties therein. In one state the valuation is to be taken as of the close of the preceding taxable period. In three states there are provisions for valuation at the end of the taxable year. Many states have adopted provisions for taking the average of the values at the beginning and end of the taxable year with the alternative provision, in certain instances, of a monthly or daily average in case the first prescribed average should prove unfair. In some jurisdictions statutes prescribe that the average monthly value be taken as the standard. Still other statutes refer to the average value during the year without further specifications. In many instances no reference whatever is made to the time at which the valuation is to be made.

No uniform method of valuation obtains. A few statutes refer to the “fair market value” or to the “fair cash value” or to “actual value.” Others define value as cost. In several


Art. 247 of the Regulations No. 5, Mississippi: “Cost value of capital assets at the close of the preceding taxable period owned and used in business. . . .”

North Carolina, Laws 1939 ch. 158, sec. 311, II, 1 (a) and 2 (a)—“value . . . on the date of the close of the calendar or fiscal year . . . ;” Tennessee, 1940 Supplement to Williams Code, sec. 1316 (1) (a)—“value . . . on the date of the close of the fiscal year . . . ;” Virginia: Tax Code, ch. 6, sec. 54—“value . . . at the close of the taxable year. . . .”

California: art. 7 (f)-4(d) of Regulations, note 16 above; Colorado, Laws 1937, ch. 175, sec. 17; Kansas, Gen. Stat., sec. 79-3218 as amended in 1937, ch. 370, sec. 3; Louisiana, art. 216 of Regulations, note 135 above; Minnesota, Mason's 1940 Supplement, sec. 2394-25 (A) (4); New York, Unincorporated Business Tax Act, note 135 above, sec. 386-g; Oklahoma, Laws 1939, ch. 66, art. 10, sec. 2 (e) (3); Oregon, art. 182 of 1938 Regulations, note 141 above.

Maryland, Regulation No. 3, note 138 above; South Carolina, Code 1932, sec. 2451 (1); United States Regulations 101, art. 119-12 at page 344.


Kentucky, Statutes (Carroll 1936) sec. 32 (2) (c) (C); North Dakota, Compiled Laws 1925 Supp. sec. 2346a6, (2), (c) (2); Utah, Rev. Stat. 80-13-21 (6).

Arizona, Rev. Code Supp. 1934, sec. 3182x, (a), 1; California, Franchise tax act, note 254 below; Georgia, 1939 Code, sec. 92-3113; Massachusetts, Gen. L., ch. 63, sec. 38 (2) (a); Pennsylvania, Purdon's Statutes Supp., Tit. 72, sec. 3420b; South Dakota, Code 1939, sec. 57.2707; Wisconsin, Statutes 1939, sec. 71.02 (3) (d) 1.

Sec. 54 of Virginia, Tax Code, ch. 6.


Sec. 214-9 of New York, Law note 194 above; South Carolina, Code 1932, sec. 2451; art. 119-12 of U. S. Regulations note 193 above.

The Kansas law, note 192 above, refers to the “average cost” of the
states adjusted book values are determinative. Many statutes and regulations are less specific and merely refer generally to the “value” of the taxpayer’s property. In some instances mention of value is entirely omitted. It is the value of the property and not the value of the taxpayer’s interest in the property which is taken into consideration.

The numerator of the fraction may include only those properties within the state owned or used by the taxpayer in connection with its business. Some specifically exclude those assets, the income from which is separately allocable or not taxable. The Mississippi Regulations, note 180 above, uses the phrase “cost value of capital assets.” The Colorado, Laws 1937, ch. 175, makes reference to “the average adjusted basis” which generally would be the cost basis adjusted for depreciation, etc. Art. 25-1 of the 1939 Minnesota Regulations, Minn. C. C. H. Tax Service, par. 14740, provides that value “shall be the cost or other allowable income tax basis adjusted for allowable depreciation.” The Oregon Regulations, note 192 above, in art. 184 refer to the “average of the depreciated cost or other allowable basis.” The Oklahoma Laws 1939, ch. 66, sec. 2 (e) refer to “average accumulated investment.”

The Louisiana Regulations, note 192 above, require the elimination of appreciation from book values together with the deduction of accumulated reserve balances. The North Carolina statute note 191 above in sub-sections 1 (1) and 2 (e) provides that “book value” shall mean original cost plus additions and improvements less reserve for depreciation. An opinion of the North Carolina Att. Gen. of August 18, 1938 in N. C. C. H. Tax Service, par. 10,809.01, ruled that the value of inventories is their book value. Art. 119-12 of the U. S. Regulations and sec. 2451 (1) of the South Carolina, Code 1932, sec. 2451, provide in certain instances that values are presumptively the book values. See Thornhill Wagon Co. v. Commonwealth, (1926) 144 Va. 194, 131 S. E. 445.

California Regulations, District of Columbia Regulations and statutes of Kentucky, New York, North Dakota, Pennsylvania, Tennessee, and Utah in notes 192, 194, 195, 196, 192, 195, 196, 191 and 195 respectively above. Arizona, California, Georgia, Minnesota, South Dakota and Wisconsin statutes in notes 196 and 192 above.

Several statutes expressly disallow deductions for encumbrances. Connecticut, North Carolina, South Carolina and Tennessee, notes 194, 191, 193 and 191 respectively above.

Goods stored outside the state may not be included in the numerator of the property ratio. Op. N. C. Att. Gen. Feb. 14, 1930, N. C. P. H. Tax Service, par. 10,920.9 and N. C. C. H. Tax Service, par. 10-804.01. However, it has been held that goods on consignment outside the state may be so included (Appeal of Heil Co., Wis. Tax Comm’n, Oct. 20, 1933) Wis. C. C. H. Tax Service, par. 10-827.09) and that raw materials purchased and processed by others outside the state should be included (Marinette Knitting Mills v. Wisconsin Dept. of Taxation, C. C. Dane County, Sept. 23, 1940 Wis. C. C. H. Tax Service, par. 14-709). Also where property is moved in and out of the state a time ratio proportion of such property should be considered to have its location within the state. Ruling of Wisconsin Tax Comm’n, (1924) Wis. P. H. Tax Service, par. 11,148, No. 788.

able. Both of these general provisions are in harmony with the constitutional limitations already discussed. 207

3. The Wage Ratio.—Wages are assigned a situs under varying rules. In several states they are localized where the services for which the compensation is paid are rendered. 208 It should be noted that under this rule the situs of wages is assigned to that state in which the wage income would be taxed to the employee. 209 Consequently, those cases involving the taxation at source of income from personal services would, by analogy, be pertinent here. 210 In other states, which constitute a majority, payroll is assigned a situs at the place at or from which the employees work. 211 The similarity of this rule to the office situs sales rule is apparent. 212 In one case arising under the Massachusetts statute the court assigned compensation paid salesmen travelling from a Boston office, who solicited orders in the New
England states, a Massachusetts situs. The Massachusetts Board of Tax Appeals has also in one case refused to assign sales commissions a New York situs. A third and minority rule assigns payroll a situs within the state if "paid during the taxable year to employees in connection with [the] business carried on within the state." The statute of yet another state may also have adopted, in addition to the situs rule, one including wages paid from within the state. Most statutes, of course, expressly limit the payroll period to the taxable year. A few have specified that payroll includes executives' salaries.

B. Allocation by a Separate Accounting.—An allocation by a separate accounting is not an unconditional right of the taxpayer. In some states it is denied altogether. In others it is dependent on the taxpayer's proof that its accounts are a true and accurate record of actual transactions and that they are so kept as to clearly reflect net income from within the state; or on proof, in addition to the accuracy of the accounts, of the inappropriateness of the apportionment fraction; or on proof that the nature of the business is susceptible to a separate accounting. Whether the state, as well as the taxpayer, also has the conditional right to a separate accounting has not yet been specifically decided. The indications are that it does.

213 Alpha Portland Cement Co. v. Commonwealth, (1923) 244 Mass. 530, 139 N. E. 158. The Massachusetts court in holding wages as well as sales had a Massachusetts situs said: "The same reasoning applies to the suggestion that the tax is invalid because wages paid in connection with the Massachusetts office included in part services rendered by travelling salesmen going to other states as well as Massachusetts."

214 Baseball Publishing Co. v. Commission, (1933) 1 Mass. B. T. A. 717. At page 721 it was noted that "two of the three salesmen spend some of their time in the New York office." The board's ruling is stated in notes 152 and 96 above.

215 Louisiana, Regulations, note 135 above, art. 216; New York, Unincorporated Business Tax Act, note 135 above, art. 16, sec. 386 (g) 2; Oregon, Regulations, note 141 above, art. 182. Under this rule wages paid employees in states in which no business was done would not be included. The rule is also vague.

216 Minnesota. The statute in note 208 above includes "payroll paid or incurred in this state."

217 California, The corporate franchise act specifically mentions officers and employees; see notes 142 and 196 above. Many of the statutes cited use language broad enough to reach a similar result.


219 Buick Motor Co. v. City of Milwaukee, (E.D. Wis. 1930) 43 F. (2d) 385, 391. Here a dealer in automobiles was, at the instance of the tax commission, required to compute its income on a separate accounting basis, there being an ascertainable market price for Buicks.
The statutes or regulations of most states generally provide that accounts must "accurately" or "clearly" reflect net income. Some specifically exclude bookkeeping records based on estimate or artificial billings. Thus, regulations have provided that "Arbitrary billing prices based upon factory cost will not be considered as properly reflecting the gross income of either the manufacturing or selling departments." In one case a separate accounting was denied where the taxpayer limited itself to a showing that the Wisconsin branch in question was billed "at the same price we make all our branch managers" and failed to offer proof with respect to prices charged independent dealers for the same products. In another case the court reached the same result where the taxpayer's books reflected only estimated expenses. Decisions with respect to artificial billings based upon inter-corporate contracts of affiliated corporations have already been cited. The fictitious prices were disregarded.

In some states the apportionment fraction is presumed to be correct. Here the taxpayer, in addition to the burden of proving the accuracy of its accounts, must rebut the prima facie presumption by showing that allocation is more accurately made by a separate accounting than by a statutory apportionment.


222 S. Kresge Co. v. Bennett, (S.D. N.Y. 1931) 51 F. (2d) 353, 355. The court said, "These later charges against the gross income in New York are merely estimated expenses of the business. The plaintiff urges that they are a close estimate because ... charges ... come within $67,000 of the actual expenses; but they remain nevertheless mere estimates."

223 See note 47 above.

224 See note 124 above and text. Mason's Minnesota Statutes, 1940 Supplement provides in sec. 2394-26 that the "methods prescribed by Section 25 shall be presumed to determine fairly and correctly the taxpayer's net income allocable to this state."

225 This might be the only burden upon the taxpayer in those states in which some preference may be given to a separate accounting. Here a fractional apportionment would apparently be allowed by way of exception. See statutes and regulations in Colorado, Kansas, Kentucky, Maryland, New Mexico, New York (unincorporated business tax act), Oklahoma, South Dakota, and Virginia where allocation by apportionment formula is allowed only in case the "books of account and records do not clearly reflect the net income;" or "when the books" fail to "show income derived from business done" within the state; or "where the books of account and records do not substantially reflect the net income;" or when a separate accounting does not "reasonably reflect the income properly assignable to this state;" or, where it is "unpracticable." See Montgomery Ward & Co. v. State Tax Comm'n, note 70 above.
Furthermore, the inaccuracy must be in such degree as to result in "unfairness" or "injustice." Whether this question of degree is the same as that involving the constitutional "right" to a separate accounting is an open question. Possibly not. Furthermore, the statutes of some states provide that proof must be to the "satisfaction" of the tax authority. Under these provisions anything less than complete disclosure of the taxpayer's books would be insufficient. 

In some states a separate accounting may be preferred for one type of business and a statutory apportionment for another. Generally construction and mercantile businesses fall within the first category and manufacturing within the second. By way
of exception, however, separate accounting may be allowed a manufacturing concern in those instances in which the factory product has a "definitely determinable market value." The allocation of the income of a construction business has been indirectly involved in several decisions without specific mention of the present problems. With respect to mercantile concerns, however, separate accounting has been approved with respect to the branch stores of Montgomery Ward & Co., but not with re-

The allocation of the income of a construction business has been indirectly involved in several decisions without specific mention of the present problems. With respect to mercantile concerns, however, separate accounting has been approved with respect to the branch stores of Montgomery Ward & Co., but not with re-

Arizona, Art. 606 of Regulations above; Wisconsin, Art. 602-1 of Regulations above. The Idaho regulations permit manufacturing concerns to report on a separate accounting basis where selling is conducted in such a manner "as to establish fairly an independent factory or production price." Art. 224 of the Iowa Regulations (Iowa C.C.H. Tax Service, p. 1498-87) and Art. 79 of the Kansas Regulations above provide generally that the separate accounting method is not satisfactory or reflective of correct taxable income in the case of manufacturing concerns.

James V. Dravo Contracting Company, (1937) 302 U. S. 134, 58 Sup. Ct. 208, 82 L. Ed. 155, 114 A. L. R. 318 (here a Pennsylvania Company contracted to build locks and dams in West Virginia. It furnished certain steel parts from its factory in Pennsylvania. Other materials and labor were secured from both within and without the state. There was a remand for failure to make an allocation of any type whatsoever). Koppers Co. v. City of Milwaukee, (1926) 191 Wis. 397, 211 N. W. 147. (here a Pennsylvania Company sold from its factory in Pennsylvania coke and gas ovens which were installed, under the taxpayer's supervision, by the purchaser in Wisconsin. To the extent that the taxpayer performed services in Wisconsin, tax liability was admitted. However, the court treated the project as a sale and the question of allocation did not arise.) Appeal of Stebbins Engineering and Manufacturing Co., (Wisconsin Tax Comm'n, Nov. 3, 1938) Wis. C. C. H. Tax Service, par. 14-546. Here, a New York company sold linings to digesters and other equipment used in the paper business. Installation was made by the New York company in Wisconsin where its employees and labor were engaged. The linings were of brick manufactured by the company in Pennsylvania. The method of allocation, having been the subject of stipulation, was not discussed.) In Appeal of Thebo, Starr and Anderson Inc., (Cal. St. Bd. of Equal., April 23, 1934) Cal. C. C. H. Tax Service, par. 5-803.015, an allocation was denied on the ground that no business was done outside the state. The taxpayer had its principal office in California, had no permanent offices nor investment outside the state and was not qualified to do business there. It had engineers supervising the installation of several butane gas plants in Washington and Oregon and selected some of the crews of workmen there. Both were paid direct by the Washington and Oregon companies. The plans were drafted in California and the taxpayer was paid commissions based on a percentage of cost.

spect to a wholesale house. It has also received judicial recognition in connection with the local branches, separately incorporated, of a chain store, there being a proper allocation of overhead. Its propriety has been assumed in certain other decisions. A manufacturing concern is not entitled to a separate accounting in the usual case. However, in three cases involving the Standard Oil Company it was decided that a separate accounting should be allowed as a matter of right where the merchandise in question had a readily determinable market price. The same principle also has been applied with respect to Buick dealers where the same condition existed. In a few cases it may have been allowed, although not as a matter of right, even

Butler Bros. v. McColgan, (Cal. 1941) 111 P. (2d) 334. Here there was involved an Illinois corporation with a principal office in Chicago and seven wholesale houses in various parts of the United States which was engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and others, and selling to retailers only. The San Francisco house maintained stocks of goods there from which sales were made and handled its own solicitation, credit, collections and accounting. The only common expenses were executive salaries, general overhead, advertising and buying, a portion of each of which was apportioned to California. The supreme court reversed the lower court which had approved a separate accounting as a method of allocation "fairly calculated to assign to the state the portion of net income reasonably attributable to the business done" in California in 102 P. (2d) 334 and upheld an allocation by a three way formula of tangible property, payroll and gross sales.

J. G. McCrary v. Commission of Corps. and Taxation, (1932) 280 Mass. 273, 182 N. E. 481. The Board of Tax Appeals below found: "The appellant had separate books of account from which its return was made up, and the facts and figures stated in the return were true and accurate. ... We find ... that the earnings shown by the return and by the appellant's books of account were its true earnings."


Standard Oil Co. of Indiana v. Wisconsin Tax Comm'n, (1929) 197 Wis. 630, 223 N. W. 85 ("The statute does not enjoin upon the commission the use of that method which will produce the largest amount of taxable income but rather that method which will most justly apportion the income properly taxable in Wisconsin;" Standard Oil Co. v. Thoresen, (C.C.A. 8th Cir. 1928) 29 F. (2d) 708 ("It is conceded to be a very easy matter for the state to determine the market value of refined oils within its borders ... and on this, having ascertained the selling price, to determine the tax necessary to be paid.") See Fisher v. Standard Oil Co., (C.C.A. 8th Cir. 1926) 12 F. (2d) 744, 747 where "two per cent was added as profit to the cost of producing, manufacturing, and refining." Compare note 50 above. Compare Butler Bros. v. McColgan (Cal. 1941) 111 P. (2d) 334.

Buick Motor Co. v. City of Milwaukee, (E.D. Wis. 1930) 43 F. (2d) 385.

220 221 222 223 224 225 226 227 228 229 230 231 232 233 234 235 236 237 238 239 240
in the absence of a product with a definitely determinable market value.\textsuperscript{241} A common problem arising in connection with a separate accounting is the apportionment of overhead and other types of general expense. The usual rule that the apportionment factor or factors must bear a rational relationship to the expense apportioned resembles that with respect to the apportionment of income. A common regulation\textsuperscript{242} provides that, "Overhead items of income and expense must be allocated to the business within and without [the state] upon a basis or combination of bases, justified by facts and conditions." A sales ratio is then mentioned as satisfactory in apportioning overhead in a mercantile business\textsuperscript{243} and direct cost of material and labor as satisfactory in a construction business.\textsuperscript{248} Federal income taxes are, in these regulations, apportioned on the basis of net income.\textsuperscript{243} In one case in which a separate accounting was denied there were involved overhead charges for management and purchasing.\textsuperscript{244} In other cases a separate accounting has been allowed where a proper apportionment has been made of such expense items as management, rent, advertising and accounting.\textsuperscript{245}

\textsuperscript{242}Arizona, art. 606 note 231 above; Kansas, art. 79 note 220 above; Louisiana, art. 214 note 135 above; Wisconsin, art. 702.2 note 220 above. Art. 224 of the 1935 Iowa Regulations provides that "Overhead items of income and expense must be allocated to the business within and without Iowa on a basis which utilizes the factors by which such items are measured."
\textsuperscript{243}Arizona, art. 606; Kansas, art. 79; Louisiana, art. 214; Wisconsin, art. 602.1. All cited in note 242 above. Also see ruling (Wis. Tax Comm'n Feb. 15, 1924) Wis. C. C. H. Tax Service, par. 10-820.04.
\textsuperscript{244}S. S. Kresge Co. v. Bennett, (S.D. N.Y. 1931) 51 F. (2d) 353: "... for instance, the services performed by the executive offices and purchasing department are charged for at a rate of two per cent, not on the invoice cost of the goods furnished to the store, but on the gross sales to the stores. If the New York stores were receiving higher prices for the same goods... they would be paying a disproportionate amount of the expense. ..." The court did not discuss two per cent and five per cent charges made by the importing and jobbing departments.
\textsuperscript{245}Standard Oil Co. of Ind. v. Wisconsin Tax Comm'n, (1929) 197 Wis. 630, 223 N. W. 85. The Wisconsin business was "charged at the market price with all products received by it, with the expense of transacting the business, including a proper allocation of general or overhead expenses and office accounting...." p. 87. In Curtis Companies v. Wisconsin Tax Comm'n, (1933) 214 Wis. 85, 251 N. W. 497, 92 A. L. R. 1065 and J. G. McCarry v. Commission of Corps and Taxation, (1932) 280 Mass. 273, 182 N. E. 481, the question of separate accounting for subsidiary corporations was involved. In the former, the tax commission claimed the separate accounting involved "four arbitrary factors, to wit: (1) The 11\% per cent margin allowed to factories on sales to the distributing subsidiaries; (2)
More difficult than the apportionment of expense items, is the allocation of that portion of total net income attributable to the performance of business functions which, although not directly productive of gross receipts, are absolutely necessary to the continuance of the business and the earning of its income. This problem, when first raised in the *Kresge Case* in connection with the purchase and warehousing of goods, was involved only indirectly. Nor was the question of buying profit directly passed upon, although raised in the *Hans Rees’ Sons Case*. Recently, however, the Kansas court in *Montgomery Ward & Co. v. State Tax Comm’n* allowed an expense ratio apportionment of income attributable to the performance outside the state of these and other business functions. Legal recognition was thus granted to that economic income which may be “earned” in the performance of essential business functions. The secondary problem of the selection of an appropriate apportionment ratio, of course, remains. It is not always easy to determine whether the solution

the distribution of advertising charges; (3) the distribution of general administrative charges; and (4) the rental charged.” In the latter case the parent company charged a flat 10 per cent commission for purchases made by it and effected a sales ratio apportionment among its subsidiaries of the expense of window displays, administration and other similar charges.

(S.D. N.Y. 1931) 51 F. (2d) 353, 355. The court said, “Furthermore, the net income allocated to New York should reflect all the plaintiff’s activities within the state. In addition to the operation of the individual stores, the plaintiff operated here a warehouse for the entire system and also purchased goods here for the entire system. Such profit as may have resulted from these activities is not completely reflected in the aggregate net profit of the individual stores within the state, which plaintiff contends is the entire net income attributable to New York.”

(Hans Rees’ Sons v. North Carolina, (1930) 283 U. S. 123, 135, 51 Sup. Ct. 385, 75 L. Ed. 879. The court said, “The so-called “buying profit” is said to result from the skill with which hides are bought and the contention is that these buying operations were not conducted in North Carolina. . . . It is apparent that the amount of the asserted buying profit is not enough to affect the result. . . .”

(Montgomery Ward & Co. v. State Tax Comm’n, (1940) 151 Kan. 159, 98 P. (2d) 143 involved a retail merchandise store operating over 500 branches in United States 21 to 24 of which were located in Kansas. It had a warehouse in Kansas City, Mo., and all buying was done outside the state. In addition offices outside the state issued complete instruction relative to store operation; prepared all store budgets, window and counter displays, advertising copy and special sales; gave detailed directions with respect to stocking and displaying merchandise; designed all store buildings; selected all store equipment; employed all store managers and department heads; conducted all hauling, accounting, tax and claim matters; and carried on other activities of similar nature. A pro rata cost of such activities was allowed as an expense in computing Kansas net income. The taxpayer successfully claimed an additional 15 per cent (expense ratio apportionment) reduction on the ground that such sum represented net income reasonably attributable to extra-state activities.
of this aspect of the problem involves a separate accounting or an equitable apportionment.\textsuperscript{249}

C. Allocation by Equitable Apportionment.—The problems of equitable apportionment\textsuperscript{250} are principally those of administration and constitutional law.

1. Administrative Methods.—Statutes providing for an equitable apportionment range from those which provide for limited adjustments of the apportionment fraction to those which permit any method considered appropriate by the tax authority, whether by a selection of a factor (factors) or by separate accounting methods. In some states where a three-way formula obtains, provision for adjustment is made by permitting the omission of any one or any two of the three factors. The factors which are considered “inapplicable” are to be excluded.\textsuperscript{251} Thus, a two-way fraction of property and sales has, on occasion, been permitted in Wisconsin where a three-way one is commonly used.\textsuperscript{252} A weighting of a factor or factors may sometimes be allowed.\textsuperscript{253} Or statutes may specify that income may be apportioned on the basis of any one or more of a group of named factors.\textsuperscript{254} Under

\textsuperscript{249}See Montgomery Ward & Co. v. State Tax Comm'n, (1940) 151 Kan. 159, 98 P. (2d) 143.

\textsuperscript{250}By equitable apportionment is usually meant the selection of a method of allocation which will assign to a state that portion of net income which approximates the amount thought properly taxable under some preconceived notion of fairness. See note 13 above.

\textsuperscript{251}Massachusetts, Gen. L. 1932, ch. 63, sec. 38.3; Pennsylvania, Purdon's Statutes, Tit. 72, sec. 3420b, 2, (a) (3) and Regulations, par. 3-05 in Pa. C. C. H. Tax Service, par. 10-809c. See also sec. 42 of the Massachusetts act which provides for additional methods of apportionment. Art. 610 of the Arizona Regulations (Ariz. C.C.H. Tax Service, par. 10-347, p. 247-44) sec. 57-2707 of the South Dakota, Code 1939, and Art. 602-5 of the Wisconsin Regulations (Wis. C.C.H. Tax Service, par. 10-829) provide for omission of a factor if not used "to any appreciable extent in the (his) trade or business." See ruling Wisconsin Tax Comm'n, 1922, Wis. P. H. Tax Service, par. 11,155-9 . . . commission "may modify the rule" of apportionment to produce correct result. See Idaho, Reg. No. 49 Art. 9 providing that the formula may be "modified." See New York law in note 253 below.

\textsuperscript{252}Appeal of Speer-Rosefelt Calendar Co., (Wis. Tax Comm'n, Nov. 6, 1926) Wis. C. C. H. Tax Service, par. 10-829.01.

\textsuperscript{253}Arizona, Art. 610 of Regulations above; Wisconsin, Art. 602.5 of Regulations above. In both states additional and wider powers are granted in other sections with respect to equitable apportionment. Arizona, Revised Code 1934 Supplement, sec. 3182x, 3 (b) and Wisconsin, Statutes 1939, sec. 71.02 (3) (d) 4.

\textsuperscript{254}California franchise tax act in Deering 1939 Supplement to Cal. Codes Act 8494a, sec. 13 and North Dakota, Compiled Laws, sec. 2346a7 (6) as amended in 1931, Laws 1931, ch. 283, sec. 2 permit "... allocation on the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property or by reference to any of these or other factors. ..." See also sec. 2346a7 (5) of North Dakota Statutes. Section 214-7a of the 1935 New York corporate franchise tax (McKinney's Consolidated Laws of New York Art. 9-A Book 59, sec. 214-7a) is more
this rule one state apparently has selected three of five statutory factors as standard.255 The provisions most widely followed, however, vest a much broader discretion in the tax authority and may permit or approve "such method as will equitably allocate" to the state a "just portion" of the total net income;256 or such "method of allocation or apportionment as seems best calculated to assign" to the state that portion derived from or reasonably attributable to sources within the state;257 or such method as "will fairly reflect"258 or which "more clearly reflects"259 the net income taxable within the state.

In all states the burden of showing the occasion for an equitable apportionment, if sought by the taxpayer, is upon it. A common provision is one which permits an aggrieved taxpayer to file with the tax authority an alternative method of allocation with supporting information and proof. If the tax authority shall conclude that the statutory formula "is inapplicable and inequitable," a redetermination is permitted on the basis proposed by

restricted, permitting the commission to add to the standard ratio (percentage) a "percentage applicable to this state of either gross sales or gross receipts and also a percentage applicable . . . of gross expenses . . . and divide by three." In People ex rel. Alpha Portland Cement Co. v. Knapp, (1920) 230 N. Y. 48, 129 N. E. 202, the court by construction modified a statutory formula to make it comply with constitutional limitations. In State ex rel. Maxwell v. Kent-Coffey Mfg. Co., (1933) 204 N. C. 365, 168 S. E. 397, 90 A. L. R. 476, a taxpayer which attempted to add an intangible property factor to a formula containing a tangible property factor was unsuccessful.

256In the Matter of the Appeal of Pacific-Burt Co., (Cal. St. Bd. of Equal., 1939) and Op. Cal. Att. Gen. Jan. 28, 1930, Cal. C. C. H. Tax Service, par. 5-803.06 the taxpayer sought to have a "purchase" factor added to those of property, payroll and sales. The board considered the facts shown by the taxpayer insufficient to justify such action. In Appeal of El Dorado Oil Works, (Cal. St. Bd. of Equal., Nov. 15, 1939) Cal. C. C. H. Tax Service, par. 5-803.017, the taxpayer urged the application of all five statutory factors including property, payroll, sales, manufacturing expense and purchases. The board took the view that the last two factors were sufficiently represented by the first three and excluded them both. Accord: Appeal of Charles Harley Co., (Cal. St. Bd. of Equal., Dec. 14, 1931) Cal. C. C. H. Tax Service, par. 5-803.10. See par. 5-803.10. In a letter of Nov. 17, 1938 the California board has drawn attention to the fact that the omission of a factor is not dependent upon the absence of the corresponding business activity merely within the state but upon its complete absence from the business as a whole. See Cal. C. C. H. Tax Service, par. 5-803.016.

259Colorado, Laws 1937, ch. 175, sec. 18 (a) ; Kansas, Gen. Stat. 1935, sec. 79-3219; Oklahoma, Income Tax Law 1935, sec. 8 (g) as amended by sec. 2 of Art. 10 of ch. 66 of 1939 laws.

257Connecticut, Laws 1935, ch. 221, sec. 8 (sec. 423c of 1935 Cumulative Supp.) ; District of Columbia 1939 Regulations, Art. 3 (c) in D. C. C. C. H. Tax Service, par. 10-802; New Mexico, Laws 1933, ch. 85, sec. 31 (d) ; Virginia, Tax Code, sec. 54.


the taxpayer or upon such other method as assigns to the state the portion of income attributable thereto. Other statutes provide that the unfairness of the apportionment formula must "appear to the tax commission;" must "be shown to the satisfaction" of the tax authority; or that the commission find such unfairness. Most of the statutes allow an equitable apportionment as an alternative to the method of fractional apportionment. A few, however, provide that the separate accounting method as well must first be shown unavailable. With respect to this burden of proof an equitable apportionment resembles a separate accounting. Thus, in North American Cement Corporation v. Graves the taxpayer objected to an allocation on a fractional basis and urged an application of an equitable apportionment under the provisions of statute on the basis of its reports, statements and accounts. This objection was overruled in the court of last resort with the statement that "the statute is valid upon its face and it has not been shown to have been so applied as to violate appellant's constitutional rights." Where a taxpayer operating a chain of restaurants within and without the state was involved, the New York court has likewise adopted a fractional apportionment in preference to an equitable one. On the other hand a showing by the taxpayer that all its factories were outside the state and that only sales activities were carried on within the state has been considered sufficient to justify the application of an equitable apportionment in the place of one by a sales ratio fraction.

Corresponding to the burden of proof upon the taxpayer is that upon the tax authority, in those cases in which it seeks an equitable apportionment,\textsuperscript{268} of showing sufficient facts to support its determination. In \textit{United Advertising Corporation v. Lynch}\textsuperscript{269} the court, in allowing an equitable apportionment, held that the New York act\textsuperscript{270} clearly permitted the commission to segregate the activity or business done within or without the state. In this case the tax commission acted upon information disclosed in the taxpayer’s return and upon testimony given at a hearing. In another case, however, the court denied the tax commission the power to apply an equitable apportionment for its failure to show that the formula was unfair.\textsuperscript{271} The statute provided that if in

\textsuperscript{268}The right of the tax authority to seek an equitable apportionment would be a logical deduction from the statutory purpose of the provision to avoid the inaccuracies of the other two methods. Thus, the circumstance that the formula method was unfair to the government would be just as valid a justification for equitable adjustment as would the circumstance that the formula method worked injustice to the taxpayer. Notwithstanding such consideration, however, the statutes or regulations of several states emphasize the taxpayer’s right and remain silent with respect to a corresponding right, if any, on the part of the state. Thus Art. 7 (f)-4 of the Regulations to the 1935 California personal income tax law provides, “if a nonresident taxpayer believes that the net income from sources within this state cannot properly be determined by the above (formula) method, he may employ . . . another method ...” Compare Minnesota Statutes, Mason’s 1940 Supplement, sec. 2394-26. Also compare sec. 6943.055, 2 of the Iowa, Code 1934; sec. 31 (d) of the New Mexico law note 257 above and sec. 54 of the Virginia tax code which provide that the portion assigned to the state by equitable apportionment shall be a sum “not exceeding, however, the amount which would be arrived at by application of the statutory rules.” Some statutes, however, are explicit to the contrary. Sec. 8 of ch. 134 of Connecticut, Laws 1935, note 260 above provides in part, “If in the opinion of the commissioner such method of allocation . . . will so operate as to subject any taxpayer to taxation on a lesser portion . . . than is reasonably attributable to this state” then there may be a hearing and a selection of another method of allocation. Compare Arizona, Art. 610 of Regulations note 251 above; California, franchise tax act note 254 above sec. 15; Colorado, Laws 1937, sec. 18 (a); Idaho, Art. 9 of Regulations No. 49; Kansas, Gen. Stat. 1935, sec. 19; Oklahoma, sec. 8 (g) of act note 255 above; New York, franchise tax act, sec. 214-7a of act note 254 above; North Dakota, sec. 234637, (5) of statutes note 254 above. The statutes or regulations in the following states may well be construed to permit a right to an equitable apportionment to the state: District of Columbia, Art. 3 (c) regulations note 257 above; Georgia, sec. 92-3115 of statutes; South Dakota, Code, sec. 57-2707; Wisconsin, Statutes 1939, sec. 71.02 (3) (d) 4. See also cases in text above.

\textsuperscript{269}(C.C.A. 2d Cir. 1933) 63 F. (2d) 243. See also State Revenue Comm’n v. Edgar Bros. Co., (1937) 185 Ga. 216, 194 S. E. 505.

\textsuperscript{270}Sec. 211-(9)-4 of act note 273 below provided in part, “If it shall appear . . . that the segregation of assets . . . does not properly reflect . . . the income earned—the tax commission is authorized and empowered to equitably adjust the tax . . .” See notes 276 to 281 post and text.

\textsuperscript{271}California Packing Corp. v. State Tax Comm’n, (1939) 97 Utah 367, 93 P. (2d) 463.
the judgment of the tax commission the formula did not fairly or equitably allocate income, it could on such information as it might obtain, make an allocation fairly calculated to assign to the state income reasonably attributable thereto. The "judgment" of the tax commission was here held to have been wrongly exercised. In another and somewhat analogous case a tax commissioner failed to show that business within the state was not "otherwise more easily and certainly separable from such total business."²⁷² For this failure of proof the method of allocation desired by the taxpayer was allowed, instead of that sought by the commissioner.²⁷³ Although these cases indicate that the tax authority has a burden of fact finding which in a way corresponds to the burden of proof upon the taxpayer, the degree of such proof remains an open question. In view of the taxpayer's ready access to its own books and records and its familiarity with its own business methods it may well be that it must show its case in greater detail and with more certainty than the tax authority.

2. Constitutional Limitations.—The principal constitutional problem concerns the question whether the grant of power to the tax authority constitutes a delegation of a legislative function or whether there is merely given a direction for the exercise of executive power. There are various rules in the several states. Some states allow the legislature to give the tax authority an unlimited grant of discretion, while others may limit the discretion to the selection of a specified alternative method or possibly to the selection of one of several specified alternative methods. The decisions of the New York court of appeals have applied this stricter rule.²⁷⁴

The New York statute²⁷⁵ in effect in 1925 empowered the tax commission "to equitably adjust the tax upon the basis of the

²⁷²Ford Motor Co. v. State, (1935) 65 N. D. 316, 258 N. W. 596 where proof by the commissioner of facts justifying a separate accounting was chiefly involved.

²⁷³The assistant auditor of the taxpayer proved to be a disappointing witness for the commissioner. Prior to 1920, the taxpayer used a branch office method of accounting suitable to allocation by separate accounting. The North Dakota law was enacted and the taxpayer's accounting system changed. The assistant auditor "On being asked whether it was abandoned on account of the enactment of the income tax law in North Dakota, . . . answered: 'No, it was abandoned everywhere regardless of whether there was an income tax or not.'"

²⁷⁴See in addition to New York cases, the discussion in International Elevator Co. v. Thoresen, (1929) 58 N. D. 776, 228 N. W. 1920.

²⁷⁵Paragraph 4 of subdivision 9 of sec. 211 of Art. 9-A of the Tax Laws as amended by ch. 322 of the 1925 Laws and repealed by Laws 1934, ch. 418, sec. 1.
ALLOCATION OF BUSINESS INCOME

corporate activity or the business done within and without the state.” Although this statute was apparently approved without discussion in two federal cases,276 it was finally invalidated by the state court as “too vague to state a workable rule.”277 Two years later the commission attempted to limit the scope of these earlier decisions by calling the court’s attention to another section of the statute278 providing that for purposes of equitable taxation income from any source may be included or excluded, provided only that the assets from which the income arose shall be included in any segregation for the purpose of computing the tax.” However, both the appellate division279 and the court of appeals280 considered the earlier decisions controlling and, with one judge dissenting in each court, held the apportionment formula would have to be applied. To meet the limitations laid down in these cases, the New York legislature modified281 the law so as to permit the tax commission to add to the statutory ratio “the percentage applicable to this state of either gross sales or gross receipts and also the percentage applicable to this state of gross expenses,” and to divide the result so found by three. If this statute should be considered to avoid the proscription of being too vague and is valid, it would seem that several methods of apportionment would be permitted under the New York rule. An equitable apportionment by the method of omission of one or more factors from a group of factors;282 by the method of the weighting of specified factors;283 or by the method of a selection of a factor from a group of selected factors,284 would all appear to be valid.

276See North American Cement Corporation v. Graves, (1936) Per curiam decisions in 243 App. Div. 834, 278 N. Y. S. 920; 269 N. Y. 507, 199 N. E. 510, 299 U. S. 517, 57 Sup. Ct. 311, 81 L. Ed. 381, and United Advertising Corporation v. Lynch, (C.C.A. 2d Cir. 1933) 63 F. (2d) 243. It is interesting to note that both of these cases were decided subsequent to the cases cited in the following note.


278Laws 1927, ch. 479, sec. 209.


280(1934) 264 N. Y. 680, 191 N. E. 624.

281Subdivision 7a was added to sec. 214 of Art. 9-A of the tax laws in 1934 (Laws 1934 ch. 418, sec. 2); and amended in 1935 (Laws 1935 ch. 745, sec. 17). See historical note at page 466 of Book 59 of McKinney’s Consolidated Laws of New York.

282See note 251 above. The omission of factors would seem a stronger case than addition of factors.

283See note 253 above.

284See note 254 above.
In *People ex rel. Schluter & Co v. Lynch* the alternate factors were not specified. This distinction may well mark the line of constitutional prohibition.

Decisions of the courts of South Carolina and Georgia have expounded a much broader rule. In both states, the statutes at one time levied a tax upon income from business within the state and granted respective tax commissions a general rule-making power. In both states the court upheld under these statutes the action of the tax commission in making an allocation, and overruled the contention of the taxpayers that there was an unconstitutional delegation of legislative power. The only express limitation put upon the tax commission's power was that the method it employed should be reasonable. This is the usual limitation to which all methods of allocation are subject. In another state, however, an administrative allocation was invalidated where the statute imposed a tax upon income "from any source whatever" instead of upon income, as provided in the South Carolina and Georgia statutes, from sources within the state. With this limitation added the rule of these courts may

---


288 In South Carolina the statute taxed nonresidents and foreign corporations on income "from property owned or from business operations from within the state" and in Georgia foreign corporations were required to make return of income "confined . . . to business done within the state."

289 The South Carolina statute conferred upon the tax commission power to make rules and regulations not inconsistent with law for the enforcement of the act and in Georgia the tax commission was empowered to make all necessary regulations for carrying out the provisions of the act.

290 In South Carolina the statute also provided that the tax was to be computed on the separable net income from business within the state and in Georgia the statute provided that the taxpayer should make its own segregation in its return and also that in the absence of a return, the tax commission could make one on the best information available.

291 The court said in the Georgia case: "Whether the method used by the commission was unreasonable was a question not determined either by the trial court or the court of appeals. . . . That question must be determined upon a reexamination of the case under the decision herein rendered."

292 *Commonwealth v. P. Lorillard Co.*, (1921) 129 Va. 74, 105 S. E. 683. The Virginia statute also failed to provide for an allocation by the taxpayer's return as the statutes did which were under consideration in *Western Union Telegraph Co. v. Query*, (1922) 122 S. C. 158, 115 S. E. 202, and in *State Revenue Comm'n v. Edgar Bros. Co.*, (1937) 185 Ga. 216, 194 S. E. 505. However, in view of *Santee Mills v. Query*, 122 S. C. 158, 115 S. E. 202, these differences appear less important than the statutory provision limiting taxable income to that earned within the state. For other aspects of the same 1916 Virginia Statute, see *Royster Guano Co. v. Virginia*, (1920)
be stated to be that the legislature may delegate to the tax authority the selection of any fair method of allocation, provided the legislature specifies that an allocation is to be made.

**CONCLUSION**

No one of the four states within which our manufacturing company carried on its activities may tax its entire income. Each one may, however, in the proper situation, tax a portion. Propriety in each case depends upon whether the company is doing business within the state and whether any income is attributable thereto. All courts would hold that the manufacturing company was doing business within the state of its factory and within the state of its branch sales office. Whether the same conclusion would be reached with respect to the company's purchases or management is a question of fact dependent upon the kind and extent of these activities. All courts would attribute a portion of the company's net income to its factory operation and to its sales activities. If the company's conduct of its purchasing or of its management constituted doing business, the same result would probably be reached with respect to them. If not, the opposite conclusion would be likely.

In order to determine the portion of its net income separately taxable in each of the four states the taxpayer may, perhaps, in each state, seek an allocation by a separate accounting. To do so it must first comply with statutory conditions. This may involve proof of the accuracy and reliability of accounting records or of the unfairness of the statutory fraction or, with respect to its manufacturing and selling activities of an independent market price of its product, or of still other statutory prerequisites. On the facts this manufacturing company would in all probability find it impossible to comply with even the minimum conditions.

253 U. S. 412, 40 Sup. Ct. 560, 64 L. Ed. 989. Both the Lorillard and the Royster Guano Cases quoted with approval the 1918 amendment to the 1916 statute providing that taxable income be limited to that "from business transacted and property located within the state, which may be determined by an allocation and separate accounting." In a situation somewhat similar to that involved in the Lorillard case the tax administrator instead of making an allocation imposed a tax upon the entire income. This assessment was in Porto Rico Mercantile Co. v. Gallardo, (C.C.A. 1st Cir. 1925) 6 F. (2d) 526 held "unlawful and void."

29 The power of the state of the company's "business domicil" to tax income from business without the state has not as yet been directly determined by the courts. Compare note 30 above, "Dividends." The power of the state of incorporation is a subject beyond the scope of this article. See note 1.
in so far as its management and purchases are concerned. Conversely, the tax authority may seek a separate accounting. Whether it has this right is doubtful under the statutes of most states. Equally uncertain are the conditions of this right, if any. Or the company may seek an allocation by statutory apportionment. It may demand this method as of right unless it is inaccurate and unfair. In that case the tax authority in many states probably has the right to substitute an equitable apportionment, and possibly in some states the right to substitute a separate accounting. The degree of inaccuracy and the degree of its proof have not been clearly defined in any state. Conversely, the tax authority may seek an allocation by fractional apportionment. This method is in many states prima facie correct. The company would have the burden of showing it to be inapplicable. The extent and degree of this burden, however, are differently defined in different states. Or the company may seek an allocation by equitable apportionment. Again it must comply with the statutory conditions by showing the statutory fraction unfair, or by showing a separate accounting unavailable, or by showing other statutory prerequisites fulfilled. On the facts the manufacturing company may well find this method of allocation the only accurate one for the state in which its management is located and for the state in which its purchases are made. Conversely again, the tax authority may seek an allocation by equitable apportionment. In many states it can, but again only upon compliance with the various statutory conditions.