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Delaware Tax Appeal Board Decision

Case Information:

Docket/Court: 348, Delaware Tax Appeal Board

Date Issued: 05/12/1971

Tax Type(s): Corporate Income Tax

OPINION

H. J. Donnelly, Chairman: Petitioner is a Delaware corporation. It is a wholly-owned subsidiary of ____ also a Delaware corporation. The parent corporation has its headquarters in New Jersey and maintains offices in New York, California and Texas.

At issue are additional corporation income tax and interest assessed by Respondent in the following amounts:

Year Ended	Tax	Interest	Total
June 30, 1965	\$ 6,165.95	\$ 832.40	\$ 6,998.35
June 30, 1966	6,519.25	521.54	7,040.79
June 30, 1967	10,801.00	216.02	11,017.02
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	\$23,486.20	\$1,569.96	\$25,056.16

In its returns, Petitioner claimed use of the three-factor formula for apportionment provided in **30 Del. C. section 1903(b)** [7, now 6] (A), (B) and (C). **1** The Respondent denied use of the formula and the validity of this denial is the sole issue to be decided. **2** The parties have entered into an extensive stipulation of facts which is incorporated herein by reference. For convenience, the principal facts

bearing on each of the three elements of the apportionment formula are summarized here.

1. The principal plant and headquarters of Petitioner is in Wilmington, Delaware, and it has another facility in Delaware. It is in these plants that the manufacturing process takes place, with the exception of some steps in the process (amounting to ten percent or more of the manufacturing process and performed by others on Petitioner's materials) which take place outside of Delaware. Although about three percent of Petitioner's inventory in process is located outside of Delaware at any one time. Petitioner made no claim in its returns for any benefit under the apportionment formula with respect to tangible personal property without the State of Delaware (see 30 Del. C. section 1903(b)7(A)) and, at the hearing, Counsel for Petitioner advised this Board that, for the years here under review, Petitioner would seek no adjustment under the formula for such property.
2. Applying the provisions of 30 Del. C. section 1903(b)7(C) to Petitioner's **gross receipts** from sales of tangible personal property, the percentages of such **gross receipts** classified as not being within Delaware were 97.8377% for the fiscal year 1965, 98.8363% for the fiscal year 1966, and 99.8631% for the fiscal year 1967. Thus, almost the entire sales of Petitioner's product were made to customers located outside the State of Delaware. The goods were shipped F. O. B. destination to customers' plants, to steamship docks (for foreign customers, primarily), and other out-of-state locations with delivery usually made by common carriers.
3. Petitioner employs several salesmen, all of whom reside outside the State of Delaware. All the working time of these salesmen is spent outside Delaware contacting customers and prospective customers in states other than Delaware. In addition, Petitioner employs two design applications engineers, more than 25 percent of whose time is spent outside Delaware in designing applications of Petitioner's products for the facilities of prospects or customers. These two engineers also spend time outside the United States straightening out problems of Petitioner's licensees, particularly in England and France. Petitioner's parent corporation, through its offices in California and Texas, makes sales as agent of Petitioner. Also, Petitioner has contracts with several manufacturers' representatives, located outside Delaware, who make sales as agents for Petitioner and, on occasion, purchase as customers of Petitioner and then resell the products outside Delaware. Applying 30 Del. C. section 1903(b)7 [6](B) to Petitioner's wages and salaries paid, the percentages of such payments classified as not being within Delaware were 1.3541% for the fiscal year 1965, 0.8993% for the fiscal year 1966, and 0.6011% for the fiscal year 1967.

In brief, it is Petitioner's position that, if by applying the provisions of the three-factor formula set forth in 30 Del. C. section 1903(b)7 [6](A), (B) and (C) the ratio obtained apportions less than all the remainder of net income to the State of Delaware, the Petitioner is thereby entitled to apportionment.

The Respondent, on the other hand, urges the view that, as a condition precedent to being permitted to apportion under the three-factor formula, the Petitioner must first establish that its entire business is not "transacted or conducted within this State

." Respondent in effect claims that the first sentence of 30 Del. C. section 1903(b)7 [6] imposes a standard that must be met independently and until this preliminary standard is met the three-factor formula is not available.

This conflict of interpretation of 30 Del. C. section 1903(b)7 [6] was one of the questions dealt with at some length in an Opinion of the Attorney General dated November 22, 1960, pertinent portions of which provide:

The exact question presented is whether, in terms of section 1903(b)7[6], the "entire business" of the taxpayer is "transacted or conducted" within Delaware. If it is, 100 percent of its general business income ****is taxed by Delaware. Stated in the alternative, as the statute also states it, is the taxpayer's business "transacted or conducted in part without this State"? If it is, some of the general business income may escape taxation under the allocation (sic) formula.

In our opinion, a most important consideration in determining the present question is the allocation (sic) formula itself. Delaware is constitutionally limited, with respect to multistate businesses, to taxing only the share of their income which is fairly apportionable to their activities within Delaware. *Northwestern States Portland Cement Co., 358 U. S. 450, 1959* and other cases. The statutory formula is the legislative determination of what share of multistate business income is fairly apportionable to business in Delaware. It is impossible to determine exactly what share of income of a multistate business is attributable to operations in one state but the formula is, nevertheless, intended and justifiable as a reasonable attempt to fix a portion of the corporation's income attributable to business conducted in Delaware. ***** Since the formula, by its nature, is intended to exclude from taxation income earned on business conducted out of Delaware, it would be inconsistent to conclude that the legislature adopted this formula in one provision but denied its benefit to some corporations in another provision of the same section 1903 on the basis that under another concept of doing business, they really were not engaged in business outside Delaware. *In other words, if the formula would operate to tax less than 100 percent of a corporation's income, it is saying in effect that that corporation's business is conducted in part outside of Delaware and it is inconsistent to give a contrary interpretation to another provision.*

(Underlining Supplied)

Neither party has brought to our attention any more recent pronouncement purporting to modify or revoke that Opinion of the Attorney General. That the opinion has stood unchallenged since 1960 lends support to the view advanced by Petitioner that it has acquired not only administrative but also legislative approval to an extent that it should not be dismissed unless some compelling reason is advanced. We see none. To the contrary, we are impressed by its logic and we recognize that there is some additional virtue in the fact that it offers an objective and certain means of computation which is capable of being applied much more equitably and uniformly than would be the case if some different and more subjective concept of "transacting or conducting business" were inserted as a condition precedent to its use.

Accordingly, we hold that for the years involved here Petitioner is entitled to use the three-factor apportionment formula provided in 30 Del. C. section 1903(b) 7 [6](A), (B) and (C). It follows that the assessments in question should be abated and the earlier contrary opinion (dated December 5, 1969) of the then State Tax Board rescinded.

It is so ordered.

1 30 Del. C. section 1903(b) 7[6] provides as follows:

"If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. If the business of the corporation is transacted or conducted in part without this State, such remainder shall be apportioned to this State on the basis of the ratio obtained by taking the arithmetical average of these three ratios:

- (A) The average of the value, at the beginning and end of the income year, of all the real and tangible personal property, owned or rented, in this State by the taxpayer, expressed as a percentage of the average of the value, at the beginning and end of the income year, of all such property of the taxpayer both within and without this State, provided that any property, the income from which is separately allocated under paragraph 1 of this subsection, or which is not used in the taxpayer's business, shall be disregarded. For the purposes of this paragraph property owned by the taxpayer shall be valued at its original cost to the taxpayer; and property rented by the taxpayer shall be valued at eight times the annual rental;
- (B) Wages, salaries and other compensation paid by the taxpayer to employees within this State, except general executive officers, during the income year expressed as a percentage of all such wages, salaries and other compensation paid within and without this State during the income year to all employees of the taxpayer, except general executive officers;
- (C) **Gross receipts** from sales of tangible personal property physically delivered within this State to the purchaser or his agent (but not including delivery to the United States mail or to a common or contract carrier for shipment to a place outside this State), and **gross** income from other sources within this State for the income year expressed as a percentage of all such **gross receipts** from sales of tangible personal property and **gross** income from other sources both within and without the State for the income year; provided that any **receipts** or items of income that are excluded in determining the taxpayer's entire net income or are directly allocated under paragraphs 1 to 6 of this subsection shall be disregarded."

2 This matter was the subject of a so-called informal hearing before the State Tax Board which, on December 5, 1969, rendered an opinion affirming the action of the then State Tax Commissioner. The State Tax Board decision was based primarily on the pleadings, since very little evidence was submitted at the hearing. Petitioner's present counsel, on December 15, 1969, requested a formal hearing which was granted. The Tax Appeal Board accordingly heard the case on December 21,

1970, which hearing was supplemented by the submission of a stipulation of facts and briefs. This revised decision is based on the supplemented record.