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Corporate State Income Tax--Sales Factor of Apportionment Formula

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CORPORATE STATE INCOME TAX—SALES FACTOR OF APPORTIONMENT FORMULA—Heaven Hill Distilleries, a Kentucky corporation, was taxed by the Commonwealth for the years 1951 to 1955 on income derived from sales made and negotiated outside of Kentucky with delivery to be made outside of the state. The sales and bottling contracts were made and negotiated by Heaven Hill Company, Inc., an Illinois corporation, pursuant to an exclusive sales agreement with the Kentucky corporation. The two corporations were wholly independent of each other and sales were made and negotiated through out-of-state offices owned, staffed and maintained by the Illinois corporation and over which the petitioner had no control. The trial court entered a twofold judgment setting aside assessments for 1954 and 1955 and ordering the Commonwealth to refund the income taxes paid for the years 1951, 1952, and 1953. On appeal, reversed. In a very concise opinion, Judge Bird stated: "To avoid allocation of out-of-state sales to Kentucky, the taxpayer must not only negotiate the sales outside of Kentucky but must in addition thereto negotiate them from offices, agencies and places of business *maintained* by the taxpayer outside of the state." *Luckett v. Heaven Hill Distilleries, Inc.*, 336 S.W.2d 584, 585 (Ky. 1960).

The holding in this case is a further attempt to properly construe a most important section of the allocation formula for determining the portion of total corporate income subject to taxation by Kentucky. Like many other states, Kentucky has sought to devise a means of taxing corporate income which is attributable to business done within the state.[1] Various methods are available, but Kentucky has selected a formula consisting of three factors: tangible property, payroll and sales.[2] The percentages of these factors which are at-

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they have not as yet been decided. They are: Konigsberg v. California State Bar, 29 U.S.L. Week 3294 (Jan. 26, 1960) (No. 28) (denial of admission to the bar solely because of refusal to answer questions about Communist Party membership after having been warned that refusal to answer pertinent questions would be ground for rejecting his application); *In re* Anastaple, 29 U.S.L. Week 3195 (March 18, 1960) (No. 58) (denial of admission to the bar solely because of refusal to answer questions regarding the Communist Party or any subversive organization listed on the U. S. Attorney General's list; and Cohen v. Hurley, 29 U.S.L. Week 3195 (May 7, 1960) (No. 84) (disbarment of attorney for refusing to answer questions or produce subpoenaed records during judicial investigation of ambulance chasing).

[1] See Lynn, "Formula Apportionment of Corporate Income for State Tax Purposes: Natura Non Facit Saltum," 18 Ohio St. L.J. 84 (1957). For an excellent work on the whole problem, see Altman & Keesling, Allocation of Income in State Taxation (1950).

[2] Ky. Rev. Stat. § 141.120(4)(b) (hereinafter cited as KRS) provides:

> Where income is derived from the manufacture or sale of tangible personal property, the portion thereof attributable to business within

(Footnote continued on next page)

tributable to Kentucky when averaged together will give the percentage of the total amount of income which the state can properly tax.[3]

Computing the percentage of each individual factor in order to arrive at the ultimate percentage of the income to be taxed is no easy matter. This comment will consider only the sales factor. According to KRS 141.120(4)(f), the percentage of this factor allocable to Kentucky is determined as follows:

> Receipts from sales and other sources shall be assigned only to the office, agency or place of business of the corporation at which the transactions giving rise to the receipts are chiefly negotiated.

Comparing this provision to the holding of the principal case, it is evident that the court has interpreted this statute to mean that the only sales not allocable to Kentucky are those negotiated at a place of business *maintained* by the corporation outside of Kentucky. The addition of the word "maintained" has had important effects in the field of corporate income tax and, as would be expected, has been attacked by corporate taxpayers.

The first case to consider KRS 141.120(4)(f) was *Allphin v. Glenmore Distilleries Co.*[4] Glenmore, a corporation engaged in the sale of whiskey, which had its main offices in Louisville, Kentucky and its production plant in Daviess County, Kentucky. The corporation had sales offices in twenty-nine states and salesmen in sixteen additional states who were responsible to the district and regional offices. Orders secured by the salesmen in those forty-nine states were sent first to Louisville for approval and then to the plant in Daviess County for shipment. Payments on accounts were made to the Louisville office.

The Department of Revenue argued that under KRS 141.120 (4)(f) the mere fact the orders were procured outside of Kentucky

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> this state shall be taken to be such percentage of the total of such income as the value of the tangible property, the payroll and business within this state bears to the value of the total tangible property, total payroll, and total business, the percentage of tangible property, of payroll, and of business, being separately determined as hereinafter provided, and the three percentages averaged.

[3] The process is explained in more detail by Lynn, *supra* note 1, at 89:

> Most apportionment formulae presently in use include three factors. They are most commonly sales, payrolls, and property. Ratios are determined indicating the relation between that portion of each factor attributable to the taxing state and the total value of that factor. Such ratios are averaged and the resultant percentage is applied to total income to determine the portion of such income properly attributable to the taxing state.

[4] 270 S.W.2d 168 (Ky. 1954).

would not prevent allocation of the income from out-of-state orders to this state if the "predominant elements of the sales transactions" took place within Kentucky.[5] The trial court held for Glenmore, however, emphasizing the fact that the sales were "chiefly negotiated," as used in the statute, outside of the Commonwealth since the orders were procured in other states.[6] On affirming, the Court of Appeals stated:

> It is our opinion that the lower court properly construed the statute in not assigning to Kentucky the receipts from sales procured by sales representatives operating out of offices, agencies or places of business *maintained* by the corporation outside of Kentucky.[7] (Emphasis added).

Thus, it can be seen that the Court of Appeals did a great deal more than merely affirm the lower court, for it read the word *maintained* into the meaning of the statute. The court justified this interpretation on the ground that four other jurisdictions which had somewhat similar statutes used this construction.[8]

The only other case involving KRS 141.120(4)(f) is *Luckett v. Coca Cola Bottling Co.*,[9] decided four years after the *Glenmore* case. There, Coca Cola, a Kentucky corporation with its manufacturing and bottling plants in Kentucky, made on-the-spot sales directly from its trucks in Indiana. Such sales were made for both cash and credit by the drivers who loaded their trucks in Louisville and who returned there with the empty bottles. Coca Cola paid Indiana a gross receipts tax on the sales and a store license fee for each truck so operated there. In holding that these on-the-spot sales should be allocatd to Kentucky, the court stated:

> We believe it is obvious the Legislature intended, and the Glenmore case held in construing the provisions of law under scrutiny, that the locus of the sale is made dependent upon the site of the office, agency or place of business out of which the salesman works. Especially do we gather this idea from the Glenmore case, because in that

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[5] *Id.* at 169.
[6] *Ibid.*
[7] *Id.* at 170.
[8] *Id.* at 169, citing Commissioner of Corp's and Taxation v. Ford Motor Co., 308 Mass. 558, 33 N.E.2d 318 (1941), where Ford manufactured automobiles and parts in Massachusetts for sales in Massachusetts and elsewhere; Maytag Co. v. Commissioner of Taxation, 218 Minn. 460, 17 N.W.2d 37 (1944), where Maytag manufactured washing machines in Iowa but maintained a sales office in Minnesota; Commonwealth v. Minds Coal Mining Corp., 360 Pa. 7, 60 A.2d 14 (1948), where Minds Coal Mining Corp. operated mines in West Virginia but had its executive and administrative office in Pennsylvania; California Packing Corp. v. State Tax Comm'r, 97 Utah 367, 93 P.2d 463 (1939), where California Packing Corp. stored products in Utah which were sold by agents sent out from its California office.
[9] 310 S.W.2d 795 (Ky. 1958).
[10] *Id.* at 796.

> opinion the word "maintained" as it appears in connection with office, agency or place of business carries the connotation of a particular or fixed location.[10]

Thus, it can be seen that the court by applying the *Glenmore* case has consistently used the term "maintained" in construing KRS 141.120(4)(f) even though the requirement is not present in the statute.

It is interesting to note that the Department of Revenue in its brief in the *Heaven Hill* case was of the opinion that the only similarity between the *Glenmore* decision and the principal case was that "both cases involve the sale of the same product, namely whiskey."[11] More specifically, the Department pointed out that in the *Glenmore* case there was no doubt but that part of the income should be allocated outside of the state; the question before the court was how much should be allocated to Kentucky. The Department, however, denied the existence of this question in the *Heaven Hill* case in view of "the cold, hard fact . . . that Heaven Hill Distilleries, Inc., engages in no activity that extends beyond the borders of the Commonwealth save and except for the shipment of its product from Bardstown in interstate commerce."[12] By this analysis, the Department takes the position that a Kentucky corporation cannot enter into a sales agreement with an independent contractor from another state in order to escape paying the Kentucky income tax. The fact that the sales were "negotiated," as stated in the statute,[13] outside of Kentucky, cannot control this type of case where it is obvious that to allow it to do so would mean a total loss of revenue to the Commonwealth.

There is naturally a fear of double-taxation in cases such as this, but one should realize that "taxation in one state is not an immunization against taxation in other states."[14] It is highly possible that more than one state will render services to a single corporation for which they should be compensated through payment of taxes. It is wise, therefore, that the court has elected to place emphasis on the question of who maintains the out-of-state office from which the sales are negotiated. If the taxpayer maintains the office, then there is a strong argument for the proposition that Kentucky should relinquish any claim to such sales in view of the fact that the state in which the office is located is giving the taxpayer benefits for which taxes should be paid to that state. If, however, the maintenance of

[11] Brief for Appellants, p. 17.
[12] *Id.* at 26.
[13] KRS 141.120(4)(f).
[14] West Pub. Co. v. McColgan, 27 Cal. 2d 705, —, 166 P.2d 861, 864, *aff'd*, 328 U.S. 823 (1946).

such offices is the obligation of an independent contractor, such as the Illinois corporation in the principal case, then the spirit of KRS 141.120(4)(f) is defeated if merely negotiating the sales outside of Kentucky will remove them from the Commonwealth's taxing power.

William M. Dishman

DAMAGES—PROPRIETY OF PER DIEM VALUATION OF PAIN AND SUFFERING BY COUNSEL IN CLOSING ARGUMENT—Plaintiff was injured when a box car, set in motion by the failure of a coupling device on defendant's locomotive, struck the coal car under which he was working. In an action for damages for personal injuries, the trial court ruled that the defendant was negligent as a matter of law, and submitted the issues of contributory negligence and the assessment of damages to the jury. From a verdict and judgment of $20,000 defendant appealed. The Court of Appeals held that the verdict was excessive with respect to the following items of proof: (1) the effect of a pre-existing back injury upon the plaintiff's present condition was not clearly established; (2) plaintiff was never hospitalized; (3) plaintiff had continued to perform certain occupations; and (4) proved medical expenses, including estimates of future treatment, were only $566. Pursuant to Rule 59.01 of the Kentucky Rules of Civil Procedure, a new trial was granted for the sole purpose of determining the issue of damages.[1] At the second trial, counsel was permitted to list various elements of plaintiff's damages on a blackboard in closing argument, including an amount for pain and suffering calculated at five dollars per day for the length of his life expectancy. From a verdict and judgment of $62,331 defendant appealed. *Held*: Affirmed. The court reasoned that, on the basis of the medical testimony presented at the second trial, the jury could have properly concluded that plaintiff's disability was not attributable to his pre-existing injury, but resulted solely from the negligence of the defendant.[2] In regard to the blackboard summation presented by counsel, the court reasoned that it is no more speculative to suggest daily compensation for plaintiff's pain and suffering than it would be to suggest a total amount. Further, since the jury must make a specific allocation of damages for pain and suffering, counsel should be permitted

[1] Louisville & N.R.R. v. Mattingly, 318 S.W.2d 844 (Ky. 1958).

[2] "The evidence adduced in this respect [concerning plaintiff's pre-existing injury] on the second trial was clearly more positive and would have been sufficient to sustain the *original* verdict." (Emphasis added). Louisville & N.R.R. v. Mattingly, 339 S.W. 2d 155, 157 (Ky. 1960).