

1965

## State and Local Taxation: Final Examination (May 1965)

William & Mary Law School

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### Repository Citation

William & Mary Law School, "State and Local Taxation: Final Examination (May 1965)" (1965). *Faculty Exams: 1944-1973*. 163.  
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(Taxes ascribed to the states in the questions are wholly hypothetical)

Furniture Manufacturing Co., M, is a North Carolina corporation with its only manufacturing plant and principal office located at Roanoke Rapids in that State. All of its ordinary wood finishing work is done at its N. C. plant, but when M receives orders from wholesalers for antique finished furniture, M sends its manufactured pieces to an independent wood finishing company, F, in Danville, Virginia, especially expert in that service, where the finish is put on as the final step in the processing and the pieces are then crated and shipped by F via common carrier directly to the purchasing retailer as directed by M. Payment for the furniture is made by the retailers to the M N. C. office.

1. Virginia imposes an annual franchise tax upon all corporations doing business in the State and its statute defines doing business in the case of a manufacturer to include the performance of any activity in the process of completing the production of goods. The tax is measured by the value of goods processed in Virginia, which is deemed to be the selling price of the goods wherever sold. Discuss the validity of the Virginia tax as imposed on M and measured by the \$100,000 gross receipts from the sales of M furniture finished and shipped by F to M's customers both within and without Virginia.

2. Virginia imposes a retail sales tax upon the sale of tangible personal property other than for resale. The tax is to be collected from the consumer and the Tax Commissioner has sought to compel F to pay the tax upon F's purchase of the stains, varnish and shellac used by F in the wood finishing work. Discuss the success potential of a protest by F.

M has formed a subsidiary, S Company, with plant and offices in South Carolina, for the manufacture of inexpensive furniture which is produced and sold under the S name. S operates entirely independent of M except that the same employees buy the raw wood for both S and M and the same sales force solicit orders for both, their salaries being fairly apportioned between the two companies. Because of the difference in the grades of furniture made by each, there would be no competition between the two even if they were totally independent, and the salesmen sell with S or M manufactured furniture depending upon the grade desired by the customer. The accounts of each are handled independently by the respective S or M office. M's margin of profit and net income is much greater than S's.

3. For income tax purposes, South Carolina apportions the net income of a business done within and without the State according to payroll, property and sales. S. C. has coupled the income of S and M for its income tax purposes and applied the three factor formula to the grouped assets of both resulting in a larger tax liability than the tax on S alone. Discuss the success potential of contesting the tax as so applied.

4. North Carolina imposes an annual franchise tax on all corporations measured by the value of the capital stock of the corporation, and in the case of corporations doing business both within and without the State, only that fraction of the value of the capital stock is subjected to the tax rate as is represented by M's N. C. real and tangible property over M's total real and tangible property wherever located. Thus in M's case the value of its capital stock necessarily includes the value of the S stock which M owns but the apportionment fraction does not take into consideration the situs of the S assets. Discuss the legal propriety of this technique.

5. Included in M's assets, and thus their value reflected in that of M's capital stock, are a substantial amount of Federal Treasury Bonds. The N. C. tax commissioner has not reduced the value of M stock subjected to the tax rate in determining M's liability under the above tax by the value of the Federal Bonds. Discuss the propriety of M's claim that constitutionally it must be so reduced.

In areas where it has not been successful in the sale of M furniture to retailers, M has established retail furniture stores in order to introduce M furniture on the retail market in those locales. Whenever an M retail store succeeded in creating a consumer demand for M furniture, the store would be closed down upon the other retailers agreeing to include M furniture in their stock. The average number of retail stores in the M chain at any one time was 100 and these were operated by the M Retailing Division, R. R had its own complete staff and program, with main office at M headquarters in N. C., and area management offices each serving the branch stores in a different part of the nation. Separate R books of account were kept reflecting the profit and losses of R and computed on the difference between retail selling prices and the same purchasing cost for M furniture as was paid to M by independent retailers.



6. An Indiana franchise tax is imposed upon chain stores, graduated according to the total number of stores under common ownership wherever located. R operated five stores in Indiana of a total of 100 stores and was compelled to pay a tax of \$500 for each such store. A competitor, Indiana Furniture Co., owning only 5 stores all within the State, pays the franchise tax of \$100 for each store. Discuss the success potential of M's suit contesting the Indiana franchise tax assessment.

7. While some of M's five Indiana stores show net profits, the total five show a deficit. R's total net income from the operation of M's 100 stores is \$1,000,000, while the total of M's net income from all sources is \$5,000,000. A three factor apportionment formula of property, payroll and sales is used in the application of Indiana's net income tax to business conducted both within and without the State. The Indiana tax commissioner proposes to so apportion M's net income of \$5,000,000 in assessing the tax to be paid by M. M does no intra-state business in Indiana other than the conductance of the 5 retail furniture stores. Discuss the legal propriety of the tax commissioner's action in this respect.

M used a substantial amount of solid mahogany in its furniture production. It purchased its supply of mahogany from a British Honduras firm which had a selling and handling agent in Norfolk. M was one of the agent's best customers and the agent caused the BH firm to stockpile a sufficient quantity of mahogany in Norfolk yards to meet M's anticipated bi-monthly demands, which could thereby be filled from the Norfolk yard in a matter of days upon receiving M's order. M would place bi-monthly orders for mahogany with the BH agent, A, in Norfolk so as to keep at hand at its N. C. yards a sufficient amount to meet its 60 day production needs. A always had a sufficient amount on hand in the Norfolk yards to meet M's next bi-monthly order. Shipments of mahogany received at Roanoke Rapids were stocked in one pile in M's yard and then fed as needed to a seven day quantity pile for use in M's immediate production operations.

8. Discuss the liability of M for an NC personal property tax on all wood which on assessment day was in M's yard at Roanoke Rapids and which had been appropriated to an executed contract calling for shipment to Roanoke Rapids and whether enroute or still in the Norfolk yard awaiting shipment.

M was one of the principal stock holders of the M Furniture Manufacturing Co. In 1955, when residing in Roanoke Rapids, M established an irrevocable inter-vivos trust, funding it with M stock and U. S. Treasury Bonds, and providing that the income of the trust be paid to him during his life and at his death the corpus be distributed free of trust to his then living issue per stirpes. He designated a Roanoke Rapids bank to be sole trustee. In 1960, M retired and moved to Williamsburg, Virginia, where he died in 1965. Both NC and Virginia have statutes which provide that "State inheritance taxes are hereby levied upon the shares of the respective beneficiaries in all property within the jurisdiction of this State which shall pass by a transfer under which the transferer has retained for his life the possession or enjoyment of the property or the income therefrom." M had children domiciled in both NC and Virginia at his death.

9. Both NC and Virginia tax commissioners have sought to subject the full value of the corpus of the trust to their respective inheritance taxes. Discuss the validity of each.