1971

State and Local Taxation: Examination (January 1971)

William & Mary Law School

Repository Citation

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I. In the constitution of State X there is language that says "No tax shall be imposed upon income". The Department of Taxation of State X wishes to recommend to the legislature the enactment of a 2% tax on sales made and services performed in the state, to be paid by the vendor, and to recommend enactment of a franchise tax applicable to corporations which would be measured by net income. The state chamber of commerce has just pointed out in a press release opposing these proposals that the second proposal is an attempt to tax income, and that since income consists primarily of receipts from sales and services, the first proposal is also an attempt to tax income.

1. Does the state constitution prohibit the tax on sales and services?
2. Does the state constitution prohibit the franchise tax measured by net income?

3. Regardless of your answer to question 2, draft a one paragraph jurisdictional provision to be included in the "franchise tax measured by net income" statute which will, to the broadest extent possible, assert valid jurisdiction over corporations doing an interstate business. The first sentence should begin "A tax is hereby imposed upon......". You need not include apportionment language.

II. Joe Doakes has just moved to town and wishes to go into the business of renting motorcycles. The town fathers learned of his plans and responded by passing an ordinance imposing a license tax on the rental of vehicles having fewer than four wheels which touch the ground. The tax was at the rate of two dollars a day for each vehicle used in the business, payable monthly. The state also imposes a sales tax of typical kind which purports to tax "all sales at retail", and which imposes on the vendor the duty to collect and remit the tax.

1. Is the license tax valid?
2. Will Doakes have to pay a sales tax on vehicles purchased for use in the business and will he have to collect a sales tax from his customers on the rentals?

III. Magnificent Merchandise Manufacturers, Inc. (MM) is a Tennessee Corporation that produces novelty items in Arkansas and markets them primarily in North Carolina, Kentucky, Virginia and West Virginia. Its net income in 1970 was $200,000. Its real property owned in Kentucky consists of a headquarters building which cost $200,000 and has a fair market value of $300,000 and it rents a truck in Kentucky for which it pays an annual rental of $1,000. Information indicates that the terminal cost $100,000 and is valued at that amount by its owner. Tangible personal property owned in Kentucky costs $30,000 and has a value of $40,000. Real property owned outside Kentucky cost $500,000 and is valued at $700,000 and tangible personal property owned outside Kentucky cost $100,000 and has a value of $90,000. Kentucky sales were $400,000 and non-Kentucky sales were $1,500,000. Kentucky payroll was $100,000 and payroll elsewhere was $500,000. Its accounts receivable at the end of the year were $200,000 and its bank deposits, all in North Carolina, were $100,000. The corporation, although chartered in Tennessee and doing most of its manufacturing in Arkansas, is managed and controlled from its headquarters in Kentucky.

1. Which states, if any, can tax all of MM income?
2. Assume that Kentucky has the Uniform Division of Income for Tax Purposes Act. Show by inserting figures in a formula how the income taxable in Kentucky is computed?
3. Which states, if any, can tax MM intangibles, and how much?
4. What effect, if any, would Kentucky's ratification of the Multistate tax compact have on MM tax liability?
5. Georgia law requires a non-domestic corporation to obtain a license to do business in the state which cost $1,000 and is non-recurring. MM desires to establish a retail outlet in Georgia. Is it legally required to pay the license fee?
IV. Amalgamated Products, Inc. plans to send sales representatives, in 1971, into Texas and Louisiana to solicit orders for acceptance at its Kentucky headquarters, with delivery being made from its warehouse in Arkansas. If enough business seems forthcoming, consideration will be given to establishing sales offices and warehouses in Louisiana and Texas to service these markets. Assume that Louisiana and Texas have corporate income taxes of broad scope. Advise the corporation of income tax consequences of its contemplated expansion into Texas and Louisiana.

7. APM is considering the hiring of a commission broker in Florida to solicit orders for ballpoint pens from Florida businessmen for use by their employees. The broker would function as an independent contractor who would secure orders and forward them to APM headquarters for acceptance and delivery. Would APM be liable to collect the Florida use tax?

8. APM has acquired mailing lists of prospective customers in Virginia and Maryland and plans to solicit orders by mailing catalogues to those on the mailing list. APM currently has a retail outlet in Virginia, but none in Maryland. Would APM be liable to collect the Virginia and Maryland use taxes with respect to the mail order sales?

9. An employee of APM, who works in Kentucky, lives in Tennessee. In addition to his salary of $14,000 he derives $6,000 annually from the rental of property he owns in Arkansas. Which states can constitutionally tax his income, and how much?

IV. Amalgamated Wood Products, Inc. owns a warehouse in Norfolk, Virginia, where it stores goods for delivery to customers and raw materials for use in its business. Virginia imposes a 1% tangible personal property tax. On December 31, 1970, the tax date, AWPI had in the warehouse 700 cabinets for shipment to England under a contract calling for shipment on January 4, 1971, 200 desks which were being stored in anticipation of orders to be received from Germany, hopefully by the end of February, 1971, and 500 chairs which had been sold to a New York distributor and were due to be shipped to him on January 7, 1971. Normally, this distributor resells abroad approximately 2/3 of his purchases from AWPI. Also in the warehouse were 1,000,000 board feet of mahogany which had just been imported from Brazil and was needed immediately by its Georgia plant, and 500,000 board feet of walnut. AWPI had never used walnut in its business and had purchased it only because the price was good. It had no immediate plans for the use of the walnut, but most likely would resell it as raw lumber. Virginia assessed a tax based on the value of the entire stored contents of the warehouse. Comment on the validity of the assessment.

V. John Smith died unexpectedly last week. He owned residences in Virginia and North Carolina and divided his time equally, although he was a native of Tennessee and continued to vote there. In addition to stock in a Michigan corporation, he owned negotiable notes made by a South Carolina payee and had savings accounts in New York and California savings and loan associations. His net estate is several million dollars. Assume each state involved asserts maximum jurisdiction to tax transfers at death. Discuss his death tax situation in terms of the claims which can be made by the various states. Is he likely to get relief from multiple taxation in the federal courts?

VI. Briefly identify and explain:
1. Capitalization of earnings.
2. Separate accounting.
3. Objection by non-manufacturing states to the apportionment formula recommended by the Willis Committee.
4. Justice Black's view of the commerce clause as it relates to state power to tax interstate commerce.
5. Revenue elasticity of a tax in relation to the tax base.
6. Resale exemption certificate.