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Income of Corporation--Taxable in State of Origin--Arbitrarily Allocating Formula

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quired of him by the Board and could take no other business, except in his spare time.

Hutcheson, *C.J.*, in a concurring opinion takes the stand that as to those services for which appellee was allowed extra compensation he was not an employee, but that the remuneration thus received was paid to him as an agency of the Board; nevertheless, the income thus derived was exempt, for to tax it would be to affect a governmental agency in such a manner as directly to interfere with the functions of government.[4]

The idea of control or right of control characterizes the relation of employer and employee and differentiates the employee from the independent contractor.[5] Except that appellee was required to use his judgment and skill as an attorney, his services were under the direct control of the Board.

The attempt of the government to tax the appellee's income was based on an extremely narrow interpretation of the statute, and was properly frustrated.

P. A.

INCOME OF CORPORATION—TAXABLE IN STATE OF ORIGIN—ARBITRARILY ALLOCATING FORMULA.—Appellant, a New York corporation, established a plant in Asheville, North Carolina, and there manufactured its entire output of heavy leathers. A warehouse and salesrooms were maintained in New York State. Sales were made throughout the United States and Canada; the evidence tended to show that forty per cent of the output of the Asheville plant was sent to New York and the balance was shipped direct on orders received from there. Evidence was offered to show that seventeen per cent of the total income of the corporation was attributable to its manufacturing and tanning operations in North Carolina. The assessment as allocated by the Commissioner of Revenue of that state allotted to the state for the purposes of taxation, pursuant to the prescribed statutory method, approximately eighty-five per cent of the appellant's annual income. Appellant aggrieved by adverse decisions in the state courts which upheld the validity of the state statutes appealed to the United States Supreme Court on the ground that the statute in question was arbitrary and its operation repugnant to the Fourteenth Amendment, *Held,* that the statutory method as applied to the appellant's business for the years in question operated unreasonably and arbitrarily in attributing to North Carolina a percentage of income out of all appropriate proportion to the business

[4] Metcalf & Eddy v. Mitchell, 269 U. S. 514, 46 Sup. Ct. 172 (1926); Panhandle Oil Co. v. Mississippi, 277 U. S. 218, 48 Sup. Ct. 451 (1928).

[5] Standard Oil Co. v. Anderson, 212 U. S. 215, 29 Sup. Ct. 252 (1909); Chicago, Rock Island & Pacific Ry. Co. v. Bond, 240 U. S. 449, 36 Sup. Ct. 403 (1916).

transacted by the appellant in that state. *Hans Rees' Sons* v. *State of North Carolina ex rel. Maxwell,* 283 U. S. 123, 51 Sup. Ct. 385 (1931).

The proportion of the income of a corporation taxable by a single state is often computed by the use of an allocating formula. Such formula determines the tax by arriving at the ratio that the corporation's assets within the state bear to its total assets.[1] The Supreme Court in previous decisions, while it has upheld similar statutes,[2] has implied that if the taxpayer could prove conclusively that as to it the operation of the statute was arbitrary and unfair, the Court would be inclined to hold the statute unconstitutional.[3]

Fully aware of the constitutional limitations upon the taxing power of the states, the Court in the case of *Farmers Loan and Trust Company* v. *Minnesota* expressed itself as determined to prevent multiple taxation of a unitary economic enterprise.[4] The principle that a state is entitled to tax a corporation for all locally-earned income has already been carried to a logical extreme. For example, a corporation in order to evade payment of an income tax may attempt to divert its locally-earned income out of the state by means of unfair contracts with artificially created subsidiaries.[5] It has been held in such cases that the state may disregard contracts and book entries and tax the corporation for all income earned within its borders.[6] Because of the desire of the Supreme Court to sustain the taxing powers, the states have been permitted to exercise such powers to an extreme. The instant case, however, will serve to reassure those who fear that the Supreme Court, going beyond reasonable limits, may permit an arbitrary assessment upon corporate income.

J. L.

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[1] For an explanation of the theory on which many allocating formulæ are based see, *The Unit Rule* (1927) 35 YALE L. J. 838.

[2] Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 41 Sup. Ct. 45 (1920); Bass, Ratcliff and Gretton v. State Tax Commission, 266 U. S. 282, 45 Sup. Ct. 82 (1924); National Company v. Commonwealth of Massachusetts, 277 U. S. 413, 48 Sup. Ct. 534 (1928); Alpha Portland Cement Co. v. Commonwealth, 244 Mass. 530, 139 N. E. 158 (1922). See also Rottschaefer, *State Jurisdiction of Income* (1931) 44 HARV. L. REV. 1075.

[3] See the discussion in Magill, *Allocation of Income by Corporate Contract* (1931) 44 HARV. L. REV. 935. For pertinent cases see *supra* note 2, and Western Union Telegraph Co. v. Mass., 125 U. S. 530, 8 Sup. Ct. 961 (1887); Wallace v. Hines, 253 U. S. 66, 40 Sup. Ct. 435 (1919).

[4] 280 U. S. 204, 50 Sup. Ct. 98 (1930), where the court says: "We have determined that in general intangibles may be properly taxed at the domicile of their owner and we can find no sufficient reason for saying that they are not entitled to enjoy an immunity from taxation at more than one place similar to that accorded to tangibles." See also Baldwin v. Missouri, 281 U. S. 586, 50 Sup. Ct. 436 (1930); Beidler v. South Carolina, 282 U. S. 1, 51 Sup. Ct. 54 (1930); Standard Oil Co. v. Thoresen, 29 F. (2d) 708 (C. C. A. 8th, 1928).

[5] For a discussion of this practice, see Magill, *Allocation of Income by Corporate Contract, supra* note 3.

[6] Palmolive Co. v. Conway, 43 F. (2d) 226 (D. C. Wis. 1930); Buick Motor Co. v. Milwaukee, 43 F. (2d) 385 (E. D. Wis. 1930); Cliffs Chemical Company v. Tax Comm., 193 Wis. 295, 214 N. W. 447 (1927).