

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

GALLAGHER, INC.,)
) DOCKET NO.: CT-1998-5
Appellant,)
)
-vs-)
)
THE DEPARTMENT OF REVENUE) FINDINGS OF FACT,
OF THE STATE OF MONTANA,) CONCLUSIONS OF LAW,
) ORDER and OPPORTUNITY
Respondent.) FOR JUDICIAL REVIEW

The above-entitled appeal came on regularly for hearing on the 4th day of February, 1999, in the City of Helena, Montana, pursuant to the order of the State Tax Appeal Board of the State of Montana, (the Board). The February 4 hearing was adjourned to allow the parties the opportunity to perform depositions and to exchange exhibits. The hearing resumed on May 13, 1999. The notices of said hearings were duly given as required by law setting the cause for hearing. The taxpayer, represented by Walter Kero and David Green, certified public accountants, and Stephen Mehaffey, attorney and certified public accountant, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Brendan Beatty, tax counsel, and Melissa Kopp, an auditor with the

Corporation License Tax Bureau, presented testimony in opposition thereto. At this time and place, testimony was presented, and exhibits were received. The Board allowed the record to remain open for a period of time for the purpose of receiving post-hearing submissions from the parties. Having received the post-hearing submissions in a timely fashion, the Board then took the cause under advisement; and the Board having fully considered the testimony, exhibits, post-hearing submissions, and all things and matters presented to it for its consideration by all parties in the Docket, and being well and fully advised in the premises, finds and concludes as follows:

FINDINGS OF FACT

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of said hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The issue under appeal is whether or not the investment activity of Gallagher, Inc., a Delaware corporation, constitutes income apportionable to the state of Montana for tax year ending June 30, 1993 through tax year ending June 30, 1996.

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BACKGROUND OF APPEAL

The issue surfaced as a result of an audit of Gallagher, Inc. by the Department of Revenue's Corporation Tax Division. The audit found that the income of Gallagher, Inc. constituted business income and was subject to apportionment in Montana. That audit resulted in an additional assessment of approximately \$12,736.29. This decision was affirmed by the Division Administrator of the Corporation License Tax Bureau. The assessment and interest totaled \$13,585.74 through October 31, 1997. Gallagher appealed that determination to the Director of the Department of Revenue. Upon review of additional evidence presented by Gallagher, Inc., the Director issued a Final Agency Decision which found that 100 percent of Gallagher's income was subject to apportionment in Montana. At the time of the May 13, 1999 hearing before this Board, the assessment and interest totaled \$42,025.

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TAXPAYER'S CONTENTIONS

Mr. Kero testified that Gallagher, Inc. is a Delaware corporation with its legal situs in Delaware. The current shareholders are the University of Montana Foundation, the Missoula Community Hospital Foundation, Shriners' Hospital and the Gallagher Foundation. The current officers include an individual, serving as president of the corporation, who is also a trust officer with U.S. Bank in Minneapolis and an attorney in Missoula who serves as vice president. Mr. Kero serves as secretary-treasurer. Mr. Kero stated that the issue at hand was triggered by a desk audit and review by Bob Chilton, an auditor with the DOR's Corporation License Tax Bureau. That audit resulted in an additional assessment of approximately \$12,736.29. (Taxpayer's Exhibit C-32) The taxpayer appealed that determination to Lynn Chenoweth, bureau chief of the Corporation License Tax Bureau. Mr. Chenoweth agreed with the auditor's initial findings. The taxpayer then appealed to the DOR director, Mary Bryson. Ms. Bryson's ruling resulted in a further assessment due to her finding that 100% of the income in dispute was apportionable to Montana.

In 1929, William J. Gallagher, a Montana citizen, started a Caterpillar franchise, Westmont Tractor and

Equipment Company, selling Caterpillar tractors and logging equipment in western Montana until 1956. In 1956, William Gallagher's son took over the business and formed his own corporation called Westmont Tractor Company.

Also in 1956, the operating assets of the predecessor to Gallagher, Inc., Westmont Tractor and Equipment Company, liquidated its inventory, accounts receivable, all of its operating assets, into cash and invested that cash into what has become the remaining assets of the corporation.

Mr. Kero testified that this course of action was chosen by Mr. Gallagher to avoid what he termed "a double layer of taxation." Mr. Gallagher had paid taxes throughout his years as a business operator and did not wish to subject the proceeds of the business liquidation to undue taxation. Those assets were comprised of stocks and bonds and a piece of real estate in Flathead County, Montana. Sometime during that transition period between an operating company and a holding company, W. J. Gallagher retired and his son took over the business. In 1995, W. J. Gallagher, the 98 percent shareholder in Gallagher, Inc., died and his widow, Rosemary Gallagher, took over the business and operated it until approximately February of 1997 when, according to the dictates of W. J.'s will and trust, the

four charities became the shareholders in the corporation.

In 1992, Gallagher, Inc. was reorganized and moved to Delaware through a transaction known as an F reorganization, IRS Code 368. This was a name change but the corporate and legal domicile was moved to Delaware. Delaware, as a state, best represents that state where the economic activity of the investments, the assets, of Gallagher, Inc. takes place.

Mr. Kero stressed that the economic activity of Gallagher, Inc., is interest, dividends and capital gains and that activity takes place where the investments are held, i.e., Delaware. Thus, the economic activity of these investments takes place largely outside of the state of Montana. First Trust (U.S. Bank) and Piper Jaffrey, headquartered in Minneapolis, were the custodians of the investments.

Taxpayer's Exhibit 2 contains copies of U.S. and Montana Corporation License Tax Returns for tax years 1992, 1993, 1994, 1995, 1996 and through February 25, 1997. The taxpayer presented these returns to show that the section on the returns where business income (gross receipts of sales less returns and allowances) is to be reported has been left blank. This fact demonstrates that Gallagher, Inc. is not engaged in an active trade or business. The

income reported on these returns is reported as dividends and interest. Mr. Kero pointed out that the taxpayer was able to benefit from a provision in IRS code which allows a special deduction for dividends received from domestic corporations. Mr. Kero emphasized that the purpose of Exhibit 2 is to demonstrate the existence of a clear-cut distinction between trade or business activities and investment activities, which are the activities of Gallagher, Inc. under federal tax law.

For tax year 1992, the year of Delaware incorporation, the taxpayer submitted a Montana return which prorated the taxable income to reflect its assertion that the legal and corporate domicile became the state of Delaware. Also for tax year 1992, the taxpayer reported the sale on a contract for deed of property located in Flathead County, Montana, in the amount of \$141,937, as the only economic activity taking place within Montana. This was an installment sale which was reported as such on several years' tax returns. The investment activity for that year, \$2,735,045, was attributed to activity outside of the state. By this assumption, a property factor (comprised of the average value of real property and tangible personal property) of 5.19 percent was attributed to Montana. The DOR took issue with this assumption and

removed the property factor of 5.19 percent in its audit.

Taxpayer's Exhibit Q is a copy of a section from Black's Law Dictionary, Sixth Edition, which contains the definition of "domicile: a person's legal home. . ." Mr. Kero stated that Gallagher, Inc.'s legal home is Delaware. Also, from Exhibit Q, a definition of "commercial domicile. A domicile acquired by the maintenance of a commercial establishment. A concept employed to permit taxation of property or activity of nonresident corporation by state in which managerial activities occurred in quantity and character sufficient to avoid contention of nonresident corporation that taxation of its activities and property located outside bounds of taxing state amounted to deprivation of property without due process." Again, from Exhibit Q, a definition of "Business. Employment, occupation, profession, or commercial activity engaged in for gain or livelihood." And "Business Enterprise. Investment of capital, labor and management in an undertaking for profit; one of the recognized attributes is centralized management and control." Exhibit Q also contains a definition of "nexus. A multi-state corporation's taxable income can be apportioned to a specific state only if the entity has established a sufficient presence, or nexus, with that state. . "

Mr. Kero asserted that the important distinction in the present issue is the difference between commercial, or business, activity and the investment activities of a personal holding company such as Gallagher, Inc. Gallagher, Inc. does not have labor reported in the production of a trade or commercial enterprise. Mr. Kero contended that there is no labor involved with the function of assets being invested and being solely held for long-term capital appreciation. "W. J. Gallagher, being the president of Gallagher, Inc., did not go and work for Chase Manhattan, CitiCorp, etc. He was retired. In order to make a distinction that Gallagher, Inc. was involved with a trade or business activity, he would have to have done those things, or he would have had to have had employees under his command and control who were doing such a thing. That doesn't exist." (Walt Kero testimony, State Tax Appeal Board hearing, May 13, 1999.)

Taxpayer's Exhibit G, containing several definitions from Internal Revenue Code, and Taxpayer's Exhibit H, copies of Code for Principal Business Activity, and case law obtained from Research Institute of America, Inc., were presented to further the taxpayer's contentions that its investment activities do not constitute a trade or business and that it is not subject to federal tax law

requirements governing dealers in securities and taxation of capital assets used in the production of income.

Taxpayer's Exhibit I embodies a copy of 15-31-302, MCA, containing the statutory definition of business income: "(1) Business income means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operation. (2) Commercial domicile means the principal place from which the trade or business of the taxpayer is directed or managed. . . (4) Nonbusiness income means all income other than business income. . ." Mr. Kero asserted that Gallagher, Inc. is involved in non-business income.

In Taxpayer's Exhibit C, a copy of a March 18, 1998 letter from the taxpayers to Department of Revenue Director Mary Bryson, in which the taxpayer disputed the findings of Bureau Chief Lynn Chenoweth regarding additional assessments due and owing, the taxpayer cited a United States Supreme Court case: Allied Signal v. Director Division of Taxation, 504 US 768 (1982). This case concerned the issue of taxation of a capital transaction of a nonresident corporation. The court found

the unitary principle to be governing and relied upon a three-pronged unitary test developed in Container Corp. v. Franchise Tax Board, 463 US 159 (1983): 1. Functional integration. 2. Centralization of management. 3. Economies of scale. The taxpayer contends that functional integration and economies of scale do not exist in the case of Gallagher, Inc. Centralization of management would be the only part of the three-part unitary test that applies.

Taxpayer's Exhibit L contains a citation obtained from Research Institute of America, Inc., concerning the Allied Signal case cited above. Mr. Kero emphasized a portion of that case in which the United States Supreme Court stressed that a state may not tax an activity merely because it has a connection to the actor it wishes to tax, there must be a connection to the actor's activities (Miller Bros. Co. v. Maryland, 347 U.S. 344-345(1954)). In the present case, according to Mr. Kero, the state of Montana has a connection to W. J. and Rosemary Gallagher, as shareholders and residents of Montana, but not to the economic activities of Gallagher, Inc., a Delaware corporation. The corporation itself, Gallagher, Inc., is separate from the shareholders. Its economic activities take place, for the most part, outside the state of Montana.

Mr. Kero made reference to the appeal of Jewel Companies v. Department of Revenue of the State of Montana, CT-1985-4 (Jewel). Jewel's investment in stock in a Mexican subsidiary (Aurerra) was sold, resulting in a capital gain transaction. The Montana Department of Revenue attempted to tax a portion of that capital gain transaction. The final disposition of the case was that the Department of Revenue was not allowed to tax that capital gain because the dividends and capital gains income from the Mexican subsidiary were earned in the course of activities unrelated to those carried out in Montana. The Mexican investment was not an integral part of Jewel's Montana activity. Jewel did not have numerous investments in the stocks of other companies; it did not have close operational ties to the Mexican company, but rather engaged in normal oversight and review of that company's activities. Jewel was not involved in the active trading of stocks; the dividends and capital gains from the Mexican company's stock were neither a function of Jewel's domestic business (its operational needs) nor a temporary investment of working capital.

Mr. Kero asserted that the Jewel finding applies in the present appeal because "if a unitary relationship did not exist between Jewel and Aurerra, then it would be

even more remote for the state of Montana to establish a unitary relationship between Gallagher, Inc. and its investments. It would be very, very difficult. In fact, in my mind, it would be impossible. Gallagher, Inc.'s board of directors did not share common associations with the board of directors of Hormel Meats, CitiBank, Boeing, even Montana Power."

Exhibit O is a copy of a State Corporate Tax Issues Practice Guide which, according to Mr. Kero, is used by the American Institute of Certified Public Accountants as a guide in determining whether or not a state has nexus and the appropriate reporting of economic activity and taxable transactions. A series of 65 questions, to be answered yes or no, serve as a guide in determination by tax preparers as to whether or not nexus exists with a state. The taxpayer answered only four of the 65 questions in the affirmative during the time period of audit: is the corporation currently filing with the state? (Montana and Delaware); has the corporation ever executed contracts in the state? (real estate contract in Flathead County); has the corporation previously filed income tax returns in the state?; and does the corporation maintain a security interest/mortgage in property until the contract price or amount borrowed has been paid?

Mr. Kero presented numerous exhibits on the subject of non-business versus business income in support of his contention that Gallagher, Inc. is not involved with an active trade or business and that its holding company activity is not business income. Under the rules adopted by the multi-state tax compact and definitions under the Uniform Division of Income for Tax Purposes (UDITPA), non-business income is to be reported to the state of commercial domicile. Since there is no commercial domicile for the taxpayer, the non-business income should be taxed to the state of commercial and legal domicile, the state of Delaware. The taxpayer asserts that it does not have employees other than a corporate officer, it does not have inventory for resale to customers, it does not have accounts receivable representing sales of goods or the furnishing of services to customers and it does not have a line of credit or other debt instruments used in financing a business activity. Gallagher, Inc. is not registered with the State Auditor's Office under the investment section as a dealer in securities and is not registered with the Montana Secretary of State as a corporation as it has no need for registration in Montana in order to protect assets, or provide opportunities and benefits.

Taxpayer's Exhibit X is a November 18, 1998

letter from Rosemary Gallagher to the State Tax Appeal Board in which she states that "First over the last twenty five years both W. J. Gallagher and myself spent the months of October through April at a second residence in Southern California. Second investment activities of Gallagher, Inc. were directed by W. J. and myself from our California residence while we were located here. Third, I was a corporate officer and shareholder of GALLAGHER, Inc. until February 1997. The purpose of this information is to put on record significant facts to be used in the appeal of Montana Department of Revenue "Agency decisions" and the "final determination by the Department of Revenue" in regards to the corporate license tax proposed and assessed against Gallagher Inc." In addition to submitting this letter, Mr. Kero testified that his conversations with Rosemary Gallagher revealed that W.J. Gallagher only spent approximately two hours per week managing the investment activity of Gallagher, Inc.; perhaps less than that because W. J. and Rosemary Gallagher had numerous other investments besides those held by Gallagher, Inc., and some of that two hours per week was devoted to the other investments.

Taxpayer's Exhibit R is a copy of the 1998 Annual Report of D. A. Davidson. Mr. Kero submitted this exhibit as a demonstration of the difference between a securities

dealer, D. A. Davidson & Co., Inc., involved in the active business of securities and the taxpayer, a personal holding company whose activity is investments. D. A. Davidson is required to hold a securities license. The taxpayer is not.

The taxpayer took issue with the failure of Department of Revenue Director Mary Bryson to issue the Final Agency Decision within the 60 day time frame prescribed by Section 15-1-211 (4) (c) ". . . Within 60 days after the taxpayer has presented objections, the director or the designee shall issue a written decision addressing the objections and describing reasons for the decision. The director's decision is the final decision and assessment of the department." By Mr. Kero's reckoning, Ms. Bryson's decision was issued between 68 and 77 days after the taxpayer presented its objections.

The taxpayer's post-hearing brief, received by this Board on June 18, 1999, contained many of the same arguments enumerated above concerning the issues of the definition of domicile, nexus, trade or business, and the Jewel Companies case.

DEPARTMENT OF REVENUE'S CONTENTIONS

The DOR argued that Gallagher, Inc. had nexus

with Montana due to the simple fact that it managed and directed its affairs from Montana and owned property in Montana. It also managed its affairs part of the year from California yet no returns were filed in California.

Mr. Beatty argued that the establishment of nexus is a fairly low standard. It is some minimal connection with the taxing state. In this case, a shareholder (W. J. Gallagher) was a paid employee of the corporation and directed and managed the affairs of the corporation from Missoula, Montana. That fact established nexus with Montana.

Mr. Beatty stated that the issues raised by the taxpayer concerning whether or not the subject income is business or non-business income or whether or not the subject corporation is unitary or non-unitary are irrelevant. The commercial domicile is Montana. Its activities were managed and directed from an office in Missoula, Montana. The DOR has determined that the income is business income. However, if for some reason, it was determined to be non-business income, the income would be allocated to the state of commercial domicile which, in this case, is the state of Montana.

Ms. Kopp testified that the DOR position is that the business activity of Gallagher, Inc., investing, is

directed and managed in Montana. Gallagher, Inc. has not established nexus with any other state nor has it filed income tax returns in any other state. The commercial domicile is the state of Montana and, consequently, 100 percent of the income should be apportioned to Montana.

DOR Exhibit D is a spreadsheet showing the additional taxes due as a result of the DOR finding that 100 percent of the income at issue is taxable to Montana. This document shows a total of \$42,025 due and owing, including interest as of May 15, 1999. Ms. Kopp testified that she obtained the information used to calculate the additional assessment from the returns filed by Gallagher, Inc. for the years ending June 30, 1993 through June 30, 1996, the tax years at issue.

Section 15-31-302, MCA, contains definitions for corporations who are subject to taxation within Montana. The term "commercial domicile" is defined in this section: "Commercial domicile means the principal place from which the trade or business of the taxpayer is directed or managed." The commercial domicile of Gallagher, Inc. is Montana because its business (investing) was directed and managed from Montana, the accounting and tax preparation was done in Montana, the officers, directors and employees resided in Montana during the audit period.

The corporation also maintained a telephone. This information was obtained through review of the filed returns, which contained telephone expense deductions.

Section 15-31-101, MCA, specifies organizations subject to taxation in Montana: "(1) The term "corporation" includes associations, joint-stock companies, common-law trusts and business trusts which do business in an organized capacity, and all other corporations whether created, organized, or existing under and pursuant to the laws, agreements, or declarations of trust of any state, country, or the United States." The DOR's position is that Gallagher, Inc. is a corporation according to the definition above. "(2) The terms "engaged in business" and "doing business" both mean actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." The DOR's position is that Gallagher, Inc. is engaged in transactions for financial gain or profit. Those transactions are investment in stocks, bonds, etc., for capital appreciation.

The fact that Gallagher, Inc. describes itself as a holding company does not exempt it from Montana's corporation license tax. Section 15-31-113, MCA, states: "A corporation is not exempt from the corporation license tax unless specifically provided for under 15-31-103 (3) or

15-31-102. Personal holding companies are not specifically exempted under those sections, consequently, personal holding companies are subject to Montana's corporation license tax.

Montana tax law is tied by statute to federal gross income, which means all income, any income. Once one gets there, Montana law takes over. For example, Montana does not allow deductions allowable under federal law unless specified in statute. The Montana corporation license tax return begins with federal taxable income, line 28 from the federal return.

ARM 42.26.206 and 42.26.207 support the Montana Code Annotated in its determination of business and non-business income. According to ARM 42.26.207, income from intangible investments (stock, bonds, etc.) is considered business income: ". . . (3) Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations. (4) Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular

course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations."

The business of Gallagher, Inc. is investment in tangible and intangible property for gain or profit. It does not have any other business.

DOR Exhibit H is a spreadsheet prepared by Melissa Kopp obtained from data on the taxpayer's corporation license tax returns for the audit period. The spreadsheet shows, for each year of the audit, the total income subject to apportionment that was reported by Gallagher, Inc., the income that was apportioned by Gallagher, Inc., to Montana for each year of the audit, and the income that was not apportioned to any other state for each year of the audit. Under the taxpayer's reasoning, approximately half a million dollars would not be subject to taxation by any state.

Delaware does have a corporation income tax. An entity is subject to that tax when it actively engages in business activity within the state of Delaware. Ms. Kopp testified that Gallagher, Inc. did not file a corporation income tax return in Delaware, to her knowledge. She stated Gallagher, Inc. is not subject to the corporate

income tax in Delaware because a corporation maintaining a statutory corporate office in the State (of Delaware) but not doing business within the State is exempt from taxation in Delaware. In addition, Gallagher, Inc. had not established a taxable nexus in Delaware, according to Ms. Kopp. Gallagher, Inc. has filed information with the state of Delaware claiming exemption from corporate income tax. Taxpayer's Exhibit 2 contains documents entitled "Delaware Information Return Holding Company/Investment Company" for various years during the audit period. It reports information on investment companies incorporated in Delaware. Gallagher, Inc. reported that it does not receive rental income from real property located within Delaware, it does not receive rental income from tangible personal property located within Delaware, it does not provide accounting and bookkeeping, legal, consultation, investment advice, collections, management or computer services in Delaware. These responses would indicate that Gallagher, Inc. would be exempt from corporate income tax in Delaware. In essence, Gallagher, Inc. has reported to the state of Delaware that it does not conduct any business activity within that state.

In his post-hearing brief, received by this Board on June 17, 1999, Mr. Beatty provided the Board with a

complete nexus analysis in response to the taxpayer's claim at the hearing before this Board that it did not have nexus with Montana. Mr. Beatty discussed the Due Process Clauses of the United States Constitution and the Montana Constitution to counter the taxpayer's argument that the subject assessment violates the Due Process Clauses. Due process concerns the "fundamental fairness of governmental activity." Quill, 504 U.S. at 312. Mr. Beatty concluded that "although a corporation's physical presence is Montana is no longer a prerequisite to satisfy the Due Process Clause of the United States Constitution, Gallagher's physical presence, through its employee's actions in Montana, clearly meets the threshold requirement of the Due Process Clauses." The Due Process Clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Mr. Beatty writes "Although many cases involving the Due Process Clause of the United States Constitution were decided on the basis of some sort of physical presence in a state, in Quill the U.S. Supreme Court expressly overruled that requirement. Quill, 504 U.S. at 306.

Mr. Beatty also discusses the nexus requirement of the Commerce Clause of the United States Constitution which concerns the effect of state regulation on the

national economy. He states "A state's tax will not violate the Commerce Clause if it is levied on a party with substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and if fairly related to the services provided by the state." He further discusses each of these items in detail and reaches the conclusion that the assessment in dispute does not violate the Commerce Clause of the United States Constitution.

DISCUSSION

The Board finds that the evidence and testimony in this matter has demonstrated that all of Gallagher's business activities are performed from Montana. All of Gallagher's employees claimed their salaries as Montana income. Gallagher did not dispute that the transactions it entered into were intended to make a profit and did, in fact, result in profit. Testimony at the hearing indicated that the agents of the corporation directed the investing activities from an office/residence in Missoula, Montana.

Mr. Kero agreed that the income at issue should be allocated to the state of domicile. He testified that Gallagher, Inc. did not file corporate income tax returns in Delaware. Mr. Green speculated that "maybe we should

have filed a return in Delaware."

The tax return filed by Gallagher, Inc. in Delaware was a franchise tax return. This appears to essentially be a fee that corporations must pay to the state of Delaware which is not based on federal or state gross income. Gallagher, Inc., because it has less than 3,000 shares outstanding, pays \$40 annually as a franchise tax.

Delaware Code (DOR Exhibit B) provides for exemption from taxation in Delaware for: ". . . (8) Corporations whose activities within this State are confined to the maintenance and management of their intangible investments or of the intangible investments of corporations or business trusts registered as investment companies . . . and the collection and distribution of the income from such investments or from tangible property physically located outside this State. . ." Mr. Kero pointed to this as the section of Delaware code which qualifies Gallagher, Inc., for exemption of taxation in the state of Delaware. This Board's interpretation of the above Delaware code is that investment management must occur inside the state in order to qualify that corporation for taxation in Delaware. . However, Mr. Kero testified that "nobody inside of the state of Delaware" manages the

investments of Gallagher, Inc.

Mr. Kero acknowledged, in response to a question by DOR counsel, that Gallagher, Inc.'s investment activity was managed and directed from W. J. and Rosemary Gallagher's home in Missoula, Montana. He stated that there was a period of time when office rent was paid to a Missoula accounting firm to rent an office upstairs from the accounting firm, generally during the summer months. Mr. Gallagher rented this office space not only for Gallagher, Inc., but also for his personal investments.

The corporation license tax returns filed by Gallagher, Inc. showed that it had a payroll. Gallagher, Inc. paid W. J. Gallagher for being a corporate officer and for managing and directing the investments. When Mr. Gallagher filed a tax return on this income, he filed his personal income tax return and paid income taxes in Montana because he considered himself to be a Montana resident for income tax purposes.

The Gallaghers resided in California during April through October of the audit years. Mr. Kero testified that the Gallaghers did not claim any sort of business residence while they were in California nor did they pay income tax to the state of California for any of the income Mr. Gallagher received while he was directing and managing

the investment activities of Gallagher, Inc. during their stay in California. Mr. Kero also acknowledged that, for the audit period, the two items on the state corporate tax issues practice guide which were answered with "no", should actually have been answered "yes" for the audit period: "yes", in response to question 3, "does the corporation have an office, agency, warehouse, or other business location owned or leased in the state?" and "yes" in response to question 11 (b), "does the corporation have employees or representatives who perform any of the following activities in the state - engaged in managerial or research activities?"

The taxpayer spent considerable time comparing its situation to that in Jewel Companies. The Board finds that such comparison is inappropriate. Gallagher, Inc. does not have any wholly owned subsidiaries that are doing something entirely unrelated to what Gallagher, Inc. does, which is to invest. Jewel Foods was a retail grocery store operation which conducted a trade or business activity. It had a Mexican subsidiary which it ultimately sold. Jewel Foods was not in business of creating and selling subsidiaries. The ordinary course of Jewel's business was selling groceries. Montana incorrectly, according to this Board and the courts, tried to make that Mexican subsidiary

unitary with Jewel Foods and to apportion that non-business income. Upon questioning by the DOR, Mr. Kero testified "It is Gallagher, Inc.'s position that it is not a unitary business." (Walt Kero testimony, State Tax Appeal Board hearing, May 13, 1999.) It appears that Gallagher, Inc. had filed its returns as a unitary business but has since changed its mind.

As to the issue of a tardy response from the Department of Revenue director, Mr. Kero is correct. The director's office should have either asked for an extension or have responded in a timely manner. However, failure to do so does not result in an abatement of the assessment or any other consequences favorable to the taxpayer. The statutory requirements of Section 15-1-211 (4) (c) are only a guideline. The statute does not provide penalty for failure to comply.

In its post-hearing brief, the taxpayer also argued that it has not received fair treatment because the amount of the revised assessment to the taxpayer was not disclosed until the May 13, 1999 hearing before this Board. While it may have been a professional and efficient gesture on the part of the Department of Revenue to include that additional assessment with the Final Agency Determination, a prudent corporation certainly would have taken it upon

itself to make an inquiry as to the amount of the additional taxes due and owing, especially since it knew that interest was continuing to accumulate, and to determine how best to stop the interest from accumulating while the issue made its way through the appeal process.

CONCLUSIONS OF LAW

1. Section 15-31-101, MCA, sets forth those corporations which are subject to tax in Montana and provides, in pertinent part:

. . . (2) The terms "engaged in business" and doing business both mean activity engaging in any transaction for the purpose of financial or pecuniary gain or profit.

(3) Except as provided in Sections 15-31-103 or 33-2-705(4), MCA, or as may be otherwise specifically provided, every corporation engaged in business in the state of Montana shall annually pay to the state treasurer as a license fee for the privilege of carrying on business in this state the percentage or percentages of its total net income for the preceding taxable year at the rate set forth in this chapter . . .

2. ARM 42.23.102 also provides:

(1) A corporation is "doing business" or "engaging in business" in Montana when it actively engages therein in any profit seeking activity. The fact that its activities may result in a loss is not material.

3. Regardless of its state of incorporation, Gallagher, Inc.'s commercial domicile is Montana. Section 15-31-302, (2), MCA, defines "commercial domicile" as the

"principal place from which the trade or business of the taxpayer is directed or managed."

4. Gallagher, Inc. is not entitled to an abatement of the subject assessment under the 60 day rule. Section 15-1-211 (4) (C), MCA, provides that the Director of the Department of Revenue shall issue a written final agency decision within 60 days after the taxpayer has presented its objections. The statute does not provide an abatement of the assessment upon failure by the Director to comply, however.

5. The appeal of the taxpayer is hereby denied and the decision of the Department of Revenue is hereby affirmed.

ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the taxes and interest assessed are properly due and owing.

Dated this 13th of July, 1999.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JAN BROWN, Member

JERE ANN NELSON, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 13th day of July, 1999, a true and correct copy of the foregoing has been served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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