

## Opinion No. 39-3286

September 23, 1939

**BY:** FILO M. SEDILLO, Attorney General

**TO:** Mr. J. O. Gallegos, Bureau of Revenue, Santa Fe, New Mexico. Attention: Mr. W. S. Barnes, Chief Auditor, Income Tax Division

{\*108} With respect to the income tax report of the Hughes Tool Company, it is clear that paragraph 3 of the department's regulations under Section 31 of Chapter 85, Laws of 1933, as amended by Section 5, Chapter 189 of the Laws of 1937 (141-1531, 1938 Supplement) is not applicable.

The corporation is engaged in a large manufacturing and mercantile business, manufacturing and selling its products throughout the world. It has a small mercantile business in New Mexico for the sale of its products manufactured elsewhere, and carries on no manufacturing in the state.

The method of computation provided for in the above regulation does not reflect the true net income earned by such an enterprise from business done in New Mexico. The regulation is specifically limited to "the case of general stores or mercantile business." It was not intended to apply to a business composed of manufacturing outside the state and carrying as an incident a small mercantile enterprise within the state, because the ratio between its sales within and without the state is entirely out of proportion to the ratio between its investments within and without the state, and between expenses within and without the state, and when their percentages are averaged as required, it is patent that the result can have no relation to the net income of the company within the state. The mercantile investment within the state is small; the investment outside the state, which includes manufacturing, is necessarily disproportionately large.

You have attempted to make the assessments by taking into consideration only the ratio between the sales within and without the state and applying it to the net income reported by the company. This constitutes an attempted compliance with the general provision of the statute as contained in subsection (b) of Section 31. If the company claims that this method of allocation will subject the company to tax on a greater proportion of its net income than is reasonably attributable to business within the state, it should, in accordance with subsection (d) of said Section 31, file with you a statement of its objections and of such alternative method of allocation or apportionment as it believes to be proper under the circumstances, together with such details and proof as it may have to support its claim that such an alternative method of allocation is more likely to express the true net income attributable to business done within the state. This is a reasonable requirement of the statute, since the company is in better position to advise you of the elements to be considered in such an extensive and complicated enterprise in arriving at a figure which would more nearly represent its net income in New Mexico.

In my conversation with the company's attorney I understood that the company planted itself squarely on the proposition that its case was covered by the above regulation, and not upon a claim that the method of computation there provided for did, in fact, reflect the company's true income in New Mexico.

Rather than attempt to suggest an alternative method of computation, I suggest that the company be invited to follow the provisions of subsection (d), and that such an allocation as may be peculiarly adapted to the business of the company, in the light of the information furnished be made especially for this company. I am satisfied {*\*109*} this is authorized by the procedure outlined in said subsection (d).

By: ANTONIO M. FERNANDEZ,

Asst. Atty. Gen.