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In the Supreme Court of Florida

Shell Oil Company,

Petitioner,

v.

Department of Revenue,

Respondent.

______________________________/

Case Nos. 66,240
66,254

On Review from the District Court
of Appeal, First District

Respondent's Answer Brief

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Statement of the Case

Respondent, Department of Revenue, (hereinafter referred to as the "Department") was the Defendant in the Trial Court and the Appellee/Cross-Appellant in the District Court. Petitioner, Shell Oil Company (hereinafter referred to as "Shell") was the Plaintiff in the Trial Court and the Appellant/Cross-Appellee in the District Court. The Trial Court below was the Circuit Court of the Second Judicial Circuit, in and for Leon County (hereinafter referred to as the "trial court"). The District Court was the District Court of Appeal of Florida, First District, (hereinafter referred to as the "District Court").

The record on appeal will be referred to as "R" followed by the appropriate page number.

The Appendix, if any, will be referred to as "A" followed by the appropriate page number.

The Outer Continental Shelf will be referred to as the "Outer Continental Shelf" and as the "OCS."

The Outer Continental Shelf Lands Act will be referred to as "OCSLA."

The Internal Revenue Code of 1954, as amended, will be referred to as the "IRC."

Shell's intangible drilling and development cost will be referred to as "IDC's".

All emphasis is supplied unless otherwise noted.

A. Course of the Proceedings.

Shell filed an action to contest the legality, assessment and levy of Florida corporate taxes payable by Shell for the tax years 1972, 1973, 1974, and 1975.

After the Department answered Shell's amended complaint, both Shell and the Department moved for summary judgment. (R. 59, 336). Shell's motion was heard first, and the trial court entered its order (R. 331) granting summary judgment on one issue and denying summary judgment on others. After hearing the Department's motion, the trial court entered a corresponding order (R. 333), granting the motion on those issues denied as to Shell and denying the motion on that issue granted as to Shell.

After the trial court's ruling on the summary judgment motions, one issue remained, Shell moved to amend its amended complaint to delete this issue. (R. 61). In its final judgment (R. 362), the trial court granted Shell's motion to amend and adopted its previous summary judgment orders, thereby disposing of all issues. Shell then filed its Notice of Appeal in the District Court and the Department filed a Notice of Appeal at the same time, instituting case no. AS-160. Case no. AS-160 was dismissed by the District Court and the Department's Notice of Appeal was treated as a Notice of Cross Appeal.

The trial court's Final Summary Judgment held, among other things, that the Department's treatment of Shell's income derived from the sales in the various states of the United States, of oil extracted from wells located on the OCS, during the years from 1972 to 1975, did not violate the OCSLA, 43 USC, §1333(a)(2)A.

The trial court found against the Department, holding that Shell could include all of the original cost of its oil and gas wells, in particular its IDC's in the property factor of the apportionment formula for determining Shell's corporate taxes for Florida.

The District Court affirmed the Final Summary Judgment entered by the trial court in its entirety.

Shell filed a Petition for re-hearing with the District Court, which was denied.

The Department filed a motion for re-hearing and classification directed to that portion of the District Court's opinion that prohibited the Department from excluding Shell's IDC's, from Shell's property factor in Florida's apportionment formula. The District Court stated that there was merit in the Department's position, that §220.42(1), F.S. indicated that IDC should be treated the same in Florida's apportionment formula, as in Shell's federal income tax return. However the District Court denied the motion on the grounds that the authorities in said motion were not cited and the issues not raised, in the brief or oral argument by the Department, and thus the law could not be raised for the first time on a motion for re-hearing.

In addition to Shell's motion for re-hearing, Shell requested that the District Court certify a question to this Court. The District Court granted Shell's request and certified the following question as being of great public importance, pursuant to Florida Rules of Appellate Procedure 9.030(a)(2)(A)(v):

> WHETHER THE STATE OF FLORIDA IS PROHIBITED BY 43 USC §1333(a)(2)(A) FROM IMPOSING A TAX UPON INCOME DERIVED FROM THE SALE IN THE UNITED STATES OF OIL EXTRACTED FROM THE OUTER CONTINENTAL SHELF?

Shell filed a Notice to Invoke Discretionary Jurisdiction to review the decision of the District Court, on the basis that the decision passed upon a question certified to be of great public importance.

The Department filed a Notice to Invoke Discretionary Jurisdiction in this Court to review the decision of the District Court, as that decision expressly and directly conflicts with the rule of law announced in decisions of the Florida Supreme Court on the same question of law.

On December 14, 1984, this Court consolidated case no. 66,240 and case no. 66,254 for all appellate purposes.

Statement of the Facts

First, this case is concerned with the income realized from the sale, in the various states, of oil extracted and transported from Shell's OCS wells. Secondly, this case is concerned with whether §220.42(1) F.S. precludes Shell from classifying IDC's as expenses in its federal income tax returns (thus affecting a reduction in taxable income for the year in which the expenses are incurred), while at the same time classifying them as capital assets (treated as part of the costs of acquisition of the oil well), for apportionment purposes under Florida law.

A. The following facts are related to the question certified by the District Court which asks whether the State of Florida is prohibited by 43 USC §1333(a)(2)(A) from imposing a tax upon income derived from the sale in the United States of oil extracted from the Outer Continental Shelf.

For the purpose of determining gross income, Shell artificially computed "income" based upon a fair market value at the wellhead of the oil extracted from its OCS wells, even though there were, in fact, no sales at the wellhead. Shell then deducted related expenses from this artificially computed "income" to arrive at its "OCS production income" which was then excluded from the tax base on Shell's Florida returns.

All of the oil, involved in this case, which was extracted from these wells was brought into the United

States, refined in the United States, and then sold in the various states.

Florida disallowed Shell's treatment of this artificially computed "income" and denied Shell's claimed exclusion of its "OCS production income" from the Florida tax base.

Nothing in the record, or in Shell's brief, discloses that any revenues or gross income, which was derived from actual sales transactions consummated on the OCS, were included in the Department's computation of Shell's Florida tax base for the years in question.

Florida is thus assessing corporate taxes on income derived from sales occuring in the various states of the United States. The significant event for the purposes of that tax is the <u>sale</u> of the oil in various states, <u>not</u> the extraction or transportation of the oil from the OCS.

B. The following facts are related to the other issues, which are raised by the Department, of whether §220.42(1), F.S., precludes Shell from classifying IDC's as deductible expenses in its federal income tax return (thus effecting a reduction in taxable income for the year in which the expenses are incurred), while at the same time classifying them as capital assets (treated as a part of the cost of acquisition of the oil well), for Florida apportionment tax purposes.

Depending on whether Shell is determining income for accounting purposes or for tax purposes, Shell either capitalizes or 'expenses' certain costs. For financial accounting purposes Shell capitalizes and depreciates all of the original costs of its producing oil and gas wells. Shell, on the other hand, for federal and Florida state tax purposes, (i) capitalizes and depreciates tangibles and (ii), expenses IDC's in conformity with Section 263(c) of the Internal Revenue Code of 1954, as amended, and with Florida law that follows federal law in that respect. In it's Florida corporate tax returns, for the years in controversy, Shell included, for apportionment factor purposes, all of the original costs of its onshore producing oil and gas wells, including the IDC's (expensed for both federal and Florida income determination purposes) in the property fraction of the apportionment formula. The Department audited and excluded all of Shell's IDC's from the property factor. In correspondence with Shell, the Department took the position that the costs should be excluded from the property factor used for apportionment purposes because they were, alternatively, either deducted for federal and Florida tax purposes or were intangibles.

ISSUES

I. WHETHER THE STATE OF FLORIDA IS PROHIBITED BY 43 USC §1333(a)(2)(A) FROM IMPOSING A TAX UPON INCOME DERIVED FROM THE SALE IN THE UNITED STATES OF OIL EXTRACTED FROM THE OUTER CONTINENTAL SHELF? [PETITIONER'S POINT I. IS COVERED BY RESPONDENT'S POINT I.]

II. WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETIONARY JURISDICTION TO REVIEW THE CHALLENGED DECISION OF THE DISTRICT COURT BECAUSE THE DECISION EXPRESSLY AND DIRECTLY CONFLICTS WITH DECISIONS OF THIS COURT.

III. WHETHER SECTION 220.42(1), F.S., PRECLUDES SHELL FROM CLASSIFYING IDC'S AS DEDUCTIBLE EXPENSES IN ITS FEDERAL INCOME TAX RETURN (THUS AFFECTING A REDUCTION IN TAXABLE INCOME FOR THE YEARS IN WHICH THE EXPENSES ARE INCURRED), WHILE AT THE SAME TIME CLASSIFYING THEM AS CAPITAL ASSETS (TREATED AS PART OF THE COSTS OF ACQUISITION OF AN OIL WELL), FOR FLORIDA CORPORATE TAX PURPOSES.

SUMMARY OF ARGUMENT

The Florida Code, founded on federal concepts, recognizes "income," ....from the sale, exchange or other disposition of property ... at such time as such income is realized for federal income tax purposes;" (§220.02(4)(a), F.S.). All "sale, exchange or other disposition" of property at issue in the instant case occurred within the state of Florida (or others among the various states), not on the Outer Continental Shelf, and hence no amount is excludable as being attributable to income producing activities recognized as the legal trigger for assignment of income under either federal or Florida law.

Decisions of this Court clearly establish that a reviewing court must follow statutes which are the law of the State and appear to control the matter before the court even though such statutes are not initially brought to the attention of the trial court and/or the appellate court.

The Florida Code requires that a taxpayer's method of accounting shall be the same as the taxpayer's method of accounting used for federal income tax purposes. (§220.42(1), F.S.). Shell elected, for federal (and therefore for Florida) income tax purposes, to deduct intangible drilling costs as a current expense rather than treat them as property, capitalize same and recover the cost thereof through amortization or depletion deductions over several tax years. Accordingly, by self recognition of denial of status as "property", these costs are properly excludable from the computation of the property factor used for Florida apportionment purposes.

ARGUMENT

POINT I

WHETHER THE STATE OF FLORIDA IS PROHIBITED BY 43 USC §1333(a)(2)(A) FROM IMPOSING A TAX UPON INCOME DERIVED FROM THE SALE IN THE UNITED STATES OF OIL EXTRACTED FROM THE OUTER CONTINENTAL SHELF?

Under §220.11, F.S., Florida imposes a tax on corporations measured by the income of the corporations, essentially on the "taxable income" subject to the Florida corporate tax, with certain modifications. The term "taxable income" is defined as taxable income under §63 of the Internal Revenue Code of 1954, as amended, which provides generally that the term "taxable income" means gross income less deductions allowed under the IRC.

Pursuant to these provisions, the Department required Shell to include, in its "taxable income," income derived from the sale, in the various states of the United States, of oil extracted from oil wells located on the OCS. The income from these sales, which were consummated within the various states, clearly constitutes "gross income" under the IRC. In determining a taxpayer's taxable income for federal income tax purposes, no exclusion or deduction is allowed under the IRC for income from the sale in the various states of oil from the OCS.

Shell is claiming this exclusion for the first time on its Florida corporate tax returns. Had this exclusion been permitted for federal purposes on the federal return, there would be no economic reason nor legal basis for Shell to separately claim this exclusion for Florida purposes.

Shell contends that an assessment of Florida corporate taxes on income derived from sales of crude oil or natural gas in the various states, which Shell extracted from wells located on the OCS (referred to by Shell as "OCS production income" on page 4 of its initial brief), constitutes the imposition of a state taxation law on the OCS in violation of 43 U.S.C. §1333(a)(2). Section 1333(a)(2), provides, among other things, that "State taxation laws shall not apply to the outer Continental Shelf."

However, requiring Shell to include income, from the sale in the various states, of oil extracted from oil wells located on the OCS, does not constitute the application of a state taxation law <u>on the OCS</u>. All of the oil from the OCS wells was brought into and refined in the various states, where the oil was sold. Florida is therefore assessing tax on <u>income derived from sales which occurred in the various states of the United States</u>. The <u>taxable</u> <u>event</u> that gave rise to the income, which is the subject of this litigation, <u>is</u> the income from the <u>sale</u> of oil, in the various states, <u>not</u> the extraction or transportation of the oil from the OCS.

In the instant case, there is no conflict between the Outer Continental Shelf Lands Act ("OCSLA") and the Florida corporate tax provisions. The purpose of OCSLA has been explained by the Fifth Circuit Court of Appeals in the case of Continental Oil Company v. Federal Power Commission, 370 F.2d 57, 67 (5th Cir. 1966), reh. den., January 27, 1967 which stated:

> Congress passed the OCSLA solely to regulate the "leasing and development. . . of the oil potential of the Continental Shelf." H.R. Rep. No. 413, 83d Cong., 1st Sess. 2-3 (1953), 2 U.S. Code Cong. & Ad. News, p. 2178 (1953).

The legislative intent behind OCSLA has also been explored by the Ninth Circuit Court of Appeals in Union Oil Company of California v. Morton, 512 F.2d 743, 747 (9th Cir. 1975) which stated that:

> Oil and gas deposits beneath the continental shelf are precious resources belonging to the entire nation. Congress, although encouraging the extraction of these resources by private companies, provided safeguards to insure that their exploitation should inure to the benefit of all.
>
> * * * *
>
> Careful study of the Act confirms that Congress intended to exercise both proprietary powers of a landowner and the police powers of a legislature in regulating leases of publicly owned resources.

In United States v. Maine, 420 U.S. 515, 527, 95 S.Ct. 1155, 1159 (1975), the United States Supreme Court ended States' attempts to offer leases on the OCS and stated that

OCSLA "provided for the orderly development of offshore resources." This result is consistent with the legislative purpose of the OCSLA solely to regulate the leasing and development of the oil potential of the OCS. Continental Oil, supra.

Shell attempts to label some of its income as "OCS production income" by assigning an amount of income, which would have been realized only if oil extracted on the OCS had been sold at the OCS oil wellheads. However, absent a sale, assigning a value to what the oil could have sold for does not constitute income. In fact, the oil was shipped to the various states to be refined and was subsequently sold. The income in question is clearly the income actually realized by Shell upon sales of the oil in the various states. No gross income was realized where the oil was extracted. If income had been realized, Shell would not have had to assume an artificial selling price for the oil at the wellhead site. Since Florida is including in its tax base the income from sales made exclusively in the various states, there is no attempt in the instant case to apply a law of taxation on the OCS.

Shell attempts to use the amount its labels "OCS production income", as an excludable amount. The statement of Shell's claimed exclusion are contained in Shell's brief at page 8. Shell does not contend that the "OCS production income" resulted from sales consummated on the OCS. Rather, Shell computed a "market value" of the oil extracted on the OCS, (the price of which the oil could have been sold if in fact it had been sold on the OCS) before any sale transactions occurred. All of the crude oil and natural gas actually produced on the OCS, at issue in this case, was in fact transported to the continental United States and sold in the various states. The amounts referred to as "OCS production income" are the amounts claimed by Shell as being excludable "OCS production income" "realized" upon the OCS.

It is essential to Shell's claim that an amount of "gross income" be both recognized and realized; (1) at a point in time before actual sales of such inventory property and; (2) at a place other than within the various states of the United States, within which the sale did occur.

In addressing Shell's claimed exclusion, Florida applied federal concepts of gross income, its recognition and realization under federal income tax laws.

Florida Statute 220.02(4)(a) follows the federal formulation of what constitutes income. It states:

> (a) "Income," for purposes of this code, including gains from the sale, exchange, or other disposition of property, be deemed to be created for Florida income tax purposes at such time as such income is realized for federal income tax purposes.

In Eisner v. Macomber, 252 U.S. 189 (1920) the Supreme Court required that income must be "realized". Realization generally connotates a sale of an asset for cash or its exchange for other property.

Realization occurs when the property is actually sold for its market value and;

> "When the last step is taken by which [the taxpayer] obtains the portion of economic gain which has already occurred to him."

Helvering v Horst, 311 U.S. 112 (1940)

Thus while the value of Shells crude oil may be said to have increased in value upon the extractions and movement from the wellhead to the pipeline, income is deemed realized by Shell only upon the sale of oil in the various states.

From the foregoing, no amount of gross income was realized by Shell when the crude oil and gas were extracted on the OCS, nor was any amount of gross income realized upon its transport by Shell into various states. The essential "trigger" for "realization", the consummation of a sale transaction, took place within various states. The amounts of artificially computed "gross income" in Shell's "OCS production income" lacks the essential element of a sales transation occurring on the OCS. This "OCS production income" is totally devoid of any basis as an exclusion in Federal law. Therefore, the time at which the essential sale transaction took place was a time at which the crude oil and natural gas was no longer on the OCS. This is clearly the "when". However, since the moment in time at which the essential sales transaction took place was necessarily a moment in which crude oil and natural gas was already within the various states, logic alone demands that the question of "where" is also answered. Shell offers no viable legal authority for its attempted disassociation of "when" from "where". The concepts underlying the applicable federal law do recognize the logical relationship of "when" with "where". The moment in time "when" the sales transaction is recognized as occurring for determination of "when" "gross income" is realized is also used to assign such "gross income" to the place ("where") of sale. The place (or source) of the gross income, is the place at which the crude oil or natural gas is located at the moment of sale, where title and possession thereof are delivered. All title passage and delivery of possession, as to the oil extracted on the OCS at issue in this case, occurred within the various states, not on the OCS.

Furthermore overwhelming confirmation of the federal concept of place of sale as determining the source of gross income is contained in the Balanovski decision of the United States Court of Appeals, Second Circuit, where it stated:

> By overwhelming weight of authority, goods are deemed "sold" within the statutory meaning when the seller performs the last act demanded of him to transfer ownership, and title passes to the buyer.

United States v. Balananovsk, 236 F.2d 298, 304 (2d Cir. 1956).

Thus, under Federal concepts, all gross income at issue in this case was both recognized and realized solely at a time ("when") and at a place ("where") within the various states, not on the OCS, as all sales transactions giving rise to the amounts of gross income related to the crude oil and natural gas extracted from the OCS were consummated within the various states. The fact that the crude oil and natural gas were produced upon the OCS does not give rise to any amount of gross income at the time or place of extraction.

The Florida Tax Code expresses a general intention that it utilizes "concepts of law which have been developed in connection with the income tax laws of the United States. . ." (§220.02, F.S.) Further §220.43(1), F.S., in pertinent part provides that ". . . . each taxpayer shall take into account the items of gross income, deduction and exclusion. . . . in the same manner and amounts as reflected in such taxpayer's federal income tax return. . . ." (Emphasis supplied).

Thus under either Federal or Florida concepts, the concepts of "gross income" derivation and items of exclusion are identical. §220.43(1), F.S. Under such concepts, no amount of "gross income" ("OCS production income"), sourced at the OCS, is recognized or realized under the instant facts and therefore no amount is excludable.

Shell's brief urges that this Court, under the rationale of James v. Dravo Contracting Co., 302 U.S. 134 (1937) and Ramah Navajo School Board v. Bureau of Revenue of

New Mexico, 458 U.S. 832 (1982), recognize federal preemption as to taxation of revenues attributed to a federal enclave.

These cases are totally distinguishable on a factual basis and thus made wholly inapplicable to Shell's contentions, and rather they support the Departments reliance upon a realization requirement.

In the James case, the exclusion from the tax base rested upon a determination that the actual sales of materials had in fact been consummated before the materials were brought into West Virginia - the realization had occurred without the jurisdiction of the taxing state:

> The contracts provided for partial payments as the work progressed and that all the material and work covered by the partial payments should thereupon become "the sole property of the Government." Payments by the Government were made from time to time accordingly.
>
> It is clear that West Virginia had no jurisdiction to lay a tax upon respondent with respect to this work done in Pennyslvania. As to the material and equipment there fabricated, the business and activities of respondent *in West Virginia consisted of the installation at the respective sites within that State and an apportionment would in any event be necessary to limit the tax accordingly. Supra at pp. 139-140.

In Ramah, the "sales transaction" giving rise to the gross receipts was both recognized and realized within the federal enclave because the sale of the personal property (by its conversion to an improvement to realty), together with rendition of the attendant services, was consummated within and therefore realized within the federal enclave. The income producing transation, the consummation of a sale of personal property, took place without the jurisdiction of the state.

In both Ramah and James, the sales transactions, relating to materials sold which generated the impermissable tax base, were recognized as occurring without the jurisdiction of the taxing state because of where the sales transactions were consummated.

In the instant case, all sales of crude oil and natural gas, at issue, occurred without the jurisdictional limits of the OCS.

In addressing the assignment of sales, for gross receipts tax purposes, the rationale of the decision of the United States Supreme Court in Moorman Manufacturing Company v. Blair, 437 U.S. 267 (1978), starting at page 209, confirms that gross receipts (like gross income) are assigned to the place (taxing jurisdiction) where the sale is made or consummated.

> Finally, it would be an exercise in formalism to declare appellant's income tax assessment unconstitutional based on speculative concerns with multiple taxation. For it is

> evident that appellant would have had no basis for complaint if, instead of an income tax, Iowa had imposed a more burdensome gross receipts tax on the gross-receipts from sales to Iowa customers. In Standard Pressed Steel Co. v. Washington Revenue Dept. 419 US 560, 42 L.Ed.2d 719, 95 S.Ct. 706, the Court sustained a tax on the entire gross receipts from sales made by the taxpayer into Washington State. Because receipts from sales made to States other than Washington were not included in Standard Pressed Steel's taxable gross receipts, the Court concluded that the tax was "apportioned exactly to the activities taxed." Id., at 564, 42 L.Ed.2d 719, 95 S.Ct. 706.

As between the states, Florida apportions income under Chapter 220, F.S. in respect to which Shell has waived its issue. Since the place of sale determines where gross income is both recognized and <u>realized</u> then the question is as certified:

> WHETHER THE STATE OF FLORIDA IS PROHIBITED BY 43 U.S.C. §1333(a)(2)(A) FROM IMPOSING A TAX UPON INCOME DERIVED FROM THE SALE IN THE UNITED STATES OF OIL EXTRACTED FROM THE OUTER CONTINENTAL SHELF.

The question certified is framed correctly and should be answered in the negative, as the District Court did when the question was before it. The basis for that negative answer is that the sales which generated the income, which are involved in this case, were consummated wholly, without the jurisdiction of the OCS.

As previously stated, Florida imposes a tax on corporations, measured by the income of a corporation, essentially on federal "taxable income" with certain modifications. See, §220.13, F.S. Regarding the income from sales, consummated by Shell in the various states, of oil extracted from OCS, modification of this federal "taxable income" is neither required nor permitted pursuant to §220.13, F.S.

Section 220.13(1)(b)2 b, F.S., allows taxable income to be reduced by a corporation's income "derived from sales outside the United States. . . ." The OCS, of course, is not outside the United States. 43 USC §1332(a); IRC §638. Thus, §220.13(1)(b)2 b, F.S., does not apply to the income in question. Nor does any other portion of §220.13, F.S., allow or require an adjustment to Shell's taxable income for gross income (net of expenses) realized upon the sale in the various states of oil extracted from oil wells located on the OCS.

Shell in its brief contends that Tres. Reg. 1.863-3(b) referenced by Rule 12C-1.13(1)(b)2 b (ii) regulates the method of apportioning income partly acquired from sources in a foreign country.

Tres. Reg. 1.863-3(b) and Rule 12C-1.13(1)(b)2 b (ii), F.A.C. are not applicable to the present controversy for several reasons. First, the source of the income in question, in the instant case, is all within the United States, since both the extraction and the sale of the oil at issue took place within the various states of the United States. Secondarily, Tres. Reg. 1.863-1(b) deals specifically with natural resource sales and allocates income derived from the sale of such products within or without the United States to sources within the United States, stating:

> (b) Natural resources. (1) The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from it the sale by the producer of the products <u>thereof within or without the United States</u>, shall ordinarily be included in gross income from sources within the United States. . . .

And, finally, Rule 12C-1.13(1)(b)2b (ii), F.A.C. addresses the method of apportionment for Florida Corporate Tax purposes, which is not part of the appeal. As stated by Shell in its brief on page 5 "To avoid confusion on the important "exclusion" issue, however, Shell elects not to argue the apportionment issue before this Court."

Thus the Department has not ignored its own regulations or acted inconsistently. Tres. Reg. 1.863-3(b) and Rule 12C-1.13(1)(b)2 b(ii), F.A.C. do not apply in this case, because the oil was not produced outside the United States and the sale of the oil, which generated the income in controversy, took place within the various states in the United States.

All of the sales transactions at issue in the instant case occurred in the various states and hence Florida is not precluded by the OCSLA from including in the computation of Shell's tax base all income derived from sales in the various states of the United States of oil extracted from wells located on the OCS.

POINT II

WHETHER THE SUPREME COURT SHOULD EXERCISE ITS DISCRETIONARY JURISDICTION TO REVIEW THE CHALLENGED DECISION OF THE DISTRICT COURT BECAUSE THE DECISION EXPRESSLY AND DIRECTLY CONFLICTS WITH DECISIONS OF THIS COURT.

POINT III

WHETHER SECTION 220.42(1), F.S., PRECLUDES SHELL FROM CLASSIFYING IDC'S AS DEDUCTIBLE EXPENSES IN ITS FEDERAL INCOME TAX RETURN (THUS AFFECTING A REDUCTION IN TAXABLE INCOME FOR THE YEARS IN WHICH THE EXPENSES ARE INCURRED), WHILE AT THE SAME TIME CLASSIFYING THEM AS CAPITAL ASSETS (TREATED AS PART OF THE COSTS OF ACQUISITION OF AN OIL WELL), FOR FLORIDA CORPORATE TAX PURPOSES.

The Department's Motion for Rehearing and Clarification filed in the District Court was directed to that portion of the District Court's decision affirming the trial court's final summary judgment prohibiting the Department from excluding Shell's intangible drilling and development costs (IDC's) from Shell's property factor in the Department's apportionment formula.

The Department urged that the District Court overlooked Section 220.42(1), Florida Statutes. That section provides, in pertinent part:

> (1) For purposes of this code, a taxpayer's <u>method of accounting</u> shall be the same as such taxpayer's method of accounting for federal income tax purposes. . . . (e.s.)

The District Court in its order on said motion stated:

> This provision, the department argues precludes Shell from classifying IDC's as expenses in its federal income tax returns (thus effecting a reduction in taxable income for the year in which the expenditures are made), while at the same time classifying them as capital assets (treated as a part of the cost of acquisition of the oil well), for Florida income tax purposes. . . .
>
> There is merit in the department's position that the statute (Section 220.42(1)) would indicate that IDC's should be treated the same in the apportionment formula as in Shell's federal income tax returns. We may speculate that had this statute been urged in the court below, in support of the department's interpretation of its rule, the trial judge's decision might well have been favorable to the department on this issue. However, so far as we have been able to determine from the record, the statute was never mentioned below. Neither was the statute cited in the department's brief in this court, nor in oral argument. . . .
>
> Our disposition of the department's motion for rehearing is mandated by the rule that authorities not cited and issues not raised in the brief or on oral argument cannot be raised for the first time on motion for rehearing. (e.s.) Shell Oil Co. v. Dept. of Revenue, 461 So.2d 959, 962-963 (1 DCA, 1984)

Judge Wentworth of the District Court concurred and dissented on rehearing, stating:

> I agree with denial of appellant's motion for rehearing but would grant cross-appellant's motion and reinstate the Department's determination of Shell's property factor in the apportionment formula. Section 220.42(1), Florida Statutes, requires that for Florida income tax purposes Shell's "method of accounting shall be the same as such taxpayer's method of accounting

of accounting for federal income tax purposes." I would conclude upon reconsideration that this statutory language dictates a construction of Rule 12C-1.15(4)(b)5, F.A.R., to require that Shell's method of accounting for federal income tax purposes, by which it deducted intangible drilling costs from gross income and precluded capitalization thereafter, determines the method of accounting by which the property factor shall be computed in the apportionment formula under the Florida code. I would reverse on cross appeal because I review the action of the trial court as if it had complied, as we should, with the mandate for judicial notice of pertinent Florida statutes in resolving this litigation. §90.201, Florida Statutes; Barnett Bank of Jacksonville v. Jacksonville National Bank, ___ s.2d ___, 9 FLW 2070 (Fla. 1st DCA, September 26, 1984.)[1] The context of the present case is peculiarly unsuited to the application of a waiver doctrine against administrators in a way which subverts the terms of a statute merely because a rule, which functionally if not nominally implements all pertinent statutes, may not have been defended with perfection. (A-10-11) (e.s.)

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[1] Although [the statute] was not called to the trial court' attention, nevertheless it must be followed by this court because the statute controls the matter before us. Bedenbaugh v. Adams, 88 So.2d 765 (Fla. 1956).

Supra at pp. 963-964.

It is from this District Court's decision that the Department now seeks review.

Article V, §3(b)(3), Fla. Const. (1968), provides this Court power to review, on a discretionary basis, a decision of a district court of appeal

> . . . that expressly and directly conflicts with a decision of another district court of appeal or of the supreme court on the same question of law. (e.s.)

Prior to the 1980 amendment, Art. V, §3(b)(3), Fla. Const. (1968), provided for a discretionary review of a decision that was in direct conflict with other appellate decisions.

Regarding the 1980 amendment, former Chief Justice Arthur England stated in 32 U.F.L.R. at 180-181:

> . . . It is not essential that a conflict of decisions be recognized or acknowledged. . . Any discussion of a point of law which in fact "directly conflicts" with another appellate precedent is grounds for a request for review. This construction . . . accommodates the . . . right to argue an alleged conflict, and that they need not be required to rely on the district courts to preserve their review right by mentioning the cases with which the court disagrees. (e.s.)

Ford Motor Company v. Kikis, 401 So.2d 1341 (Fla. 1981); Nielsen v. City of Sarasota, 117 So.2d 731 (Fla. 1960).

Previous decisions of this Court clearly established the principle that the reviewing court must follow statutes which are the law of the state and appear to control the matter before the court, even though such statutes are not brought to the attention of the trial court. Atlantic Coast Line R. Co. v. Holliday, 74 So. 479 (Fla. 1917);

Bedenbaugh v. Adams, 88 So.2d 765 (Fla. 1956); City of Lakeland v. Select Tenures, Inc., 176 So. 274 (Fla. 1937); Peterson v. Paoli, 44 So.2d 639 (Fla. 1950); Jones v. City of Arcadia, 3 So.2d 338 (Fla. 1941).

The District Court in its Opinion held that even though §220.42(1), F.S., might well have been controlling on the issue of the treatment of IDC's by Shell, that it was going to ignore such controlling statutory law, because it was not cited in trial court and not cited until rehearing, as controlling statutory law which was overlooked. See Rule 9.330, F.R.A.P.

In order to make such a ruling, the District Court expressly and directly conflicted with the prior rulings of this Court, which have clearly held that even though controlling statutes were not brought to the attention of the trial court, the reviewing court, in this case the District Court, must follow such statutes. The District Court attempted to side step the issue by saying that the issue was framed upon the interpretation of Rule 12C-1.15(4)(b)5, F.A.C.

However, as Judge Wentworth observed in her separate concurring and dissenting Opinion, the reconsideration of §220.42(1), F.S., dictates the construction of Rule 12C-1.15(4)(b)5, F.A.C., as urged by the Department.

This is not a case of an immaterial issue. The consideration of §220.42(1), F.S., when interpreting Rule 12C-1.15(4)(b)5, F.A.C., is not only material, but to do as the District Court did, is prejudiced to the Department's administration of Ch. 220, F.S. Likewise, to apply the rationale of the District Court ignores the very material legislative intent and directive set forth in §220.42, F.S., that for the purpose of the Florida Code, a taxpayer's method of accounting shall be the same as such taxpayers <u>method of accounting</u> for federal income tax purposes.

Under general <u>financial accounting methods</u>, expenditures (costs) are capable of being classified as one of two mutually exclusive classifications, depending on the remaining useful life of the expenditure.:

> In addition to the initial cost of acquiring a plant asset, other costs related to its efficiency or capacity may be incurred from time to time during its service life. It is often difficult to recognize the difference between expenditures that add to the utility of the asset for more than one accounting period and those that benefit only the period in which they are incurred. Costs that add to the utility for more than one period are chargeable to an asset account or to a related accumulated depreciation account; they are termed <u>capital expenditures</u>. Expenditures that benefit only the current period are chargeable to expense accounts; they are referred to as <u>revenue expenditures</u>. (e.s.)
> (C. Rollin Niswonger and Philip E. Fess, Accounting Principles (11th Edition) page 243.)

Thus, an expenditure may be either a "cost" which is "expensed" in the computation of income for the current period or may be a "cost" which is "capitalized" (treated as "property"), the recovery of which is "expense" in increments over both the current and future time periods, which encompass its useful life. In this context, Shell in exercising an authorized election for federal income tax purposes, chose to treat the "intangible drilling costs" as a current year expense, with full recovery of the entire expenditure (cost) in the year expended for purposes of determining federal taxable income. Only in reversed circumstances where such election is not made is the total expenditure (cost) federally recognized as surviving (as property) and eligible for future treatment under rules of federal tax accounting.

The Department refused to allow Shell to include IDC's which had been fully "expensed" <u>under its chosen federal method of accounting</u> in the property factor of the apportionment formula used to determine "net income" under the Florida Code. The Department urges alternatively (1) that the federal election it made under its <u>federal accounting method</u> used for determining its "federal taxable income" for Florida purposes is equally binding upon Shell (as an element of its federal accounting method) for determination of the "property factor" authorized to apportion its "adjusted federal income" to Florida, or (2) that "intangible" personal property is not includible in the property factor for Florida apportionment purposes, and (3) in the event Shell prevails in the inclusion of its IDC's in the property factor for determining apportionment, the Department must be permitted to adjust the underlying "federal taxable income" to "capitalize" such expenditures and subject them to recovery over the "15 to 20 years" admitted useful life.

Shell urges that it can eat its cake and have it too. It claims that expenditures (costs) fully recovered for income determination purposes can be somehow reinstated and capitalized for Florida property factor purposes in the apportionment of the underlying income being assigned to Florida. The claim is made, albeit the income in the initial year has already been negatively impacted by the recovery of the full cost. The assignment of Florida's share of the federal income is impacted by expenditures which are barred from inclusion in "property" by <u>federal accounting methods</u> and procedures.

Section 220.02(3), F.S., in pertinent part, provides:

> It is the intent of the Legislature that the income tax imposed by this code utilizes, to the greatest extent possible, concepts of law which have been developed in connection with the income tax laws of the United States. . . .

> as provided in subsection (3). If no method of accounting has been regularly used by a taxpayer, net income for purposes of this code shall be computed by such method as in the opinion of the department fairly reflects income. (e.s.)

Lastly, an authoritative law review article contemporaneously (to the enactment of the Code) published states:

> Generally, Florida has adopted federal accounting methods and periods, federal tax bases, federal tax rules and regulations, federal tax concepts of income realization and recognition, and federal procedures for filing returns, and making tax payments. This federal 'piggyback,' as it is often called, will survive only if the Florida legislature adopts future amendments to the Internal Revenue Code. The legislative history of the present Florida Code clearly reflects an intent to adopt federal principles of taxation in order to simplify the administration of the tax. (e.s.) Thomas P. Finan, The Florida Code: A Consideration of Substantive Aspects, An Introduction to Florida Corporate Income Taxation, College of Law, The Florida State University, April, 1972, at page 36.

From the foregoing, obviously the tax accounting method used by Shell for federal purposes is equally applicable to the determination of "federal taxable income" under the Florida Code.

The Florida legislature could have chosen to authorize an alternative to the federal election in the instant circumstances. It did so, as to elections under the completed contract method of accounting by the enactment of Sec. 220.42(3), F.S. Further, it addressed the federal election as to the installment sales method of accounting by providing an alternative in the enactment of Section 220.131(1)(c), F.S. (1981) (Chapter 71-984, Laws of Florida). It is of conclusive significance that the Legislature DID NOT provide an alternative to the federal election as to intangible drilling and development costs which was chosen by Shell as part and parcel of its federal accounting method.

Arguendo, even if Shell were entitled to a separate election under the Florida Code, by filing Florida returns wherein the IDC costs were immediately fully expensed, for income purposes the taxpayer has for Florida purposes made the identical election as it made for federal purposes--it has adopted the federal accounting method in filing its Florida returns. No expenditure or cost related to IDC remains unrecovered and hence there is no asset or "property" value remaining on a "Florida" balance sheet which can be used in the Florida property factor.

The question of whether certain reoccurring decisions, if consistently made, constitute "methods of accounting" for federal tax purposes has been resolved.

The Tax Court, in Electric & Neon, Inc. v. Comr., 56 T.C. 1324 (1971), acq., 1973-2 C.B. 1, aff'd 496 F.2d 876

(5th Cir. 1974), in a well reasoned decision, held that the regular practice of expensing the cost of constructing neon signs was an accounting method. Section 481 was then applied to eliminate the distortion created when the Commissioner was upheld in requiring capitalization for the year in issue and all future years. Also, in Coors v. Comr., 60 T.C. 368 (1974), acq. 1974-2 C.B. 2, aff'd. 519 F.2d 1280 (10th Cir. 1975), cert. denied, 423 U.S. 1087, the Tax Court found the taxpayer's regular practice of expensing overhead costs on self-constructed assets to be a method of accounting.

Shell has over the instant years consistently "expensed" and deducted its expenditures for IDC's pursuant to its election under Internal Revenue Code Section 263(c) for both federal and Florida income determination purposes. A definitive explanation of the nature and application of this element of its chosen federal accounting method is contained in a recent publication of the Professional Develoment Institute of North Texas State University:

> Costs of drilling and developing mineral properties are commonly classified into two categories, depending on their nature. The classification dichotomy had its genesis in the Internal Revenue Code. The Regulations under Sec. 612 of the 1954 IRC divides such costs into (1) intangible drilling and development costs and (2) tangible costs (lease and well equipment). Intangible drilling and development costs are defined to include: . . . . expenditures made by

an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas . . . drilling and development work. . . Examples of items to which this option applies are all amounts paid for labor, fuel, repairs, hauling, supplies, or any of them, which are used--

1. In the drilling, shooting, and cleaning of wells.
2. In such clearing of ground, draining, road making, surveying, and geological works as are necessary in preparation for the drilling of wells, and
3. In the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. (Horace R. Brock, John P. Klingstedt, and Donald M. Jones, Accounting for Oil & Gas Producing Companies, Part 1: Exploration, Acquisition Development and Production (Professional Development Institute, North Texas State University, p. 195) (1983)

Tres. Reg. 1.612-4 goes on to describe some items not included in the IDC category:

(c) Nonoptional items distinguished.

1) Capital items: The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or strutures not incident to or necessary for the drilling of wells, such as structures

> for storing or treating oil or gas. These are capital items and are returnable through depreciation.
>
> 2) Expense items: Expenditure which must be charged off as expense, regardless of the option provided by this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of oil and gas.

IRS Rev. Rul. 70-44 further explains items that are treated as IDC's and those that are not. A portion of this Ruling follows:

> Such language excludes expenditures incurred in installing production facilities. The items thus excluded consist of expenditures relating to the installation of equipment such as pumping equipment, flow lines, separators, storage tanks, treating equipment, and salt water disposal equipment. Equipment of a character that is ordinarily considered as having a salvage value, whether it consists of production facilities or equipment necessary for the completion of a well, include cost of casing in a well (even though cemented in the well to such an extent that it has no net salvage value), is a depreciable item, the cost of which may be recovered only through the depreciation allowance. Harper Oil Company v. U.S., 425 F.2d 1335 (10th Cir. 1970), 70-1 USTC 9330. A producing well is completed when the casing including the so-called 'Christmas tree," has been installed.

It is held that the cost of the installation of the items listed below is not subject to the option provided for in Tres. Reg. 1.612-4(a):

> 1) Oil well pumps (upon initial completion of the well) including the necessary housing structures.

2) Oil well pumps (after the well has flowed for a time), including the necessary housing structures.
3) Oil well separators, including the necessary housing structures.
4) Pipelines from the wellhead to oil storage tanks on the producing lease.
5) Oil storage tanks on the producing lease.
6) Salt water disposal equipment, including any necessary pipelines.
7) Pipelines from the mouth of a gas well to the first point of control, such as a common carrier pipeline, natural gasoline plaint, or carbon black plant.
8) Recycling equipment, including any necessary pipelines.
9) Pipelines from oil storage tanks on the producing leasehold to a common carrier pipeline.

Thus, under Shell's elected method of federal accounting the expenditures for IDC's are not capable of being capitalized and thereby are ineligible to be included as "property" (or as an asset). In conformance with its federal accounting method, Shell cannot properly include such expenditures for IDC's in its list of assets upon the required Schedule L of its federal tax return. For this purpose, "expensed" IDC's are not "property."

The definition of the Florida corporate tax base ("net income") is contained in §220.12(1), F.S., as follows:

> For purposes of this code, a taxpayer's net income for a taxable year which commences on or after January 1, 1972, shall be that share of its adjusted federal income for such year which is apportioned to this state under s. 220.15, less the exemption allowed by s. 220.14. (e.s.)

Thus, the three essential elements necessary to determine Shell's "net income" are (1) "adjusted federal income," (2) assigned to Florida by apportionment under §220.15, F.S., (3) less the allowable exemption. No controversy exists in this case relative to the construction of "adjusted federal income" or the allowable exemption. The present issue relates solely to the apportionment process by which a share of the "adjusted federal income" is assigned to Florida under its statutes.

The Department correctly urges that, alternatively:

1. Section 214.71(1), F.S. (which is incorporated by reference in §220.15, F.S.) excludes from the definition of "property" used for the property factor for apportionment purposes "intantible" property and since Shell federally elected to treat certain IDC expenditures as "intangible," <u>such expenditures must be excluded from the property factor</u>.

2. The determination of "property" for inclusion in the property factor <u>is conclusively determined by Shell's choice of a federal accounting method</u>, and in this case, while "costs" existed, such costs are <u>not</u> expenditures recognized as "property" for apportionment purposes under the Florida Code because of Shell's chosen <u>federal accounting method</u>.

Section 214.71(1), F.S., states:

> The property factor is a fraction the numerator of which is the average value of the taxpayer's real and <u>tangible personal property</u> owned or <u>rented and used in this</u> state during the taxable year or period and the denominator of which is the average value of such property owned or rented and used everywhere. (e.s.)

Generally, IDC expenditures are intangible and therefore excluded from the express inclusion of "tangible personal property." Admittedly, certain intangible costs or expenditures incurred in connection with the acquisition of an item of tangible personal property can be deemed added to the direct cost of the tangible asset, capitalized as an increment of its value and thereafter treated as (depreciable or amortizable) tangible property. However, Shell <u>under its federal accounting method</u> chose not to add the value of the intangible increment to its tangible asset values. <u>Since the federal accounting method is mandated as a method to be used for all Florida Code purposes, which includes §220.15, F.S., the disassociation of the intangible expenditures from the related tangible property for property factor purposes is equally mandated.</u> The decision to exclude intantible costs from the value of "property" operates to separate the "costs" of a given well into two component parts--tangible and intangible-and only the former is considered "property" for the purposes of both §§220.15 and 214.71(1), F.S., as applied for purposes of Chapter 220, F.S.

As set forth above, §220.42, F.S., mandates that Shell's chosen <u>federal accounting method</u> is mandated to be used for "purposes of this code."

Section 220.42(1), F.S., provides that:

> <u>For purposes of this code</u>, a taxpayer's method of accounting shall be the same as such taxpayer's method of accounting for federal income tax purposes, except as provided in subsection (3). If no method of accounting has been regularly used by a taxpayer, <u>net income for purposes of this code</u> shall be computed by such method as in the option of the department fairly reflects income. (e.s.)

The essential question, is whether the chosen <u>federal accounting method</u> is applied solely to the determination of income used in the Florida tax base or whether it is equally applied to the determination of the property factors used in the apportionment formula. Obviously, "<u>for purposes of this code</u>" includes reference to §220.15, F.S., which contains provisions for apportionment. Further, the last sentence of this section states that "net income for purposes of this code" which doubtless expresses a legislative intent to include all three elements of the determination of "net income" in determinations to be impacted by the federal accounting method the taxpayer has chosen. (<u>Were it intended otherwise the reference would have been to "federal taxable income" rather than "net income</u>.")

Under _Shell's_ election of a _federal accounting method_, expenditures for _IDC's are not_ treated as "_property_." The apportionment method used to determine "net income" pursuant to §220.12, F.S., requires a property factor. This factor must be determined on a basis consistent with Shell's chosen _federal accounting method_. Expenditures which are not considered "property" under Shell's chosen method are not includible in the property factor by definition under that method.

Shell's contention that IDC's are includible in the property factor for apportionment purposes at the same time that such costs have been completely recovered through current or earlier period deductions _is a wholly inconsistent_ and _inequitable_ position. Equity demands that either the Department exclude such costs from the apportionment factor or, alternatively, adjust the item of income (deduction) to include only a ratable portion of the expense in each of the years for which the item is used for apportionment.

In carnival parlance, this is the equivalent of the infamous "shell game" where the number of peas under the three shells can range from none to three, depending solely on the dexterity of the manipulator of the shell's. Here, the operator places all peas (IDC's) in play for purposes of apportionment, but allows none to surface for purposes of income determination.

The National Conference of Commissioners on Uniform State Laws promulgated the Uniform Division of Income for State Purposes Act (UDITPA). The Florida Statutes "track" UDITPA. The fundamental concept underlying the selection of the three factors of sales, payroll and property was that these were the most appropriate measures of the business activities of a taxpayer which contributed to the resultant income being apportioned. Necessarily, the factors must bear a reasonably direct relation to the income being apportioned. This requires that the property considered must rationally relate to the determination of the income in the year in question. Where costs related to "property" were totally deducted in an earlier period(s), to use such items for apportionment in subsequent years (repeatedly) would permit a double effect and an inequitable result, wholly inconsistent with UDITPA. Atlantic Richfield Co. v. Department of Revenue, 9 Oregon Tax Rep. 451 (1984) (on Appeal to the Oregon Supreme Court).

Each state which adopted UDITPA, in whole or in pertinent part, retained the discretion to apply alternative rules.

> In the same year, the National Conference of Commissioners drafter the Uniform Division of Income for Tax Purposes act (UDITPA), in

> response to the concern over nonuniformity in the states' application of apportionment formulas. UDITPA specified that nonbusiness income be allocated to a single taxing jurisdiction, specified that business income be business income be apportioned among taxing jurisdictions on the basis of an equally weighted three-factor formula, [footnote omitted] and defined in the formula factors as payroll, property, and sales. However, UDITPA also granted the States considerable discretion to apply alternative rules when those specified did not fairly represent the extent of a taxpayer's business activity in a State. (e.s.) Report to the Chairman, House Committee on Ways and Means, Controller General of the United States, GAO-GGD 82-78, July 1, 1982, at page 10.

Florida redetermined the property factor on a basis consistent with Shell's chosen federal accounting method. This redetermination is authorized under §214.73, §220.15, and 220.42(1), F.S., as heretofore explained. Costs which are not capitalized under Shell's chosen federal accounting method are not includible in construction of the property factor because under the chosen method they do not survive as an "asset" or "property" or value added to an item of "property."

Since Florida law requires that the federal accounting method be used to determine "net income" and that determination requires use of the apportionment factors as appropriate under Shell's federal accounting method, IDC's are properly excluded. It is totally immaterial that under financial accounting methods, such costs may be properly includible.

Shell cannot be permitted, under the concept of "piggy-backing" federal concepts, to report a lesser asset value to the federal government and a higher value to Florida when such inconsistency operates to reduce its tax obligation to this state.

The dichotomy that exists between Shell's <u>federal accounting method</u> visited upon the case is the result of the deliberate and knowing choice made by Shell. The Department is by statute authorized and obligated to apply Shell's choice of <u>federal accounting method</u> in all aspects of the determination of Florida "net income" to prevent distortion which would otherwise arise to the disadvantage of the state's revenue. The value of each asset (well) used for Florida purposes must be the identical federal value determined under the <u>federal accounting method</u>. §220.42(1), F.S. Shell cannot eat its cake and have it too. See <u>Marks v. Green</u>, 122 So.2d 491 (1 DCA 1960).

The Department respectfully submits that based upon the above facts and law that this Court reverse the District Court on its finding that Shell may include all of the "original costs" of its oil and gas wells, in particular its IDC's in the property factor of the apportionment formula for determining its Florida tax base.

It must not be forgotten that a given dollar of expenditure <u>cannot</u> be deducted <u>twice</u>. It is <u>either</u> deducted immediately, if expensed or it is deducted in increments over the useful life of the asset (property) if capitalized. Under <u>any</u> accounting method, only in the latter case, can the "capitalized" expenditure be added to the value of the "property." <u>An expense is never property</u>.

CONCLUSION

The Department, based upon the foregoing, respectfully request this Court to answer the question certified in the negative, as did the District Court. Further, the Department requests that this Court reverse the District Court on the issue concerning Shell's entitlement to include IDC's in the property factor in the apportionment formula, and remand that issue to the District Court with directions to enter an order consistent with §220.42(1), and the Department's treatment of Shell's IDC's.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Answer Brief has been furnished by mail this 8th day of April, 1985, to Counsel of Record.

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