State Taxation Of Nondomiciliary Corporations

STATE TAXATION OF NONDOMICILIARY CORPORATIONS

The United States Supreme Court long has recognized that the income of a business operating in interstate commerce is not immune to fairly apportioned state taxation.[1] The Supreme Court has established, however, that jurisdictional boundaries limit state power to impose a tax on such income.[2] A state cannot give its income tax extraterritorial effect.[3] The Supreme Court recently considered the limits of state taxing power regarding nondomiciliary multinational and multistate corporations.[4] The Court addressed the issue whether the due process clause[5] or commerce clause[6] of the United States Constitution prevents state apportionment of the consolidated income of a corporate taxpayer when the taxpayer performs only limited operations within the state.[7] In a

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[1] *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458-63 (1959) (net income of nondomiciliary corporation generated by interstate activities held apportionable when taxing state demonstrated sufficient connection to income); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120 (1920) (tax upon net profits valid although on profits derived mainly from interstate commerce); United States Glue Co. v. Town of Oak Creek, 247 U.S. 321, 328-29 (1918) (nondiscriminatory tax on net profits held not violative of commerce clause).

[2] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978); National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 756 (1967). *See generally* Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171 (1970) [hereinafter cited as Rudolph]. A state may tax only income arising from sources within the state. Rudolph, *supra*, at 181. The controlling question is whether the state has provided anything to the corporation for which the state then can assess a tax in return. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940); *see infra* note 7 (carrying on business within state provided state opportunity to tax business).

[3] Rudolph, *supra* note 2, at 181.

[4] *See, e.g.*, F.W. Woolworth Co. v. Taxation & Revenue Dep't, 50 U.S.L.W. 4957 (U.S. June 29, 1982); ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982). *See generally* P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 235-45 (1953) [hereinafter cited as HARTMAN].

[5] U.S. CONST. amend. XIV. The fourteenth amendment to the United States Constitution provides in part that no state shall deprive any person of life, liberty, or property without due process of law. *Id.*

[6] U.S. CONST. art. I, § 8. Article one, section eight of the United States Constitution provides in part that Congress shall have the power to regulate interstate commerce. *Id.*

[7] *See, e.g.*, Exxon Corp. v. Department of Revenue, 447 U.S. 207, 210 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 427 (1980). A state may impose taxes on corporations as a pecuniary charge for the protection and services the state affords corporations. Southern Pac. Co. v. McColgan, 68 Cal. App. 2d 48, 81, 156 P.2d 81, 95, 99 (1945). The due process clause of the fourteenth amendment requires both a minimal connection between the interstate activities and the taxing state and a rational relationship between the income attributed to the state and the local corporate activity for a state to tax income generated in interstate commerce. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978); *see* Norfolk & W. Ry. v. Missouri State Tax Comm'n, 390 U.S. 317, 325-26 (1968) (state tax assessment on railroad's rolling stock held invalid because tax projected state's power

series of decisions, the Court concluded that when a corporate taxpayer operates a unitary business,[8] a state may tax the total net corporate income reasonably related to the activities conducted within the taxing state.[9]

The Supreme Court has not decided that one method of state taxation is preferable over another.[10] State taxation statutes consequently vary from state to state.[11] As a result of the varied state tax schemes, corporations operating in more than one state may be subjected to

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beyond borders). Carrying on business within the state provides the requisite minimal connection. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444-45 (1940); General Motors Corp. v. State, 181 Colo. 360, 368, 509 P.2d 1260, 1264 (1973). State taxation meets the rational relationship requirement if the state seeks to tax only corporation profits earned within the state. Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 119-20 (1920); *see* Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931) (state tax formula attributing disporportionate amount of corporate income to state held unconstitutional).

A state tax that reaches income generated outside the state, however, does not destroy the minimum connection between the tax and the transactions within the state for which the tax is an exaction. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940); Qualls v. Montgomery Ward & Co., 266 Ark. 207, 228, 585 S.W.2d 18, 30 (1979). For example, a state may tax its citizens upon income received from property situated in another state on the theory that domicile itself affords a basis for income tax. New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 312-16 (1937). The commerce clause prohibits discriminatory taxation of interstate commerce. Department of Revenue v. Association of Washington Stevedoring Companies, 435 U.S. 734, 750 (1978); Qualls v. Montgomery Ward & Co., 266 Ark. 207, 226-27, 585 S.W.2d 18, 28-29 (1979). Subjecting an interstate business to duplicative taxation that an intrastate taxpayer would not be subjected to, however, violates the commerce clause. General Motors Corp. v. Washington, 377 U.S. 436, 449 (1964). *But see* Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292, 295 (1944) (state tax on all property used in intrastate commerce held valid despite taxability of same property in other states). Alternatively, exacting more than the state's proportionate share from the interstate business violates the commerce clause. Department of Revenue v. Association of Washington Stevedoring Companies, 435 U.S. 734, 747-48 (1978); *see* Fargo v. Hart, 193 U.S. 490, 499, 502 (1904) (state tax formula held unconstitutional because formula did not reflect true value of corporate worth within taxing state).

[8] *See infra* notes 24-25 (definition of unitary business).

[9] F.W. Woolworth Co. v. Taxation & Revenue Dep't, 50 U.S.L.W. 4957, 4961 (U.S. June 29, 1982); ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4952, 4968 (U.S. June 29, 1982); Exxon Corp. v. Department of Revenue, 447 U.S. 207, 222-23 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 439-40 (1980); *see infra* text accompanying notes 37-98 (discussion of *Woolworth*, *ASARCO*, *Exxon*, and *Mobil* cases).

[10] *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 278-79 (1978) (United States Constitution does not favor one form of state taxation over another); General Motors Corp. v. District of Columbia, 380 U.S. 553, 561 (1965) (Supreme Court refrained from defining single appropropriate method of state taxation).

[11] Comment, *State Taxation of Foreign Source Corporate Dividends: Another Conquest of the Expanded Unitary Business Doctrine*, 22 URB. L. ANN. 229, 229-30 (1981); *see* H.R. REP. No. 1480, 88th Cong., 2nd Sess. 119 (1964) (discussion of various state apportionment plans). *See generally* CONTROLLERSHIP FOUNDATION: APPORTIONMENT AND ALLOCATION FORMULAE AND FACTORS USED BY STATES IN LEVYING TAXES BASED ON OR MEASURED BY NET INCOME OF MANUFACTURING, DISTRIBUTIVE AND EXTRACTIVE CORPORATIONS (1954).

either overtaxation or undertaxation.[12] Congress has the power to regulate state taxation regarding interstate commerce[13] and currently is seeking to establish some uniformity in state taxation of multistate and multinational corporations.[14] Additionally, state tax administrators have combined to form the Multistate Tax Compact (MTC)[15] and have drafted the Uniform Division of Income for Tax Purposes Act (UDITPA)[16] to achieve some uniformity in state taxation. Until Congress or the states promulgate effective and binding regulations, however, corporate taxpayers remain open to inconsistent state taxation of corporate income.[17]

State income taxation of multinational and multistate corporations requires a determination of the amount of corporate income that

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[12] *See, e.g.*, General Motors Corp. v. State, 181 Colo. 360, ____, 509 P.2d 1260, 1266 (1973) (overlapping state taxation of nondomiciliary corporation and lack of uniformity in state tax plans do not present any constitutional problems); J.G. McCrory Co. v. Commissioners of Corps. & Tax'n, 280 Mass. 273, ____, 182 N.E. 481, 484 (1932) (held no statutory basis for excise tax on nondomiciliary corporation doing business within taxing state).

[13] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978).

[14] *See infra* text accompanying notes 127-33 (discussion of recent congressional action regarding uniformity in state taxation).

[15] *See* Killefer, *State Taxation of Commerce*: Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 8 J. CORP. TAX'N 3, 8 (1981) [hereinafter cited Killefer]. In 1966, the National Association of Tax Administrators attempted to resolve the problem regarding taxation of multistate corporations by forming the Multistate Tax Commission and drafting the Multistate Tax Compact. *Id.* The purposes of the Multistate Tax Compact are to facilitate the proper determination of tax liability of multistate taxpayers, achieve uniformity among state tax systems, facilitate taxpayer compliance in filing returns, and avoid duplicative taxation. *Id.* The Multistate Tax Commission administers the Multistate Tax Compact. *Id.*

[16] *See* Killefer, *supra* note 15, at 8. In 1967, the Multistate Tax Commission adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), the model act for state apportionment of income. *Id.*; UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT, 7A U.L.A. 91, 93-108 (1978). UDITPA classified corporate income as either business or nonbusiness income. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT, §§ 1(a), 4, 7A U.L.A. 93, 97 (1978). Business income includes income from tangible and intangible property acquired, managed, or disposed of in integral or necessary parts of the taxpayer's trade or business operations. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT, § 1(a), 7A U.L.A. 93 (1978). UDITPA required apportionment of business income. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT, § 9, 7A U.L.A. 100 (1978). Nonbusiness income represents remaining nonqualifying corporate income that states cannot apportion. *Id.* § 1(e), 7A U.L.A. at 94 (nonbusiness income includes all income other than business income). UDITPA required specific allocation of nonbusiness income. *Id.* § 4, 7A U.L.A. at 97. UDITPA attempts to ensure that 100% of a corporation's income is available for taxation by the states in which a corporation operates. *See generally* Hellerstein, *Construing the Uniform Division of Income for Tax Purposes Act: Reflections on the Illinois Supreme Court's Reading of the "Throwback" Rule*, 45 U. CHI. L. REV. 768, 768-771 (1978).

[17] *Compare* Honolulu Oil Corp. v. Franchise Tax Bd., 60 Cal. 2d 417, ____, 34 Cal. Rptr. 552, 555-56, 386 P.2d 40, 43-44 (1963) (nonintegrated multistate petroleum corporation held entitled to apportion income rather than use specific accounting to determine state tax) *with* Webb Resources, Inc. v. McCoy, 194 Kan. 758, ____, 401 P.2d 879, 889-91 (1965) (nonintegrated multistate petroleum corporation held not entitled to apportion income, instead must allocate income to determine state tax).

reasonably relates to sources or activities within the taxing state.[18] State taxing commissions utilize three basic approaches to determine corporate taxable income.[19] First, under the separate accounting method, corporations must allocate income for tax purposes to the same geographic or functional divisions that the corporation uses for other financial and accounting purposes.[20] Second, the specific allocation method requires the corporation to allocate certain items of income to a specific legal or business situs.[21] Third, under the apportionment method

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[18] Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940); *see* G. ALTMAN & F. KEESLING, ALLOCATION OF INCOME IN STATE TAXATION 28-31 (1946) [hereinafter cited as ALTMAN & KEESLING].

[19] J. HELLERSTEIN, STATE AND LOCAL TAXATION 310-12 (1969) [hereinafter cited as HELLERSTEIN]; Dexter, *The Unitary Concept in State Income Taxation of Multistate—Multinational Businesses*, 10 URB. LAW. 181, 181 (1978) [hereinafter cited as Dexter].

[20] HELLERSTEIN, *supra* note 19, at 310. State taxing authorities permit separate accounting when the taxing authorities accurately can separate a corporation's income producing activity and income sources within the state from the corporation's income producing activities and income sources outside the state. Dexter, *supra* note 19, at 181. States utilize two major methods of separate accounting. Under the management profit method, the corporation adds a fixed percentage to the cost of goods after each stage of the operations necessary to produce and sell the goods. ALTMAN & KEESLING, *supra* note 18, at 90. Under the fair market value approach, states recognize intracorporate transactions at the fair market value of the goods transferred, regardless of the actual costs involved. *Id.* at 91. The fair market value minus cost represents profit on intracorporate transactions. *Id.* at 91-92. Separate accounting cannot account for the interrelationship between departments since intracompany transactions are priced hypothetically. *Id.* at 38; HELLERSTEIN, *supra* note 19, at 310. Income figures from one company department consequently fail to reflect the contributions from other company departments and inaccurate profit figures result. *See* ALTMAN & KEESLING, *supra* note 18, at 38; HELLERSTEIN, *supra* note 19, at 310; Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980) (separate accounting useful for internal auditing but fails to isolate accurately portions of income produced in various states).

[21] Dexter, *supra* note 19, at 181. Specific allocation generally applies to properties and income not associated with the taxpayer's overall business operations. *Id.* For example, the property tax situs of an ocean-going vessel is the legal domicile of the owner. Southern Pac. Co. v. Kentucky, 222 U.S. 63, 71, 76-77 (1911) (steamships owned by Kentucky corporation and used for coastal trade taxable by Kentucky). Specific allocation assigns income to a particular jurisdiction for tax purposes only. Roger Dean Enters. v. State Department of Revenue, 387 So. 2d 358, 361 (Fla. 1980). The state of incorporation represents the company's legal domicile, while the principal place of business represents the company's commercial domicile. Wheeling Steel Corp. v. Fox, 298 U.S. 193, 208-12 (1936) (intangible property belonging to company taxable in state of commercial domicile).

The taxation situs concept stems from the ancient idea that the government of the taxpayer's domicile protected the property of the taxpayer. Southern Pac. Co. v. Kentucky, 222 U.S. 63, 68 (1911). Courts have recognized that states may tax income from intangible property at the commercial situs of the property owner if the corporation uses the property directly in the transaction of business. First Bank Stock Corp. v. Minnesota, 301 U.S. 234, 237 (1937); Wheeling Steel Corp. v. Fox, 298 U.S. 193, 208, 211-12 (1936). Thus, the state of commercial domicile may tax income from intangible property because the state provides protection and benefits to the corporations. Chestnut Sec. Co. v. Oklahoma Tax Comm'n, 125 F.2d 571, 575-76 (10th Cir. 1942), *cert. denied*, 316 U.S. 668 (1942). The only benefit the legal domicile often offers the taxpayer is technical, as in the case of incorporation. *Id.* The

the taxing state utilizes a formula to determine the corporate net income attributable to the sources and activities within the taxing state.[22] States may use any one or a combination of these methods, but controversy exists regarding the applicability of each.[23] The threshold question in determining which method to use is whether the corporation being taxed operates as a unitary business.[24]

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nature of intangible property, however, permits more than one tax situs. Curry v. McCanless, 307 U.S. 357, 367 (1939) (intangible property not necessarily ascribed to one situs, therefore intangible property utilized in several states taxable in the several states); Cream of Wheat Co. v. County of Grand Forks, 253 U.S. 325, 330 (1920) (intangible property differs from tangible property because intangible property may have multiple tax situs). Income from intangible property conceivably can be taxed in as many as four states. Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act*, 15 U.C.L.A. L. REV. 156, 157 (1967). The state of incorporation, state of commercial domicile, state in which the property has been pledged as security, and in the case of dividends, the state of domicile of the declaring corporation conceivably may all tax income from intangible property. *Id.* In the case of property having several tax situs, the Constitution does not prohibit taxation by the several states. Curry v. McCanless, 307 U.S. 357, 372-73 (1939) (each of two states constitutionally may impose tax on testamentary transfer of intangible property); Cream of Wheat Co. v. County of Grand Forks, 253 U.S. 325, 329 (1920) (intangible property acquiring business situs outside state of owner's domicile held taxable by state of legal domicile).

[22] Dexter, *supra* note 19, at 181. States prefer income tax apportionment over separate accounting or specific allocation in instances when states cannot separate accurately income producing activities and sources within the state from income producing activities and sources outside the state. *Id.* Under the apportionment theory of taxation, corporate net income derives from individual states in proportion to corporate activities within each state, and the individual states tax the entire corporate net income accordingly. ALTMAN & KEESLING, *supra* note 18, at 28. Taxation by apportionment utilizes a mathematical formula weighing various economic factors related to producing net income and using a ratio comparing business operations within the taxing state to the entire corporate operations. *Id.* at 97. One formula compares the proportion of a taxpayer's real and intangible personal property located within the taxing state to the taxpayer's total real and intangible personal property. Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 119 (1920). Most states' formulas compare intrastate tangible property, payroll, and gross sales with total amounts for these three factors. HELLERSTEIN, *supra* note 19, at 309; Lynn, *Formula Apportionment of Corporate Income for State Tax Purposes: Natura Non Facit Saltum*, 18 OHIO ST. L.J. 84, 89 (1957). The taxing state typically computes ratios for the three factors comparing intrastate to out-of-state operations and then averages the ratios in order to determine the measure of the tax to the state. HELLERSTEIN, *supra* note 19, at 309; *see, e.g.*, ARK. STAT. ANN. § 84-2063 (1980); N.M. STAT. ANN. § 7-4-10 (1981); VT. STAT. ANN. tit. 32, § 5833 (1981). In some instances, states substitute manufacturing costs for the payroll factor. HELLERSTEIN, *supra* note 19, at 309; *see* General Motors Corp. v. District of Columiba, 308 U.S. 553, 559 n.9 (1965) (Court recognized that payroll factor sometimes replaced by manufacturing costs factor). The United States Constitution requires only that the state formula used produce reasonable and rational results. Butler Bros. v. McColgan, 315 U.S. 501, 506-10 (1942).

[23] *See* Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931) (apportionment formula unconstitutional if formula attributed disproportionate share of corporate income to intrastate business); Fargo v. Hart, 193 U.S. 490, 499 (1904) (same); *see* Keesling & Warren, *The Unitary Concept In the Allocation of Income*, 12 HASTINGS L.J. 42, 43-45 (1961) [hereinafter cited as Keesling & Warren].

[24] Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 479-80, 183 P.2d 16, 20-21 (1947). Several courts have held that when a number of business operations have common owner-

Finding a unitary business[25] permits state apportionment of corporate net income.[26] Once the taxpayer or state[27] establishes that the business is a unitary business, the primary state concern becomes the amount of the corporate income that the state should include in the taxpayer's tax base.[28] The tax base consists of all income produced by the

ship, benefit one another, depend on each other, and contribute to each other, the business operations constitute a single unitary business. *See, e.g.*, W.R. Grace & Co. v. Commissioner of Revenue, 378 Mass. 577, 585-86, 393 N.E.2d 330, 335 (1979); Montana Dep't of Revenue v. American Smelting and Ref. Co., 173 Mont. 316, ___, 567 P.2d 901, 908 (1977). Unitary businesses operate with a high degree of interrelationship and interdependence among affiliated corporations, subsidiaries, and divisions. Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 108, 417 N.E.2d 1343, 1347 (1981). The integrated relationship creates problems in determining accurately the amount of taxable income generated within a state. *Id.* In tax situations involving a unitary business, states prefer the apportionment method of taxation over separate accounting or specific allocation. *See Id.* at 115-16, 417 N.E.2d at 1350-53. Apportionment of unitary income results in attributing income to each of several states in which the unitary business operates. ALTMAN & KEESLING, *supra* note 18, at 90, 107. Separate accounting or specific allocation often results in corporate losses in several states where the unitary business operates. People *ex rel.* Studebaker Corp. v. Gilchrist, 244 N.Y. 114, ___, 155 N.E. 68, 70-71 (1926). Thus, these two methods of taxation may produce misleading results in taxation of unitary businesses. *Id.*; *see* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980); Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 480-81, 183 P.2d 16, 21 (1947). *See generally* Dexter, *supra* note 19, at 198-204; Lavelle, *What Constitutes a Unitary Business*, 25 S. CAL. T. INST. 239 (1973).

[25] The Supreme Court recognized the unitary business principle over sixty years ago. ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4965 n.14 (U.S. June 29, 1982); *see* Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n, 266 U.S. 271, 282 (1924) (company operating manufacturing, distributing, and selling divisions held unitary business); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120-21 (1920) (same). When a business makes a series of intracorporate transactions, and profits accrue only with final sales, a state may tax a just proportion of net profits for the privilege of doing business within the state. *Bass*, 266 U.S. at 280. A similar concept called the "unit rule" preceded the unitary business principle. *See* Pullman's Palace Car Co. v. Pennsylvania, 141 U.S. 18, 26 (1891). The unit rule represented a property tax by which a state treated an entire railroad system as a taxable unit and distributed the assessed value of the unit according to the ratio of rail located in the taxing state to the whole length of the railway system. *Id.*; *see also* State R.R. Tax Cases, 92 U.S. 575, 601 (1876).

[26] *See* Ford Motor Co. v. Beauchamp, 308 U.S. 331, 336 (1939) (taxation of unitary enterprise necessitated apportionment since value of property in taxing state was increased when used in connection with corporation's property outside taxing state); Wallace v. Hines, 253 U.S. 66, 69 (1920) (apportionment necessary if business taxed utilized property outside taxing state which added to value of property within taxing state).

[27] State authorities insist on apportionment of unitary taxpayers operating within their state in order to determine reasonably the amount of tax that the taxpayer owes the state. *See, e.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-74 (1978); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452, 464-65 (1959). Sometimes, however, a corporate taxpayer argues in favor of apportionment. *See* Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 408, 34 Cal. Rptr. 545, 546, 386 P.2d 33, 34 (1963) (taxpayer asserted unitary operations resulted in lower tax base); Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 109, 417 N.E.2d 1343, 1347 (1981) (same).

[28] *See* Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, 358-60, 71

unitary business.[29] Courts apply several judicially developed tests[30] and interpret state taxing statutes[31] to determine which parts of a business operation are within the unitary business. Generally, if operation of the business within the taxing state is dependent upon or contributes to operation of the business outside the state, then the business outside the state is part of the unitary business.[32] More specifically, when corporations cannot characterize fairly the income of the business as having a single identifiable geographic or functional source,[33] courts include the business income in the unitary business.[34] Because state taxation of multistate corporations lacks both a uniform test and uniform statute,

N.W.2d 797, 804-05 (1955) (state found retail operations part of unitary business including wholesale distribution of auto parts); Coca Cola Co. v. Department of Revenue, 271 Or. 517, 525-26, 533 P.2d 788, 792 (1975) (bottling operations held part of syrup-producing operations in unitary soft drink business). *But see* Commonwealth v. Columbia Gas & Elec. Corp., 336 Pa. 209, ____, 8 A.2d 404, 412-13 (1939) (income from holding company operations excluded from corporation's taxable net income because corporation did not engage in holding company activities within taxing state).

[29] *See* Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, 361, 71 N.W.2d 797, 804-05 (1955) (tax base includes income from both retail and wholesale operations); Coca Cola Co. v. Department of Revenue, 71 Or. 517, 529, 533 P.2d 788, 792 (1975) (tax base includes income from both bottling and syrup-producing operations).

[30] *See, e.g.*, Butler Bros. v. McColgan, 315 U.S. 501, 508 (1942) (unitary business determined by unity of ownership, operations, and use); Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, 357, 71 N.W.2d 797, 804-05 (1955) (unitary business indicated by mutual contribution and mutual benefits regarding interdivisional relations). Commonwealth v. Ford Motor Co., 350 Pa. 236, 243, 38 A.2d 329, 334-35 (1944) (unitary business determined by necessity and connection of corporate divisions to each other).

[31] Xerox Corp. v. Comptroller, 290 Md. 126, 129-30, 428 A.2d 1208, 1211 (1981) (interpreting MD. ANN. CODE art. 81, § 316(c) (1980)); W.R. Grace & Co. v. Commissioner, 378 Mass. 577, 585-86, 393 N.E.2d 330, 335 (1979) (interpreting MASS. GEN. LAWS. ANN. ch. 63, § 38 (West 1969)).

[32] Great Lakes Pipe Line Co. v. Commissioner of Tax'n, 272 Minn. 403, ____, 138 N.W.2d 612, 616-19 (1965), *appeal denied*, 384 U.S. 718 (1966); *cf.* Logan Clay Prods. Co. v. Commonwealth Bd. of Fin. & Revenue, 11 Pa. Commw. 629, ____, 315 A.2d 346, 354 (1974) (entire net income generated by corporation's multistate operations not included in formula computation used in determining state tax owed because corporation operated independent and noncontributory businesses). *See generally* ALTMAN & KEESLING, *supra* note 18, at 101. The test of a unitary business is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. *Id.* (giving examples); *see also* Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 NAT'L TAX J. 487, 488-92 (1968) [hereinafter cited as *Recent Developments*].

[33] *See* Exxon Corp. v. Department of Revenue, 447 U.S. 207, 220-21 (1980) (taxpayer argued functional source of income limited taxation of income to states where income arose). Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (taxpayer argued that geographic source of income limited taxation of income to states where income arose).

[34] Exxon Corp. v. Department of Revenue, 447 U.S. 207, 220-21 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980); *see* HELLERSTEIN, *supra* note 19, at 400 (income from unitary business impossible to allocate wholly to one step in the economic process).

the results reached by different courts are not consistent.[35] Moreover, the decisions are often vague and arbitrary.[36]

In *Mobil Oil Corp. v. Commissioner of Taxes*,[37] the Supreme Court addressed the constitutionality of the Vermont Commissioner of Taxes' inclusion in Mobil's tax base of dividends earned from foreign-source investments under the unitary business concept.[38] The Court held that neither the due process clause nor the commerce clause precluded Vermont's inclusion of foreign-source dividends in Mobil's apportionable tax base.[39] The Court reasoned that a vertically integrated company[40] such

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[35] Dexter, *supra* note 19, at 193; *see Recent Developments*, *supra* note 32, at 497-503 (analysis of decisions regarding unitary business concept). *Compare* Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 412-13, 34 Cal. Rptr. 545, 551, 386 P.2d 33, 39 (1963) (nonintegrated oil company held to operate one unitary business) *with* Skelly Oil Co. v. Commissioner of Tax'n, 269 Minn. 351, 369, 131 N.W.2d 632, 643 (1964) (integrated oil company held to operate two distinct unitary businesses which were production company and marketing company).

[36] ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4967 n.22 (U.S. June 29, 1982). *Compare* People *ex rel.* Studebaker Corp. v. Gilchrist, 244 N.Y. 114, ____, 155 N.E. 68, 70-71 (1926) (subsidiary of parent automobile company held distinct from unitary operations of parent) *with* Commonwealth v. Ford Motor Co., 350 Pa. 236, ____, 38 A.2d 329, 333 (1944) (operating divisions of automobile company held not separate from parent company). *See generally* TAX FOUNDATION, INC., *"Taxation of Interstate Business"* (1979 TAX FOUNDATION SEMINAR) [hereinafter cited as TAX FOUNDATION SEMINAR]. The language of the several tests determining the extent of a unitary business tends to find a unitary business in almost any large multistate and multinational business. *See Id.* at 75-78.

[37] 445 U.S. 425 (1980). In *Mobil*, Vermont imposed a corporate income tax, calculated by means of an apportionment formula, upon dividend income received by Mobil from its affiliates doing business abroad. *Id.* at 429-32. Mobil incorporated in New York and had its principal place of business in New York. *Id.* at 427. In Vermont, Mobil engaged soley in the wholesale and retail marketing of petroleum products. *Id.* at 428. Mobil contended that Vermont's apportionment scheme taxed income earned outside Vermont's jurisdiction, but the Vermont Supreme Court ultimately upheld the tax. Mobil Oil Corp. v. Commissioner of Taxes, 136 Vt. 545, 394 A.2d 1147 (1978), *aff'd*, 445 U.S. 425 (1980).

[38] *Id.* at 437-49. The *Mobil* Court noted that Mobil's election to attack Vermont's assessment of Mobil's tax base rather than Vermont's apportionment formula substantially narrowed the issues presented. *Id.* at 434. Justice Stevens objected to the Court's treatment of Mobil's arguments. *Id.* at 451 (Stevens, J., dissenting); *see infra* text accompanying notes 46-50 (discussion of dissent).

[39] *Id.* at 427. Mobil argued that Vermont could not tax Mobil's foreign-source dividends because no minimum connection existed between the business activities of Mobil's foreign affiliate corporations and Vermont. *Id.* at 437-42. Mobil additionally argued that the Vermont tax plan subjected the corporation to double taxation because the dividends were wholly taxable in New York, Mobil's legal domicile. *Id.* at 442-46; *see supra* notes 5-7 (general discussion of due process clause and commerce clause arguments).

[40] GREENWALD, DICTIONARY OF MODERN ECONOMICS 623 (2d ed. 1973). Vertical integration requires operation of a single business at more than one stage of production or distribution. *Id.* The most comprehensive type of vertical integration includes productive stages from the acquisition of raw material to the completion and distribution of the finished product. *Id.* A single company organized vertically often can carry out an entire production process more efficiently than a number of individual firms. *Id.* The company brings together complimentary processes and coordinates various production stages resulting in increased efficiency and economies of scale. *Id.*; *see* Commonwealth v. Ford Motor Co., 350 Pa. 236, 242-45, 38 A.2d 329, 31-33 (1944) (discussion of vertical integration).

as Mobil produces a unitary stream of income, no portion of which is capable of segregation or attributable to one activity.[41] The integrated relationship between divisions makes impossible the accurate determination of the amount of taxable net income generated within a state.[42] The fact that Mobil's affiliated corporations were legally separate entities did not change the underlying economic realities of Mobil's unitary business operation.[43] The Court concluded that Mobil failed to establish that the corporation's dividend earning activities were unrelated to Mobil's sale of petroleum products in Vermont.[44]

The *Mobil* majority assumed that the dividends in issue would represent the income of the operating divisions of Mobil if Mobil and its affiliates comprised a single integrated enterprise.[45] Justice Stevens objected to the majority's broad definition of unitary businesses on three grounds.[46] First, many of the businesses that the majority included in Mobil's unitary business paid only dividends to Mobil and were neither engaged in the petroleum business nor had any connection with Mobil's marketing business in Vermont.[47] Second, Mobil had no control over the percentage of earnings paid out in dividends of corporations in which Mobil only had a minority interest.[48] Finally, Vermont failed to incor-

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[41] 445 U.S. at 440-41. *But see* Rudolph, *supra* note 2, at 185 (states may allocate intangible income to corporation's commercial domicile); Keesling & Warren, *supra* note 23, at 52-57 (investment income not necessarily attributable to general operations and consequently not apportionable).

[42] Moorman Mfg. Co. v. Bair, 437 U.S. 267, 280 (1978) (Powell, J., dissenting); HELLERSTEIN, *supra* note 19, at 400.

[43] 445 U.S. at 440-41.

[44] *Id.* at 441-42.

[45] *Id.* at 440-41.

[46] *Id.* at 460 (Stevens, J., dissenting). Justice Stevens accepted in theory the majority's definition of a unitary business. *Id.* at 459-60. Justice Stevens objected, however, to the majority's definition as applied to the *Mobil* facts. *Id.*

[47] *Id.* at 460 (Stevens, J., dissenting). Justice Stevens objected to Vermont's treatment of Mobil's dividend income from corporations in which Mobil retained small minority interests and which were unrelated to Mobil's unitary business. *Id.*; *see id.* at 456 n.9 (listing of corporations whose dividends were included in Mobil's tax base). The majority failed to address the tax base issue, reasoning that Mobil failed to attack the reasonableness of Vermont's assessment of Mobil's net taxable income. 445 U.S. at 434 (majority opinion). The tax base portion of the *Mobil* opinion resulted more from a failure of proof than from a constitutional ruling. *See id.* Mobil offered no evidence contradicting the conclusion that most, if not all, of its subsidiaries and affiliates contributed to Mobil's worldwide petroleum enterprise. *Id.* at 435. The majority pointed out that the dissent raised de novo the issue of Vermont's inclusion of all of Mobil's dividend income in Mobil's tax base. *Id.* at 434 n.11; *cf.* Chase Brass & Copper Co. v. Franchise Tax Bd., 10 Cal. App. 3d 496, ____, 95 Cal. Rptr. 805, 810 (1970) (holding income from several sister subsidiary corporations not includable in taxpayer's tax base because sister subsidiaries lacked relationship with taxpayer), *cert. denied*, 400 U.S. 961 (1970). *But cf.* Southern Pac. Co. v. McColgan, 68 Cal. App. 2d 48, ____, 156 P.2d 81, 92-93 (1945) (corporate taxpayer taxed on dividends received from corporations less than one percent owned by taxpayer and unrelated to general business of taxpayer).

[48] *Id.* at 460 (Stevens, J., dissenting). The dividends issue in *Mobil* illustrates one problem involved in defining a unitary business, but Mobil failed to raise the dividends issue. 445 U.S. at 434-36 (majority opinion); *see supra* note 38. *Compare* Mobil Oil Corp. v. Commis-

porate any of the apportionment factors of the payor corporations into the apportionment formula applied to Mobil's tax base.[49] The majority avoided these three issues because Mobil waived any objections to the mechanics of the Vermont apportionment formula.[50]

The Court reaffirmed *Mobil* in *Exxon Corp. v. Department of Revenue*, which presented to the Court the constitutionality of Wisconsin's inclusion in Exxon's tax base of corporate income derived from oil and gas extracted from Wisconsin under the unitary business concept.[51] As in *Mobil*, the Court rejected Exxon's due process and commerce clause attacks.[52] The Court held that Exxon's marketing and extraction activities were both part of Exxon's unitary petroleum business.[53] Though the company accounted for each department as a separate corporation, Exxon operated a highly integrated business that benefitted from centralized management and controlled interaction between

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sioner of Taxes, 445 U.S. 425, 449 (1980) (all dividend income included in tax base of unitary business) *with* ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4968 (U.S. June 29, 1982) (dividends unrelated to taxpayer's unitary business excluded from tax base).

[49] *Id.* at 460 (Stevens, J., dissenting). Justice Stevens concluded that Vermont overstated the tax base and applied its apportionment formula in an arbitrary and unconstitutional way. *Id.* The majority pointed out, however, that Mobil failed to present this argument to the lower court and consequently refused to rule on the issue. *Id.* at 441 n.15 (majority opinion). Inclusion of all the subsidiaries' and affiliates' sales, payroll, and property in the calculation of Vermont's apportionment formula would result in decreased net taxes for Mobil since the numerator would remain the same and the denominator substantially increases, for a net result of a diminished apportionment fraction. *Id. But see* Commonwealth v. Ford Motor Co., 350 Pa. 236, ____, 38 A.2d 329, 334 (1944) (statutory formula included in multiplicand book value of stock of wholly-owned subsidiaries without including in denominators of allocative fractions tangible property, wages, and gross receipts of subsidiaries).

[50] *See supra* notes 41-43. If Mobil had raised the issue of inclusion of dividend receipts from domestic corporations in the tax base, the Court probably would have decided the issue according to its later reasoning in the *Woolworth* case. *See* F.W. Woolworth Co. v. Taxation & Revenue Dep't, 50 U.S.L.W. 4957, 4959-61 (U.S. June 29, 1982) (income from business unrelated to unitary operations of taxpayer held not part of apportionable income). Alternatively, the Court might have applied the reasoning in the *Hans Rees' Sons* case. *See* Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 134 (1931) (apportionment formula reaching profits in no way attributable to transactions within taxing jurisdiction held unconstitutional).

[51] 447 U.S. 207 (1980). Exxon marketed but did not refine or extract petroleum in Wisconsin. *Id.* at 213. Wisconsin sought to tax income derived from the out-of-state extraction of oil and gas that Exxon then transferred to its out-of-state refineries. *Id.* at 214-15. Exxon maintained its principal place of business in Texas and incorporated in New York. *Id.* at 210. Exxon contended that its exploration and production department, refining department, and marketing department constituted separate businesses and that Wisconsin could tax only income produced from the marketing operations. *Id.* at 215. The Wisconsin Supreme Court held that the marketing operations were part of a single unitary petroleum business conducted by Exxon. Wisconsin Dep't of Revenue v. Exxon Corp., 90 Wis. 2d 700, ____, 281 N.W.2d 94, ____ (1979), *aff'd*, 447 U.S. 207 (1980).

[52] 447 U.S. at 210, 226-27, 229-30.

[53] *Id.* at 225-30. The Court held that Exxon's out-of-state activities passed both the sufficient connection test and rational relation text required by the due process clause. *Id.* at

departments.[54] Exxon argued that the income derived from exploration and production must be treated as situs income and allocated to the situs state rather than apportioned by Wisconsin.[55] The Court ruled that the location of raw materials did not alter the fact that income derived from the sale of raw materials represented part of Exxon's unitary business income.[56]

In addressing both Mobil's and Exxon's claims, the Supreme Court focused on the integration and interdependence of the parties' affiliated corporations and functional divisions.[57] In *Exxon* and *Mobil*, the Court held that if income from subsidiaries, affiliates, or separate divisions reflected profits derived from a functionally integrated enterprise, then that income represented income to the parent corporation earned in part of the parent's unitary business.[58] The Court considered several factors in Exxon's operations as illustrative of a unitary business.[59] These factors

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226-27; *see supra* notes 5 & 7 (discussion of due process requirement). The Court also noted that the risk of double taxation is not violative of the commerce clause. 447 U.S. at 228. Double taxation of interstate commerce violates the commerce clause when intrastate commerce is not subjected to the same taxation. *See* Standard Pressed Steel Co. v. Department of Revenue, 419 U.S. 560, 562 (1975); Western Live Stock Co. v. Bureau of Revenue, 303 U.S. 250, 256 (1938). Exxon contended that the commerce clause requires allocation of income derived from exploration and production to the situs state. 447 U.S. at 227. The *Exxon* Court refused to accept Exxon's allocation argument and held that Exxon operated a unitary business subject to apportionment of unitary income. *Id.* at 228.

A state tax violates the commerce clause when the tax unfairly burdens commerce by exacting from the interstate activity more than the activity's share of the cost of state government. *See* Department of Revenue v. Association of Washington Stevedoring Companies, 435 U.S. 734, 747-48 (1978). The *Exxon* Court held that Wisconsin's taxation of Exxon's unitary income did not violate the commerce clause because Exxon failed to prove actual multiple taxation. 447 U.S. at 228. The *Exxon* Court took notice of the practical effect of the tax, which taxed income bearing a relation to the benefits and privileges conferred by Wisconsin to Exxon. *Id.* at 228-29; *see* Department of Revenue v. Association of Washington Stevedoring Companies, 435 U.S. 734, 746-47 (1978) (general business tax levied only on value of services performed within taxing state held properly apportioned and could not result in multiple burdens on interstate commerce); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288-89 (1977) (practical economic effect on tax determinative of validity under commerce clause); Evco v. Jones, 409 U.S. 91, 93 (1972) (per curiam) (holding invalid unapportioned tax levied on gross receipts derived from activities in interstate commerce since taxpayer was exposed to duplicative taxation to which intrastate business was not exposed); Gwin, White & Prince, Inc. v. Henneford, 305 U.S. 434, 436-39 (1939) (same).

[54] *Exxon*, 447 U.S. at 224.

[55] *Id.* at 224-25 (discussion of interrelationship of Exxon's three functional departments). Exxon's Coordination and Services Management provided many essential corporate services for the entire company, including the coordination of the refining and other operational functions to obtain an optimum short range operating program. *Id.*

[56] *Id.* at 228-29. The commerce clause does not require allocation of taxable income when a taxpayer uses accounting methods to separate such income geographically or functionally. *Id.* at 229-30.

[57] *Id.* at 224-26; *Mobil*, 445 U.S. at 438-41.

[58] *Exxon*, 447 U.S. at 222-23; *Mobil*, 445 U.S. at 440.

[59] *Exxon*, 447 U.S. at 224-25. Factors not considered by the *Exxon* Court but considered by other courts as indicative of a unitary business include interlocking director-

included centralized ownership, centralized administration, centralized purchasing, centralized marketing, and controlled interaction and integration of functional departments.[60] The Court reasoned that these five factors operated to obscure fair allocation of income between Exxon's several divisions.[61] The Court stated that provided a tax assessed by a state bears a rational relation to the protections, opportunities, and benefits given by the state to the corporation, unitary taxation does not violate the constitutional rights of the corporation.[62] The *Exxon* Court sanctioned state apportionment of a corporation's unitary income, regardless of the source or form of the income.[63]

Guided by the principles set out in *Mobil* and *Exxon*,[64] the Court held that states could not include certain corporate income in the unitary businesses of the taxpayers in *F.W. Woolworth Co. v. Taxation and Revenue Department*[65] and *ASARCO Inc. v. Idaho State Tax Commission*.[66] In its *Mobil* decision, the Court expressly kept open the possibility

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ships, intracompany sales, and centralized insurance, legal, and financial services. *See* Montana Dep't of Revenue v. American Smelting and Ref. Co., 173 Mont. 316, ____, 567 P.2d 901, 908 (1977); Zale-Salem, Inc. v. State Tax Comm'n, 237 Or. 261, ____, 391 P.2d 601, 602 (1964). Additionally, courts include income generated from intangible property employed in the corporation's general activities and commingled with the corporation's unitary income. *See* Corning Glass Works v. Department of Revenue, 616 S.W.2d 789, 792-93 (Ky. Ct. App. 1981); Montgomery Ward & Co. v. Commissioner of Taxes, 276 Minn. 479, ____, 151 N.W.2d 294, 296 (1967).

[60] 447 U.S. at 213, 224. Additionally, the *Exxon* Court considered Exxon's uniform product packaging, uniform credit card system, and uniform product promotion as illustrative of Exxon's unitary business. *Id.* at 224.

[61] *Id.* at 226; *see Mobil*, 445 U.S. at 438; *cf.* HELLERSTEIN, *supra* note 19, at 400 (apportionment necessary method of taxation for unitary business since alternative method for accurately separating profit in unitary business nonexistent).

[62] *Exxon*, 447 U.S. at 228-29; *see Mobil*, 445 U.S. at 445-46.

[63] *Exxon*, 447 U.S. at 222-23, 229; *see Mobil*, 445 U.S. at 440.

[64] *See supra* text and accompanying notes 57-63 (discussion of *Exxon* and *Mobil*). *Exxon* and *Mobil* stressed two principles. First, state income taxation utilizing apportionability of corporate income depends upon determining the extent of the unitary business. *Exxon*, 447 U.S. at 223; *Mobil*, 445 U.S. at 439. Second, a state may tax a corporation's foreign-source dividends if the dividends represent contributions of income of the dividend payors resulting from functional integration, centralization of management, and economies of scale of the taxpayer, its subsidiaries, and affiliates. *See Exxon*, 447 U.S. at 222-25; *Mobil*, 445 U.S. at 438.

[65] 50 U.S.L.W. 4957 (U.S. June 29, 1982). In *Woolworth*, the corporation headquarters were in New York, but the corporation conducted a large retail operation throughout the United States. *Id.* at 4957. The corporation owned three foreign corporations and was the majority stockholder in a fourth. *Id.* Each subsidiary operated independently of the others in four separate foreign countries. *Id.* Upon auditing Woolworth, the New Mexico Department of Taxation included dividends paid by these four subsidiaries in Woolworth's business income. *Id.* at 4958. The Department argued that the dividend income received by Woolworth, therefore, was taxable by apportionment. *Id.* The New Mexico Supreme Court agreed. *See* Taxation & Revenue Dep't v. F.W. Woolworth Co., 95 N.M. 519, 529, 624 P.2d 28, 38 (1981), *rev'd*, 50 U.S.L.W. 4957 (U.S. June 29, 1982).

[66] 50 U.S.L.W. 4962 (U.S. June 29, 1982); *see infra* note 85 (discussion of *ASARCO* facts).

of excluding from apportionable income dividends received from a foreign subsidiary.[67] The Court stated that when the business activities of the dividend payor are independent of the activities of the parent corporation in the taxing state, the foreign dividends are not part of the unitary business income.[68] Due process considerations consequently preclude apportionability of the dividends.[69] The *Woolworth* and *ASARCO* cases involved factual situations distinguishable from the factual situations in *Mobil* and *Exxon*.[70] As a result, Woolworth and ASARCO succeeded in proving that their dividend paying subsidiaries were not part of their respective unitary businesses.[71]

The main issue in *Woolworth* was whether foreign-source dividends paid to a nondomiciliary parent corporation constituted apportionable unitary income.[72] The Court noted that although Woolworth had the potential to operate its subsidiaries as integrated divisions of a single unitary business, potential does not determine the apportionability issue.[73] Woolworth's dividend income derived from unrelated business activities of subsidiaries, each of which operated as a separate business enterprise.[74] The Court stated that Woolworth's retail operation

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[67] 445 U.S. at 441-42. The taxpayer corporation has the burden of proof to establish that dividend income is not part of the unitary income of the corporation. *Id.* at 442.

[68] *Id.* at 442.

[69] *Id.*

[70] *See ASARCO*, 50 U.S.L.W. 4962, 4967 n.22 (U.S. June 29, 1982) (*Mobil* principles followed but critical factual differences result in different conclusion in *ASARCO*); *supra* notes 37, 51, & 65; *infra* note 85 (subsidiaries in *ASARCO* and *Woolworth* not part of unitary operation).

[71] *See ASARCO*, 50 U.S.L.W. at 4968; *Woolworth*, 50 U.S.L.W. at 4961.

[72] *Woolworth*, 50 U.S.L.W. at 4957. In addition to deciding whether foreign-source dividends constituted unitary income, the *Woolworth* Court also decided whether New Mexico's apportionment formula could include the "gross-up" figure that Woolworth calculated in its federal tax return to claim a foreign tax credit. *Id.* Gross-up is an accounting device by which a domestic corporation may credit against its federal income tax liability foreign taxes paid by its foreign subsidiaries out of their accumulated profits. *In re* Goodyear Tire & Rubber Co., 133 Vt. 132, 137, 335 A.2d 310, 313 (1975). The Supreme Court noted that the gross-up figure was a fictitious amount useful only for federal income tax purposes. *Woolworth*, 50 U.S.L.W. at 4961-62; *see* H.R. REP. NO. 1447, 87th Cong., 2d Sess. A83 (1962) (discussing treatment of gross-up amount). New Mexico's effort to tax the amount of the gross-up as income contravened the due process clause because the foreign tax credit involved foreign subsidiaries that had no unitary business relationship with New Mexico. *Woolworth*, 50 U.S.L.W. at 4962. New Mexico contributed nothing for which it could tax the gross-up. *Id.*

[73] *Woolworth*, 50 U.S.L.W. at 4959.

[74] *Id.* at 4960-61. The Court noted that the critical distinction between a retail merchandising business as conducted by Woolworth and a vertically integrated oil company is the centralized operation of the latter. *See id.* at 4961. Woolworth's international retail operations failed to benefit from the flow of trade, interchange of personnel, or interdependence of operating divisions as would a unitary business. *Id.* Woolworth maintained its subsidiaries as investments and did not attempt to integrate, advise, or control them. *Id.*; *cf.* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 440-41 (1980) (corporation failing to operate subsidiaries for investment purposes held to operate unitary business).

distinguished the organization of the business from an integrated multinational corporation.[75] The Court recognized that Woolworth received an economic benefit from ownership of the stock in the subsidiaries, but emphasized that the underlying unity or diversity of business enterprise determines inclusion within the unitary business.[76]

To determine the unitary or nonunitary character of Woolworth's subsidiaries, the Court used the *Mobil* test and considered whether contributions to the income of the subsidiaries or parent resulted from functional integration, centralization of management, and economies of scale.[77] The Court found little functional integration of Woolworth and its subsidiaries.[78] The subsidiaries each made independent decisions regarding merchandise, store site selection, advertising, accounting, and financing.[79] The parent and the subsidiaries did not engage in any centralized purchasing, manufacturing, or warehousing.[80] Moreover, each subsidiary's management operated relatively autonomously.[81] Full-time management operated each subsidiary independently of the parent company, each subsidiary developed its own policies, and no rotation of personnel occurred.[82] Finally, the Court found that neither Woolworth nor any subsidiary benefitted from economies of scale.[83]

In *ASARCO*,[84] ASARCO did not contest the fact that it operated an integrated company which mined, smelted, refined, and sold various nonferrous metals.[85] ASARCO, however, did contest the Idaho Tax Com-

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[75] 50 U.S.L.W. at 4961; *see supra* note 74 (noting distinction between retail merchandising business and vertically integrated oil business).

[76] 50 U.S.L.W. at 4959. *But see* ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4971 (U.S. June 29, 1982) (O'Connor, J., dissenting) (parent corporation's ownership of subsidiaries created business advantages to parent sufficient to establish unitary business); Flint v. Stone Tracy Co., 220 U.S. 107, 166 (1911) (possession by corporation of investments and other assets creates business advantage to corporation since credit, goodwill, and prestige thereby are enhanced).

[77] *Woolworth*, 50 U.S.L.W. at 4959; *see supra* text accompanying notes 57-58 (discussion of *Mobil* test).

[78] *Woolworth*, 50 U.S.L.W. at 4959-60.

[79] *Id.*

[80] *Id.*

[81] *Id.* The *Woolworth* Court noted that Woolworth and its subsidiaries shared several common directors. *Id.* Frequent communications between the parent and the subsidiaries took place. *Id.* Major financial decisions of the subsidiaries, including dividend amounts and debt creation, needed Woolworth's approval. *Id.* Woolworth also included the subsidiaries in the annual corporate reports on a consolidated basis. *Id.* The dissent argued that these factors indicated unitary operation of the business. *Id.* at 4969-74 (O'Connor, J., dissenting). The majority countered that Woolworth's type of participation normally existed between any parent corporation and its subsidiaries. 50 U.S.L.W. at 4961 (majority opinion). Woolworth did not provide planning, financing, purchasing, accounting, or coordinating services to its subsidiaries as did both Mobil and Exxon. *Id.*

[82] *See* 50 U.S.L.W. at 4960.

[83] *See id.* at 4960-61 (economies of scale discussed).

[84] 50 U.S.L.W. at 4962 (U.S. June 29, 1982).

[85] *Id.* at 4962. ASARCO maintained its commercial domicile and headquarters in New

mission's identification of five ASARCO subsidiaries as part of ASARCO's unitary business.[86] The Idaho Tax Commission asserted that corporate purpose should govern what parts of a business are included within a unitary business.[87] Under Idaho's definition of a unitary business if a parent corporation acquired, managed, or disposed of any property for purposes relating or contributing to the parent's business, the state could apportion the income generated by that property.[88] The Court rejected Idaho's assertion because Idaho's position would permit states to apportion income from property when business activities of out-of-state subsidiaries were independent of the activities of the parent in the taxing state.[89] Due process standards are inconsistent with a definition of unitary business that emphasizes corporate purpose.[90]

The Supreme Court concluded that no centralized management, functional integration, or economies of scale existed between ASARCO and its subsidiaries.[91] Since ASARCO had minimal business relations[92]

York and incorporated under New Jersey law. *Id.* ASARCO's Idaho business consisted principally of the operation of a silver mine. *Id.* Four foreign subsidiaries of ASARCO paid ASARCO corporate dividends and interest on outstanding loans. *Id.* at 4963. ASARCO additionally realized a capital gain on the sale of stock of one of the subsidiaries. *Id.* The Idaho State Tax Commission maintained that ASARCO's income from the dividends, interest, and capital gain was business income and therefore was apportionable. *Id.* at 4964. The Idaho Supreme Court agreed. American Smelting & Ref. Co. v. Idaho State Tax Comm'n, 99 Idaho 924, ____, 592 P.2d 39, 52, *aff'd sub nom.* ASARCO Inc. v. Idaho State Tax Comm'n, 102 Idaho 38, 624 P.2d 946 (1981) (per curiam), *rev'd*, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

[86] 50 U.S.L.W. at 4962. ASARCO did not contest the Idaho Supreme Court's ruling that six of ASARCO's wholly owned subsidiaries were part of ASARCO's unitary business. *Id.* at 4964. ASARCO contested the Idaho Supreme Court's ruling that five partially owned subsidiaries were part of ASARCO's unitary business. *Id.* at 4964. ASARCO asserted that the five subsidiaries were business enterprises distinct from ASARCO's operations in Idaho and therefore the due process clause prohibited Idaho's effort to levy upon income not properly within its jurisdiction. *Id.* at 4966.

[87] *ASARCO*, 50 U.S.L.W. at 4963.

[88] *Id.*

[89] *Id.* at 4967. The *ASARCO* Court stated that Idaho's proposed definition of a unitary business was too broad. *Id.* Idaho asserted that integration of intangible assets into ASARCO's business made the income from the intangible assets part of a unitary business. *Id.* The Court rejected Idaho's definition of a unitary business because all corporate operations, including any investments, are for purposes related to or contributing to the corporation's entire business. *Id.* When pressed to its logical limit, the Court concluded, Idaho's definition of a unitary business becomes no limitation at all. *Id.*

[90] *Id.* Due process standards prohibit nondomiciliary states from apportioning and taxing intangible income when the business activities of the payor are independent from the activities of the dividend recipient in the taxing state because no minimum relation exists between the income producer and the taxing state. *Id.*; *see* Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954) (due process requires definite link between taxing state and person, property, or transaction state seeks to tax); Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940) (scope of state power to tax depends upon a rational relation between activity being taxed and protection, opportunities, and benefits given by state).

[91] *See* 50 U.S.L.W. at 4966-67.

[92] *See* Keesling & Warren, *supra* note 23, at 50-57 (discussion of operational and economic unit in unitary and nonunitary businesses).

with its subsidiaries, the subsidiaries represented mere investments outside ASARCO's unitary business.[93] The Court held that ASARCO established that its subsidiaries were not part of ASARCO's unitary business.[94] The Court focused on the fact that ASARCO failed to exercise any control over its subsidiaries and overlooked the fact that the subsidiary corporations operated businesses similar to ASARCO's unitary business.[95] The Court reiterated its *Woolworth* position that neither the potential to operate a unitary business nor actual economic gain to the parent determined the unitary nature of the business.[96] The majority refused to consider a corporation's economic advantage, profits stability, or control potential gained by operation of several subsidiaries in determining the extent of a unitary business and thereby refused to expand the unitary business concept.[97] In dissent, Justice O'Connor contended that the test of inclusion in a unitary business is the related nature of a subsidiary's business or the business advantage the parent receives from the relationship between parent and subsidiary.[98]

The accepted test of inclusion in a unitary business as developed by

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[93] 50 U.S.L.W. at 4966; *see* Square D Co. v. Kentucky Bd. of Tax Appeals, 415 S.W.2d 594, 600 (Ky. Ct. App. 1967) (unity of ownership does not itself create the required integration of business operations justifying taxing state in claiming a pro rata share of income of out-of-state sources); People *ex rel.* Studebaker Corp. v. Gilchrist, 244 N.Y. 114, 123, 155 N.E. 68, 71 (1926) (stock ownership not enough to bring parent corporation's income into state for purpose of taxation of subsidiary corporation).

[94] 50 U.S.L.W. at 4968.

[95] *Id.* at 4966. The Court found that ASARCO maintained the potential to control its subsidiaries, but did not exercise that control. *Id.* The Court refused to equate potential control over subsidiary operations with unitary operation of a corporation. *Id.*; American Bakeries Co. v. Johnson, 259 N.C. 419, ____, 131 S.E.2d 1, 8 (1963) (corporate separation must be recognized despite similar or related business operations of several common controlled corporations); Logan Clay Prods. Co. v. Commonwealth, 11 Pa. Commw. 629, ____, 315 A.2d 346, 353-54 (1974) (same).

[96] *ASARCO*, 50 U.S.L.W. at 4966. The *Woolworth* decision recognized that the potential to operate a business in a unitary fashion does not dispose of the issue whether the corporation operates as a unitary business. *See Woolworth*, at 4959.

[97] 50 U.S.L.W. at 4968 n. 24. Justice O'Connor argued that the majority ignored business advantages accruing to ASARCO from operation of the subsidiaries in issue. *Id.* at 4972 (O'Connor, J., dissenting). Justice O'Connor additionally argued that ASARCO's holdings in its subsidiaries represented part of its unitary business. *Id.*

[98] *Id.* at 4972. (O'Connor, J., dissenting). Justice O'Connor dissented, arguing that ASARCO failed to prove that its subsidiaries earned income unrelated to ASARCO's unitary operations. *Id.* at 4968-74. Justice O'Connor stated that ASARCO failed to segregate its investment decision-making from its nonferrous metals business. *Id.* at 4969. Justice O'Connor further pointed out that ASARCO failed to show that its stock holdings were independent of the management of ASARCO's financial requirements. *Id.* at 4970. Finally, Justice O'Connor argued that since ASARCO had the controlling position in each of its subsidiaries, the investments actively contributed to ASARCO's unitary business. *Id.* at 4971. *But see* 50 U.S.L.W. 4968 n.24. The majority pointed out that the dissent considered several factors in determining the unitary character of a business that the Court did not consider in either *Mobil* or *Exxon* and which unnecessarily broadened the definition of a unitary business. *Id.*

the Court in *Mobil*, *Exxon*, *Woolworth*, and *ASARCO* is whether unity and integration of management and company divisions exist and whether economies of scale exist.[99] The *Mobil* test focuses on whether the business operations consist of a series of transactions or interrelated departments substantially controlled by one corporation.[100] The *Mobil* test utilizes two factors from a similar test adopted forty years ago by the Supreme Court in *Butler Brothers v. McColgan*.[101] The "three unities" test that the Court used in *Butler Brothers* considered unity of ownership, operation, and use to determine the extent of a unitary business.[102] A corporation met the unity of ownership requirement if the corporation retained ownership of a subsidiary's stock to transact further business or if the stock was connected integrally with the business of the owner.[103] Businesses found to operate in a unitary manner owned substantially all of the stock of the subsidiary corporations.[104] A corporate group met the operation requirement if the business operated with centralized administration, advertising, purchasing, and management.[105] Courts held that a unitary business fulfilled the use requirement if the business integrated its use of executive forces and operational

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[99] *See ASARCO*, 50 U.S.L.W. at 4966-67; *Woolworth*, 50 U.S.L.W. at 4959-61; *Exxon*, 447 U.S. at 222-25; *Mobil*, 445 U.S. at 438-39.

[100] *Exxon*, 447 U.S. at 222-25; *Mobil*, 445 U.S. at 438-40.

[101] *See Mobil*, 445 U.S. at 438 (citing *Butler Bros. v. McColgan*, 315 U.S. 501, 508-09 (1942)).

[102] *See* Butler Bros. v. McColgan, 315 U.S. 501, 508-09 (1942). The *Butler Brothers* Court adopted the three unities test to determine whether a business operated in a unitary manner. *Id.* The determinative factors are unity of ownership, management and administrative operations, and use of executive forces and operational systems. *Id.* Prior to the *Butler Brothers* case, the Court realized the importance of unity of ownership and use in determining the existence of a unitary business. *See* Fargo v. Hart, 193 U.S. 490, 499 (1904) (taxation by apportionment intended to reach intangible value created by use of property in taxing state with use of commonly owned property outside taxing state); Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 220-23, *reh'g denied*, 166 U.S. 185 (1897) (value of separate articles of tangible property joined together in unity of ownership and use may develop into greater intangible property value).

[103] Southern Pac. Co. v. McColgan, 68 Cal. App. 2d 48, ___, 156 P.2d 81, 99 (1945). *See generally* Comment, *Taxation of the Multistate Business: The Ownership Requirement of the Unitary Concept*, 14 CAL. W.L. REV. 92 (1978) [hereinafter cited as *Taxation of Multistate Business*].

[104] *See, e.g.*, Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 479-80, 183 P.2d 16, 22 (1947) (wholly owned subsidiary corporation held part of large unitary operation); Montana Dep't of Revenue v. American Smelting & Ref. Co., 173 Mont. 316, 328-29, 567 P.2d 901, 908 (1977) (same). *But see* J.G. McCrory Co. v. Commissioner of Corps. and Tax'n, 280 Mass. 273, ___, 182 N.E. 481, 482-483 (1932) (no basis to tax profits of nondomiciliary parent corporation, though wholly owned subsidiary in taxing state operated at loss).

[105] Honolulu Oil Corp. v. Franchise Tax Bd., 60 Cal. 2d 417, ___, 34 Cal. Rptr. 552, ___, 386 P.2d 40, 41-43 (1963) (unity of operations defined as centralized production, operations, purchasing, fiscal and sales policies, and financial and legal services); Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 412, 34 Cal. Rptr. 545, 548-49, 386 P.2d 33, 36-37 (1963) (unity of operations defined as centralized coordination of exploration, well production, technical development, drilling operations, and legal activities).

systems.[106] In rare circumstances courts disregarded the unity of operations requirement and stressed the actual control of the parent corporation over the operations of its subsidiary.[107] In general, the basis of finding a unitary business under the three unities test depended upon finding substantial contributions and dependence between the parent and its subsidiaries.[108]

Critics of the three unities test have contended that the unity concept is ambiguous and of little assistance in determining the extent of a unitary business.[109] Some courts have utilized a "mutual benefit" test in order to determine the extent of a unitary business.[110] The mutual benefit test examines whether a number of business operations having common ownership mutually benefit one another and whether each operation depends upon or contributes to the other operations.[111] The test focuses upon the organization of operating and administrative departments,[112] coordination and standardization of activities,[113] and integration of corporate income.[114] The mutual benefit test is similar to the three unities test in that the mutual benefit test also emphasizes finding a

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[106] *See* Honolulu Oil Corp. v. Franchise Tax Bd., 34 Cal. Rptr. 552, ____, 386 P.2d 40, 43 (1963) (unity of use resulting in economies of scale defined as integrated use of executive forces and operational systems); Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 478-80, 183 P.2d 16, 20-21 (1947) (same).

[107] *See* Appeal of F.W. Woolworth Co., CAL. TAX. RPTR. (CCH) ¶ 204-806 (July 31, 1972) (unity of operations requirement in test for unitary business unnecessary if parent corporation controls subsidiary through management decisions at highest level); Chase Brass & Copper Co. v. Franchise Tax Bd., 10 Cal. App. 3d 496, 504-06, 95 Cal. Rptr. 805, 808-09 (same), *cert. denied*, 400 U.S. 961 (1970).

[108] *See* Butler Bros. v. McColgan, 315 U.S. 501, 508 (1942) (test based on contributory activities); Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 412-13, 34 Cal. Rptr. 545, 549, 386 P.2d 33, 38 (1963) (same).

[109] *See* Coca Cola Co. v. Department of Revenue, 271 Or. 517, 524 n.2, 533 P.2d 788, 792 n.2 (1975) (criticism of three unities test); Keesling & Warren, *supra* note 23, at 47 (three unities test ambiguous and of little value).

[110] *See*, Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, 355-56, 71 N.W.2d 797, 805 (1955) (adopting mutual benefit test for unitary business); Zale-Salem, Inc. v. State Tax Comm'n, 237 Or. 261, 265, 391 P.2d 601, 602 (1964) (same).

[111] *See* Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, 355-56, 71 N.W.2d 797, 805 (1955) (holding mutually beneficial corporate activities conducted in several states one unitary business).

[112] *See* Zale-Salem, Inc. v. State Tax Comm'n, 237 Or. 261, ____, 392 P.2d 601, 601-02, (1964) (technically separate corporations mutually benefitted one another through organization of various departments).

[113] *See* Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, ____, 71 N.W.2d 797, 804-05 (1955) (corporate operations in different states mutually beneficial due to coordination of activities).

[114] *See* Great Lakes Pipe Line Co. v. Commissioner of Tax'n, 272 Minn. 403, ____, 138 N.W.2d 612, 616-17 (1965), *appeal dismissed*, 384 U.S. 718 (1966) (integration of corporate income mutually benefitted separate business activities of corporation).

[115] *See supra* text accompanying notes 108, 110-14 (mutual benefit test for unitary business requires finding mutual contribution between two or more businesses operated under common ownership).

contributory and dependent relationship between parent and subsidiary corporations operating in a unitary business.[115]

Mobil, *Exxon*, *Woolworth*, and *ASARCO* represent the Supreme Court's view that state apportionment of unitary business income is desirable.[116] In *Mobil*, the Court recognized that unitary apportionment counters abusive income allocations by unitary businesses in intercorporate transactions.[117] Affiliated corporations often gain tax advantages, to the disadvantage of certain states, through the use of intercompany transactions.[118] Related companies can allocate income to operating divisions or subsidiary corporations in favorable taxing states or countries.[119] Intercompany transactions free from market restraints may emphasize tax purposes over business purposes in the form of interest free loans,[120] price fixing,[121] rent-free use of equipment and technology,[122] manipulated dividends,[123] and other forms of income shifting. Unitary ap-

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[116] *See, e.g.*, Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 439 (1980) (linchpin of apportionability in field of state income taxation is unitary business principle); ALTMAN & KEESLING, *supra* note 18, at 161-64; *Dexter*, *supra* note 19, at 183. *See also* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 460 (1959) (purpose of apportionment is taxation of multistate and multinational corporate taxpayers in proportion to taxpayer's intrasate corporate activities).

[117] *See Mobil*, 445 U.S. at 438-39 (citing Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

[118] *See* Dow Chem. Co. v. Commissioner of Revenue, 378 Mass. 254, ____, 391 N.E.2d 253, 257 (1979) (tax avoidance aided by "non-arm's-length" arrangements between parent and subsidiary companies regarding intercompany pricing, transfer of patent rights, intercompany management fees, and similar practices).

[119] *See* Corning Glass Works v. Department of Revenue, 616 S.W.2d 789, 790 (Ky. Ct. App. 1981) (corporation may avoid or limit state taxation by shifting income to operations in states with low tax rates).

[120] *See* Tollefsen v. Commissioner, 431 F.2d 511, 513 (2d Cir. 1970) (cash withdrawals made by parent corporation from wholly owned inactive subsidiary in form of loans held not loans, but rather taxable dividend income); Aristar, Inc. v. United States, 553 F.2d 644, 646-47 (Ct. Cl. 1977) (allocating additional interest income to holding company which made interest free loans to subsidiaries in order to reduce taxes of controlled enterprise). *See generally* Comment, *Disguised Dividends: A Comprehensive Survey*, 3 U.C.L.A. L. REV. 207, 222-28 (1956).

[121] *See* Wisconsin Big Boy Corp. v. Commissioner, 452 F.2d 137, 140 (7th Cir. 1971) (fee structure used by parent corporation permitted splitting of income between several subsidiary corporations in order to obtain tax advantages); Asiatic Petroleum Co. v. Commissioner, 79 F.2d 234, 236 (2nd Cir. 1935) (holding non-arm's-length intersubsidiary transfers of property sham transaction in attempt to avoid taxes). *See generally* H.R. REP. NO. 350, 67th Cong., 1st Sess., 14 (1921) (noting companies frequently use foreign subsidiaries to shift income to avoid taxes).

[122] *See* Cooper v. Commissioner, 64 T.C. 576, 581 (1975) (material distortion in sole shareholder's income resulted when corporation used assets belonging to shareholder without having paid rent); *cf.* Sparks Nugget, Inc. v. Commissioner, 458 F.2d 631, 636-38 (9th Cir. 1972) (excessive rental agreement between two closely affiliated corporations did not reflect actual value of lease, but served to aid lessor's income needs).

[123] *See* Northwest Nat'l Bank v. United States, 556 F.2d 889, 891-92 (8th Cir. 1977) (purpose behind dividend distribution was to obtain tax advantage unavailable in arm's-length

portionment of corporate income attributes income to taxing states regardless of any income shifting that might take place.[124] Unitary apportionment, therefore, counters abusive corporate allocations.[125]

The Supreme Court allows state legislatures great latitude in the choice and application of apportionment statutes.[126] Federal legislation, prescribing the methods by which states can tax foreign operations of nondomiciliary corporations, presently is pending in both houses of Congress.[127] The bills, which are very similar, would limit the income of multinational corporations subject to state taxation and define the manner in which states may tax multinational income.[128] Both bills generally would prohibit states from apportioning the income of any related foreign corporation through the unitary business method.[129] These bills would exempt from state taxation most dividends received by parent corporations from foreign subsidiaries and affiliates.[130] Industry representatives favor the bills and states' rights spokesmen oppose the legislation.[131] Application of the unitary business principle itself remains

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transaction, consequently distorting respective net incomes of both parent and subsidiary corporations). Dividends represent a vehicle by which a parent corporation can move assets from a subsidiary to itself in order to gain various tax advantages. *Id. See generally* Eustice, *Tax Problems Arising from Transactions Between Affiliated or Controlled Corporations*, 23 TAX L. REV. 451, 481-523 (1968).

[124] *See Taxation of Multistate Business*, *supra* note 103, at 96-99 (illustrative example of abusive intracompany accounting and application of apportionment as solution); *cf.* Western Auto Supply Co. v. Commissioner of Tax'n, 245 Minn. 346, ____, 71 N.W.2d 797, 806 (1955) (separate accounting inherently incapable of accurately attributing income of unitary business because separate accounting rests in part on estimates and often resorts to arbitrary allocations).

[125] Corning Glass Works v. Department of Revenue, 616 S.W.2d 789, 790 (Ky. Ct. App. 1979). Apportionment inhibits a multistate business from shifting losses for a tax advantage by attributing income to the taxing state in proportion to the business' intrastate activity. *Id.* Transactions between related corporate taxpayers that are not at arm's length necessitate unitary apportionment in order accurately to reflect income attributable to the states in which the business operates. *See* TAX FOUNDATION SEMINAR, *supra* note 36, at 50.

[126] Comment, *State Taxation of Commerce*, 8 J. CORP. TAX'N 3, 10 (1982).

[127] *See* S. 655, 97th Cong., 1st Sess. (1981) [hereinafter cited as S. 655]; H.R. 1983, 97th Cong., 1st Sess. (1981) [hereinafter cited as H.R. 1983].

[128] S. 655, *supra* note 126, § 7518(a); H.R. 1983, *supra* note 126, § 7518(a).

[129] S. 655, *supra* note 126, § 7518(a); H.R. 1983, *supra* note 126, § 7518(a).

[130] S. 655, *supra* note 126, § 7518(e); H.R. 1983, *supra* note 126, § 7518(e).

[131] *See generally State Taxation of Foreign Source Income: Hearings on H.R. 5076 Before the House Comm. on Ways and Means*, 96th Cong., 2nd Sess. (1980) [hereinafter cited as *House Hearings*]; *State Taxation of Interstate Commerce and Worldwide Corporate Income: Hearing on S.983 and S.1688 Before the Subcomm. on Tax'n and Debt Management Generally of the Senate Comm. on Finance*, 96th Cong., 2nd Sess. (1980) [hereinafter cited as *Senate Hearings*]. Industry representatives generally support S. 655 and H.R. 1983, and states' rights spokesmen generally disfavor the bills. *Comprare House Hearings*, *supra*, at 192 (statement of Dallas A. Hurston, Assistant Director of Taxes for Coca-Cola), *and Senate Hearings*, *supra*, at 99-100 (statement of John S. Nolan on behalf of the British National Committee of the International Chamber of Commerce) *with House Hearings*, *supra*, at 18 (statement of Bryon Dorgan, Past Chairman, Multistate Tax Commission), *and Senate Hearings*, *supra*, at 362 (statement of Sen. Church). These hearings refer

the central issue.[132] To date, neither bill has left committee.[133]

The critics of the pending legislation, and unitary apportionment generally, cite two problems with apportionment. First, states sometimes apply apportionment formulas in arbitrary and unreasonable ways.[134] Second, states often apportion unitary income without regard to the possibility of duplicative taxation.[135] Supporters of unitary apportionment admit that states possess great freedom in applying their individual formulas, but note that courts readily strike down taxing formulas that exceed constitutional limits.[136] Moreover, recent case law demonstrates that the threat of double taxation is minimal.[137] Neither Mobil nor Exxon could prove that double taxation actually existed. Consequently, the Court held that the corporations' arguments were too speculative.[138]

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to H.R. 5076 and S. 1688, rather than H.R. 1983 and S. 655. The latter bills retained identical language of the former bills with several minor changes. *Compare* S. 655, 97th Cong., 1st Sess. (1981) (clarifying the extent to which a state or other political subdivision may tax certain income from sources outside the United States), *and* H.R. 1983, 97th Cong., 1st Sess. (1981) (same) *with* S. 1688, 96th Cong., 1st Sess. (1979) (same) *and* H.R. 5076, 96th Cong., 2nd Sess. (1979) (same). One subsection appears in both S. 655 and H.R. 1983 which did not appear in S. 1688 or H.R. 5076. *See* S. 655, 97th Cong., 1st Sess., § 7518(e)3 (1981) (special rule with respect to dividends from domestic corporations treated as foreign corporations); H.R. 1983, 97th Cong., 1st Sess., § 7518(e)3 (1981) (same).

[132] *See Senate Hearings, supra* note 131, at 40 (prepared statement of Donald C. Lubick, Assistant Secretary of Treasury for Tax Policy). Spokesmen in favor of S. 1688 generally oppose the unitary method of apportionment as the Supreme Court has developed the concept. *Id.* States' rights spokesmen oppose the legislation because the legislation proposes a reduced tax base for state income taxation. *See id.* at 371 (statement of Benjamin F. Miller, California Franchise Tax Board).

[133] The Senate bill remains in the Senate Finance Committee. [1982] 1 CONG. INDEX (CCH) ¶ 14,175. The House bill remains in the House Ways and Means Committee. [1982] 2 CONG. INDEX (CCH) ¶ 28,251.

[134] *See id.* at 172 (prepared statement of Earnest S. Christian, Jr., Council to the Committee on State Taxation). International business representatives agree with Justice Stevens' *Mobil* dissent, stating that apportionment formulas often result in inconsistent evaluations of the taxpayer's tax liability. *See id.* at 100 (statement of John S. Nolan on behalf of the British National Committee of the International Chamber of Commerce); *id.* at 53 (prepared statement of Donald C. Lubick, Assistant Secretary of Treasury for Tax Policy). *See also* Comment, *Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code*, 89 HARV. L. REV. 1202, 1228-29 (1976) (criticism of formulary apportionment).

[135] *See Senate Hearings, supra* note 131, at 98 (statement of John S. Nolan on behalf of the British National Committee of the International Chamber of Commerce); *id.* at 181 (prepared statement of Earnest S. Christian, Jr., Counsel to the Committee on State Taxation). *But see* ALTMAN & KEESLING, *supra* note 18, at 14-15. The duplicative taxation problem might arise because of the fine line between double taxation and tax avoidance. *Id.* A credit allowance may be a solution against the overpaid tax figure. *Id.*

[136] *See, e.g.*, Norfolk & W. Ry. v. Missouri State Tax Comm'n, 390 U.S. 317, 325-26 (1968) (state tax apportionment held invalid because income attributed to taxing state disproportionate to business transacted in the taxing state by corporation); Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931) (same).

[137] *See Exxon*, 447 U.S. at 228; *Mobil*, 445 U.S. at 444-45.

[138] *See Exxon*, 447 U.S. at 228; *Mobil*, 445 U.S. at 444-45.

Until either Congress enacts legislation in the area of state taxation of multistate and multinational corporations or all fifty states adopt UDITPA,[139] corporations must follow individual state statutes and court decisions regarding taxation of corporate income. The Supreme Court has focused upon the economic and managerial relationship between parent and affiliates in order to determine what to include in a corporation's unitary business.[140] The Court rejected the notion that amount of investment or type of investment compels inclusion of income in a corporation's tax base.[141]

Recent Supreme Court decisions guide corporations facing the potential problem of overtaxation at the state level.[142] Several alternatives and administrative remedies exist for corporations desiring to show the nonapplicability of unitary apportionment in specific instances.[143] First, the corporation can demonstrate the nonunitary status of the income in question.[144] Second, the corporation may be able to prove actual double taxation of the income in question.[145] Third, the corporation can demonstrate the lack of fiscal relationship between the state and the income in question.[146] Fourth, the corporation can apply directly to the state revenue department on a case-by-case basis for relief from an unreasonable apportionment statute.[147] Finally, the corporation can form an investment subsidiary in a hospitable state for the purpose of receiving dividends.[148]

Cases and commentators have demonstrated that some method of

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[139] *See supra* notes 15-16 and accompanying text (discussion of UDITPA). A recent survey indicates that thirty-nine states have adopted UDITPA or similar legislation. State of Indiana, SURVEY ON THE UNIFORMITY OF STATE TAX LAWS, p.4 (1977) [hereinafter cited as SURVEY].

[140] *See* ASARCO Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4965 (U.S. June 29, 1982); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 50 U.S.L.W. 4957, 4959-61 (U.S. June 29, 1982); Exxon Corp. v. Department of Revenue, 447 U.S. 207, 224 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980); *supra* notes 25, 40-44, 53-61 & 102 and accompanying text (discussion of factors held indicative of unitary business).

[141] *Mobil*, 445 U.S. at 438.

[142] *See, e.g.*, *ASARCO*, 50 U.S.L.W. at 4962; *Woolworth*, 50 U.S.L.W. at 4957.

[143] *See infra* text accompanying notes 144-148.

[144] *See ASARCO*, 50 U.S.L.W. at 4968 (income earned outside of unitary operations not apportionable); *Woolworth*, 50 U.S.L.W. at 4961 (same).

[145] *See Exxon*, 447 U.S. at 228. The *Exxon* Court suggested that actual double taxation of corporate income violates the commerce clause. *Id.* (dictum).

[146] *See* Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954) (lack of minimum connection between taxing state and transaction sought to be taxed violates commerce clause).

[147] *See* UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT § 18, 7A U.L.A. 89 (1978). Section 18 provides that corporations may contest directly the accuracy of the state apportionment statute as the statute applies to the particular corporation. *Id.*

[148] *See* Krol, *Minimizing State Taxes with "Receipts Factor" Planning, Investment Subsidiaries*, 52 J. TAX'N, 362, 366 (1980). Formation of an investment subsidiary in a hospitable state might eliminate the possibility of double taxation by the commercial domicile and the taxing state, but would not stop other states from inconsistent apportionment. *Id.*

unitary apportionment is preferable to separate accounting or specific allocation when the corporate taxpayer conducts business in more than one tax jurisdiction.[149] Apportionment serves to counter abusive income shifting by a corporation trying to avoid or to evade taxes.[150] The *Mobil* test reasonably determines the extent of a unitary business and represents over sixty years of development by the Supreme Court and several state courts.[151] The biggest problem in the area of state apportionment is finding a formula that produces accurate tax results, preventing both undertaxation and overtaxation.[152] Cooperation among the states in the form of mutual tax credits[153] or taxation by combined reporting[154] will compensate for individual state formula inaccuracies. Alternatively, federal regulation of the amount of income included in the tax base of a unitary business and of state taxation formulas will assure reasonable state taxation of corporations.[155] In the absence of congressional legislation or cooperation among income taxing states, however, corporate taxpayers, state courts, and state tax administrators will continue to depend upon the Supreme Court decisions in *Mobil, Exxon, Woolworth,* and *ASARCO* for guidance in the taxation of multistate and multinational corporations.

DAVID KEITH FRIEDFELD

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[149] *See, e.g.,* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438-39 (1980); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452 (1959); Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 280, 282 (1924); ALTMAN & KEESLING, *supra* note 18, at 29, 38, 100; Dexter, *supra* note 19, at 181-83; *Keesling & Warren, supra* note 23, at 43-45; *cf.* Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, ___, 183 P.2d 16, 21 (1947) (separate accounting cannot accurately determine income of various parts of unitary business); Webb Resources, Inc. v. McCoy, 194 Kan. 758, ___, 401 P.2d 879, 886 (1965) (specific allocation cannot be used to determine income of various parts of unitary business).

[150] *See supra* notes 117-25 and accompanying text.

[151] *See supra* notes 37-44 & 57-63 and accompanying text.

[152] *See* ALTMAN & KEESLING, *supra* note 18, at 14.

[153] *See* ALTMAN & KEESLING, *supra* note 18, at 15. Many states presently allow credit against use tax liability for sales tax due and paid in other states. *See* SURVEY, *supra* note 138, at 3, 23-25.

[154] *See* Montana Dep't of Revenue v. American Smelting & Ref. Co., 173 Mont. 316, ___, 567 P.2d 901, 908 (1977) (combined reporting obvious extension of unitary apportionment); Coca Cola Co. v. Department of Revenue, 271 Or. 517, ___, 533 P.2d 788, 793 (1975) (same). Combined apportionment includes income of all subsidiaries and affiliates of the taxpayer and eliminates all intercorporate transfers, such as dividend income, from the calculation. *Mobil,* 445 U.S. at 441 n.15. Moreover, the combined apportionment formula includes the subsidiaries' and affiliates' sales, payroll, and property in the calculation which generally results in a smaller apportionment fraction. *Id. See generally* Coca Cola Co. v. Department of Revenue, 271 Or. 517, ___, 533 P.2d 788, 790-93 (1975) (discussion of combined apportionment).

[155] *See supra* notes 126-33 and accompanying text.