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Constitutional Limitations on State Taxation of Corporate Income From Multinational Corporations

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I. Introduction

In the highly controversial[1] 1983 watershed case *Container Corp. of America v. Franchise Tax Board*,[2] the states won a significant victory in their efforts to harvest revenue from the net income of multinational enterprises. In this seminal case the United States Supreme Court sustained the worldwide combined method of income taxation as applied to a United States based parent corporation and its subsidiaries organized and operating in foreign countries. The Court approved California's use of the "'unitary business' principle"[3] to bring into the parent corporation's tax base the income of these foreign subsidiaries for the purpose of applying the State's corporate franchise tax. This worldwide combined method of reporting permits a taxing state to attribute part of the total income of a multinational unitary enterprise, conducted by a group of domestic and foreign corporations, to that state for tax purposes.[4]

The *Container* decision will have a substantial effect on the states' ability to tax multijurisdictional corporations, particularly those domestic corporations with foreign subsidiaries incorporated abroad.[5] The decision is all the more significant because of the current Administration's philosophy of increasing the states' independence while concurrently cutting federal aid to states.[6] This federalistic approach has left many states in severe financial straits; thus, any decision that allows states to increase tax revenues in a politically painless way will have profound effects.

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1. The United States Supreme Court received 32 amicus briefs on the merits. The Court decided the case by a five-to-three voto, with Justice Steveus recusing himself from considering the case.

2. 103 S. Ct. 2933 (1983).

3. *Id.* at 2939. This Article traces the evolution of the unitary business principle in parts II and III.

4.
> When States extend the unitary concept to include foreign corporations the approach is known as "worldwide combined reporting." . . . Under worldwide combined reporting a State applies its apportionment formula to the combined income of the foreign corporate entities included in the unitary group with the income of the corporation(s) doing business in the State.

Comptroller General, Report to the Chairman, House Comm. on Ways and Means, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving, GAO/GGD-82-38, at 31 (July 1, 1982) [hereinafter cited as GAO Report].

5. The success of the states with "worldwide combined reporting," sanctioned in *Container*, established an important beachhead for the states in the taxation of foreign source income. As of July 1, 1982, although only 13 states employed worldwide combined reporting, 70% of the large corporations with foreign operations apparently did business in states using this method. GAO Report, *supra* note 4, at ii.

6. *See City Lights Burn Less Bright*, The Economist, Mar. 21, 1981, at 29.

This Article explores the Supreme Court's treatment, leading up to and including the *Container* decision, of state taxation of corporate income from multinational operations. Part II highlights the Court's development, prior to 1982, of the basic principles of federal limitations on the states' taxing powers that guided its decision in *Container.*[7] Part III takes a more detailed look at two 1982 Supreme Court cases, *ASARCO, Inc. v. Idaho State Tax Commission*[8] and *F.W. Woolworth Co. v. Taxation and Revenue Department,*[9] in which the states suffered a setback in their efforts to extend the reach of their taxing powers over income from multinational businesses. Part IV dissects the *Container* opinion, with a more in-depth explanation of the Court's analysis and the dissenters' response, and concludes with a discussion of the issues that the *Container* Court reserved for future decisions.[10]

II. Developments Prior to 1982 in State Taxation of Income from Multinational Operations

State taxation of income from multinational operations has evolved through a series of cases beginning with the United States Supreme Court's 1924 decision in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*[11] and culminating in the 1983 *Container* decision. In *Bass* the Court sustained a state tax on an apportioned share of a single corporation's income from operations that extended across national boundaries. The complaining taxpayer Bass, an English corporation[12] that brewed ale in England and sold it in the United States and elsewhere, raised due process objections to the use of an apportionment formula for attributing taxpayer's income to activities in the taxing State of New York, where ale was sold. In sustaining the tax, the Court found that taxpayer's transnational operations were a "unitary business," which yielded no profits until the process of manufacture in England resulted in sales. Thus, the State justifiably could attribute to taxpayer's in-state sales a fair proportion of the profits from the unitary business.[13] According to the Court, in taxation a state may

7. *See infra* notes 11-95 and accompanying text.
8. 458 U.S. 307 (1982). *See infra* notes 96-145 and accompanying text.
9. 458 U.S. 354 (1982). *See infra* notes 146-78 and accompanying text.
10. *See infra* notes 179-336 and accompanying text.
11. 266 U.S. 271 (1924).
12. In *Bass* no question regarding income from another corporation was present, since the corporate taxpayer conducted all its operations as a single legal entity. *See id.* at 282.
13. *Id.*

take into account property situated elsewhere when it "can be seen in some plain and fairly intelligible way that it adds to the value of the [property] and the rights exercised in the State." This is directly applicable to tbe carrying on of a *unitary business* of manufacture and sale partly within and partly without the State.[14]

Furthermore, the Court disregarded taxpayer's claim that it had operated at a loss in the taxing State, finding "no sufficient reason why a foreign corporation . . . should be relieved of a privilege tax because it did not happen to have made any profit [from business conducted in that state] during the [taxable] year."[15]

The initial development of the unitary business principle as the basis of apportionment and the fairness of formula requirement occurred primarily—with the notable exception of *Bass*—in *multistate* situations, in which the taxpayer conducted its business through branches or divisions, rather than through subsidiary corporations. While the concept of a unitary business as a prerequisite for apportioning income from a *multinational* business emerged in *Bass*, the Court gave little useful guidance on the criteria for determining the existence of a unitary business operation. Although the Court still has not charted a "bright-line" test, in subsequent years it has developed some judicial criteria for determining whether a multistate or multinational enterprise is unitary for tax purposes.[16]

In addition to the requirement that the taxpayer be a unitary enterprise, the Court has demanded that the formula for apportioning income from multistate and multinational operations to the taxing state must pass constitutional muster on the fairness of the formula. The formula may violate the fairness requirements of the due process and commerce clauses[17] if there is no " 'rational relationship between the income attributed to the [taxing] State and the intrastate values of the enterprises.' "[18] To upset the tax on fairness grounds, the objecting taxpayer must shoulder the burden

14. *Id.* (emphasis added) (quoting Wallace v. Hines, 253 U.S. 66, 69 (1920)).

15. *Id.* at 284.

16. *See* F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); Butler Bros. v. McColgan, 315 U.S. 501 (1942); *infra* notes 23-35, 47-52, 82-95, 113-45 & 157-78 and accompanying text.

17. Seemingly, both the commerce and the due process clauses play roles in this issue of formula fairness. *See* ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 327 n.23, 328-29 (1982); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 219-20, 227-28 (1980).

18. ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 316 (1982) (quoting Mobil Oil Corp. v. Commissioner of Taxes, 455 U.S. 425, 436-37 (1980)).

of proving that the income apportioned to the taxing state is " ' "out of all appropriate proportion to the business transacted" in the taxing State.' "[19] This burden, however, is heavy. In only one case has the Court invalidated a state net income tax imposed on interstate operations because of the unfairness of the formula. In the 1931 *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*[20] decision, while recognizing the unitary character of taxpayer's multistate business, the Court unhorsed the net income tax because taxpayer had met this burden of proving the formula unfair.[21] Amplifying on what it regarded as unreasonable, the Court found that the *Hans Rees'* formula attributed eighty-three percent of taxpayer's income to the taxing State, even though only seventeen percent came from taxpayer's activities in that State.[22]

Later, in the multistate tax case of *Butler Brothers v. McColgan*,[23] the Court blazed significant trails in its treatment of formulary attribution of income from a multistate unitary business. In that opinion the Court more clearly articulated criteria that it continues to rely upon in determining the existence of a unitary business; in addition, the Court's review of the utilized apportionment formula offers a clear indication of the difficulty that the taxpayer faces in proving a formula unfair. The taxpayer in *Butler Brothers* asserted that a California corporate franchise tax, measured by taxpayer's apportioned net income, violated the due process clause because it brought extraterritorial values within the reach of the apportionment formula. Taxpayer (Butler Brothers) was a single foreign corporation engaged in the wholesaling of dry goods and general merchandise through seven wholesale distribution *branches*, rather than through *other corporations*, located in seven states. Butler Brothers was qualified to do business in the taxing State, but its home office in Chicago, Illinois managed and controlled the business. Taxpayer acted as a middleman, purchasing

19. ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 333-34 (1982) (O'Connor, J., dissenting) (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 220 (1980) (quoting Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931))).

Later the Court imposed two additional commerce clause hurdles that a state must overcome in taxing income from multinational operations. The two hurdles are known as the *Japan Line* doctrine. *See infra* notes 68-69 & 265-74 and accompanying text. For a fuller discussion of *Japan Line,* see P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION § 2:17 (1981); J. HELLERSTEIN, STATE TAXATION ¶ 4.14 (1983).

20. 283 U.S. 123 (1931).

21. *See id.* at 135.

22. *See id.* at 134.

23. 315 U.S. 501 (1942).

from manufacturers and others, and then selling to retailers only. As part of its corporate structure, Butler Brothers maintained in Chicago a central buying division, which ordered goods for resale from manufacturers, who in turn shipped the goods to the wholesale distributing houses in the seven states. Both parties stipulated that because taxpayer bought and sold the goods in large quantities, taxpayer was able to purchase them at a discount.[24]

To determine the amount of the income attributable to the taxing State for corporate franchise tax purposes, the State apportioned the taxable net income by using a three-factor property, payroll, and sales formula.[25] Although taxpayer showed by its separate accounting[26] a *loss* of $82,851 for its wholesale distribution store in the taxing State, its business as a whole (including all branch distributing houses) produced a substantial profit. Thus, the State applied its three-factor apportionment formula to the multistate operations of the taxpayer on the ground that taxpayer was a "unitary business."[27] Taxpayer, however, contended that the use of the formula resulted in converting a loss of $82,851 in the taxing State into a profit of over $93,500 in that State, and that the difference of some $175,000 either was created out of whole cloth or had been appropriated by the taxing State from other

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24. *See id.* at 508.

25. The "three-factor" or Massachusetts formula attributes a portion of the income from a multistate business to a state for tax purposes by multiplying the total net income of the multistate business by a fraction representing the arithmetic average of the values of the business' property, payroll, and sales within the taxing state to those of the business as a whole. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 429 (1980). The rationale of the three-factor formula is that in a unitary multistate business, no method of assigning net income can determine the exact amount of income attributable to any geographic area or to any given part of a series of multistate business operations that culminate in the realization of net income. The formula method of computing taxable income approximates the portion of the business' income that is "reasonably related to the activities conducted within the taxing State." Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978). The three-factor formula is based on tbe assumption that the total income of a business enterprise results from certain income-producing factors—property, payroll, and sales. Thus, the formula attributes the income produced by the combination of these factors to the state where these factors are located. *See* P. HARTMAN, *supra* note 19, § 9:18.

26. The "separate accounting" method of assigning income from a unitary multistate business to a state for tax purposes treats the business' operations within the taxing state as an entity separate and distinct from the business' out-of-state operations. Since this method considers the in-state operations as separate, it determines the income from the in-state operations without reference to the success or failure of the multistate business' operations in other states. The inherent difficulties of using separate accounting to isolate multistate or multinational net income have prompted all the states with income taxes to adopt formula apportionment methods. *See* P. HARTMAN, *supra* note 19, §§ 9:17-:18.

27. *See* Butler Bros. v. McColgan, 315 U.S. at 508.

states.[28] Thus, taxpayer insisted, the State was taxing extraterritorial values in violation of the due process clause.

The *Butler Brothers* Court was of a different persuasion. It read the apportionment formula as "fairly calculated" to assign to the taxing State that portion of the net income "reasonably attributable" to the business done in that State.[29] In reaching its decision, the Court did not impeach the integrity of taxpayer's separate accounting method, which showed that the distributing branch in the taxing State operated at a loss. The Court observed that a particular accounting system, although "useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders,"[30] or "may not reveal the facts basic to the State's determination."[31] In the Court's view, the propriety of using the formula depended upon whether taxpayer's entire multistate business enterprise properly could be regarded as "unitary." Although the Court recognized that the seven divisions operated somewhat independently,[32] it rejected taxpayer's position that each of them functioned as a free-standing operation, and not as part of a unitary business. The Court held that taxpayer's total multistate operations constituted a "unitary enterprise" and that the taxing State properly could apply the formula method of attributing income to taxpayer's total net income.[33] The operation of taxpayer's central buying division by itself demonstrated to the Court that functionally the various branches were closely integrated.[34] The central division purchased goods for resale at a lower price because it purchased large quantities. Taxpayer was able to buy in large quantities only because it sold in large quantities. Since taxpayer's store in the taxing State, although operating at a loss, contributed to those sales, that in-state store helped taxpayer to obtain a purchasing profit that benefitted taxpayer's business as a whole.[35]

Having determined that taxpayer's entire multistate enter-

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28. *Id.* at 506.

29. *Id.*

30. *Id.* at 507.

31. *Id.* at 508 (citation omitted).

32. The Court was satisfied that "[e]ach of [Butler Brothers'] houses in the seven states maintains stocks of goods, serves a separate territory, has its own sales force, handles its own sales and all solicitation, credit and collection arrangements in connection therewith, and keeps its own books of account." *Id.* at 504.

33. *See id.* at 508-09.

34. *See id.* at 508.

35. *See id.*

prise constituted a "unitary business," the Court then directed its attention to the fairness of the apportionment formula. Repelling a due process clause attack, the *Butler Brothers* Court sustained the amount of income attributed to the taxing State by the use of the apportionment formula. The Court held that taxpayer had failed to prove that the formula was arbitrary or unreasonable. Demonstrating the magnitude of the burden a taxpayer must shoulder in order to derail a tax for unfairness of apportionment, the Court concluded that the taxpayer had not met the "distinct burden of showing by 'clear and cogent evidence' that [the formula as applied] results in extraterritorial values being taxed."[36] The Court further observed that if factors which were responsible for taxpayer's net income were present in other states, but not present in the taxing State, taxpayer had not revealed them.[37] The Court took the position that, absent such proof, the taxing State justifiably could assume that the branch of business located within the State "contributed its aliquot share to the advantages of centralized management of this unitary enterprise and to the net income earned."[38] Moreover, as the Court noted, "[n]or [were] there any facts shown which permit[ted] the conclusion that the other advantages of centralized management [were] attributable to other branches but not to the one in [the taxing state]."[39]In essence, the rationale of the Court in *Butler Brothers* seems to be that the benefits which a business derives from centralized management and centralized bulk purchasing—more favorable prices—in any practical or realistic manner cannot be attributed to a particular state by the separate accounting method; these benefits inseparably affect the entire enterprise.[40] As the cases discussed below illustrate, the Court expressly has embedded doctrines developed in *Butler*

36. *Id.* at 507 (citation omitted). This language subsequently appeared in a number of net income tax opinions in which the Court was not satisfied that tbe taxpayer had carried the virtually insurmountable burden of proving that the apportionment formula produced an unreasonable result. *See, e.g.*, Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 221-22 (1980).

37. *See* Butler Bros. v. McColgan, 315 U.S. at 509.

38. *Id.*

39. *Id.* (citation omitted).

40. *Id.* at 508-09. For treatment of the origin and nature of the unitary concept, see P. HARTMAN, *supra* note 19, § 2:4; J. HELLERSTEIN, *supra* note 19, ¶ 8.11; Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Businesses*, 10 URB. LAW. 181 (1978); Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 HASTINGS L.J. 42 (1960). For a description of separate accounting and apportionment by formula as methods of dividing the tax base for purposes of taxation, see P. HARTMAN, *supra* note 19, §§ 9:16-:18; J. HELLERSTEIN, *supra* note 19, ¶¶ 8.3, 8.5, 9.1-.11.

Brothers in its later opinions concerning taxation of income from multinational business enterprises.[41]

The next significant case on taxation of income from multinational operations conducted through separate corporations was the 1980 decision in *Mobil Oil Corp. v. Commissioner of Taxes.*[42] In *Mobil* the Court formalized the doctrine that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle."[43] The essential commercial and corporate facts of *Mobil* are not complicated. The *Mobil* taxpayer, a New York corporation with its commercial domicile in New York, engaged in an integrated petroleum business, ranging from the exploration of production reserves to the production, refining, transportation, distribution, and sale of petroleum and related products. Taxpayer carried on its far-flung business in the United States and in a number of foreign countries; it conducted its operations abroad through partly owned subsidiaries and affiliates, many of which were organized under the laws of foreign nations, and none of which conducted business in the taxing State (Vermont). Taxpayer's only activities in the taxing State consisted of wholesale and retail selling.[44]

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41. *See* F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354, 372 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 327 n.23 (1982); Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 221 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438, 442 (1980).

42. 445 U.S. 425 (1980). Elsewhere the author has analyzed *Mobil* more fully. *See* P. HARTMAN, *supra* note 19, § 9:26. For other treatments of *Mobil*, see J. HELLERSTEIN, *supra* note 19, ¶ 9.12[1]; Delap, *From* Moorman *to* Chicago Bridge; *U.S. Supreme Court Decisions Relating to "Unitary" Taxation*, 2 J. STATE TAX'N 197, 201 (1983); Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on* Mobil, Exxon, *and H.R. 5076*, 79 MICH. L. REV. 113 (1980).

43. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439. (footnote omitted). The Court since has applied the same principle in Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 223 (Court considered only multistate business); in F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 362; in ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. at 319; and in the latest case, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933, 2940-41 (1983).

Similarly, since the "linchpin of apportionability" is the "unitary-business principle," as a matter of due process, any apportionment formula applied to income from multinational business enterprises must not reach wider than the scope of the "unitary business" operations. *See* ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S at 328-29; F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 372. In *ASARCO* and *Woolworth* the Court held that intangible income—dividends, capital gains, and interest—of United States based nondomiciliary parent corporations doing business in the taxing states, received from foreign organized and operated subsidiaries, was not apportionable business income because a unitary enterprise did not exist. For a discussion of these two cases, see *infra* notes 96-178 and accompanying text.

44. 445 U.S. at 428.

The taxing State included in the tax base to which it applied the apportionment formula the dividends paid to taxpayer by the subsidiaries and affiliates operating abroad. The propriety of the inclusion in taxpayer's taxable income of these foreign source dividends was the issue in *Mobil.*

In resisting the tax, taxpayer claimed that the inclusion of the foreign source dividend income in the tax base violated both the due process and commerce clauses. Taxpayer took the view that foreign source dividends were per se nonapportionable and, therefore, should be attributed *in full* to the state of taxpayer's commercial domicile (New York), which had no tax on this type of corporate income. Pursuant to this litigation strategy, taxpayer apparently did not try to prove that it was not engaged in a unitary operation with the foreign subsidiaries and affiliates. Moreover, as the Court saw it, taxpayer had disclaimed and, therefore, had waived any dispute with "the accuracy or fairness of [the] apportionment formula."[45] These positions adopted by the taxpayer strongly affected the Court's decision by appreciably narrowing the issues that the Court addressed. The Court did not consider whether the application of the apportionment formula produced unfair attribution of taxpayer's income to the taxing State, where taxpayer only marketed its products.[46] In short, the Court took the position that taxpayer attacked only the tax *base*, and not the fairness of the apportionment.

In its due process attack, taxpayer urged that Vermont could not tax the dividend income because no "nexus" existed between that State and either taxpayer's management of its investments or the business activities of the dividend payors—the subsidiaries and affiliates.[47] The Court met this objection first by concluding that Mobil was engaged in a unitary business with the dividend-paying foreign subsidiaries and affiliates. The Court enunciated the general principle governing a state's apportionment and taxation of income derived from an extraterritorial source, declaring that the "linchpin of apportionability in the field of state income taxation is the unitary-business principle."[48] In accord with the unitary business principle, the Court pointed out that the complaining taxpayer, in order to establish that its dividends from subsidiaries and affiliates were not subject to the apportioned tax under review,

45. *Id.* at 434.
46. *See id.*
47. *Id.* at 436.
48. *Id.* at 439 (footnote omitted).

needed to show "that its dividend income . . . was earned in the course of activities *unrelated* to the sale of petroleum products" in the taxing jurisdiction.[49] The Court noted that taxpayer had "offered no evidence that would undermine the conclusion that most, if not all, of its subsidiaries and affiliates contribute to [taxpayer's] worldwide petroleum enterprise."[50] The *Mobil* Court proceeded to describe why taxpayer had not dislodged the State's application of the unitary business principle:

> Moreover, [taxpayer] has made no effort to demonstrate that the foreign operations of its subsidiaries and affiliates are *distinct* in any *business* or *economic* sense from its petroleum sales activities in [the taxing State]. Indeed, all indications in the record are to the contrary, since it appears that these foreign activities are part of [taxpayer's] integrated petroleum enterprise. . . . Vermont was entitled to conclude that the *dividend income's foreign source* did not destroy the *requisite nexus* with in-state activities.[51]

Since the Court found that taxpayer's sales activities in the taxing State were an integral part of a unitary business enterprise, it declared that a sufficient nexus to justify apportionment existed.[52]

Having determined that taxpayer formed a unitary operation with its taxpaying subsidiaries and affiliates, the Court next concluded that the *form* of business organization does not control the determination of the underlying unity of the business operation. If a unitary business exists when a particular corporation conducts its business through *branches* or *divisions*, the Court felt that a unitary business presumably also would exist if that corporation conducts its business through subsidiaries and affiliates.

> Superficially, intercorporate division might appear to be a more attractive basis for limiting apportionability. But the *form of business organization* may have nothing to do with the underlying *unity or diversity of business enterprise.* Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability. . . . Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives.[53]

The *Mobil* Court did not go so far as to say that all dividend income which a corporation receives is taxable in every state where that corporation does business. The Court recognized that when

49. *Id.* (emphasis added).
50. *Id.* at 435.
51. *Id.* at 439-40 (emphasis added).
52. *See id.* at 441.
53. *Id.* at 440-41 (emphasis added) (footnote and citation omitted).

the business activities of the dividend-paying subsidiaries and affiliates have nothing to do with the activities of the dividend recipient in the taxing state, then no underlying unitary business exists and, therefore, no sufficient nexus to satisfy due process requirements is present.[54] In such a case, courts must deny apportionment. The *Mobil* Court, however, was of the opinion that taxpayer had failed to sustain its "burden of proving any unrelated business activity on the part of its subsidiaries and affiliates that would raise the question of nonapportionability."[55] As a consequence, the Court held that taxpayer had not shown its foreign source dividends to be exempt, as a matter of due process, from apportionment for income tax purposes by the State of Vermont.

Although the *Mobil* Court did not consider whether the apportionment formula produced an unfair result,[56] a fairness issue might well have been present but for taxpayer's alleged waiver of that issue. In applying the apportionment formula to Mobil's income, the taxing State had included in the tax base dividends from taxpayer's foreign subsidiaries and affiliates; however, in the denominator of the apportionment fraction the State did not permit the inclusion of the subsidiaries' and affiliates' sales, payroll, and property. Of course, the omission of these elements resulted in a larger apportionment fraction and, consequently, in greater shares of income attributable to the taxing State.[57] This omission could lead one to question the fairness of the formula under the due process clause. Indeed, Justice Stevens questioned the formula's fairness in dissent, arguing that taxpayer had not waived its due process objections to the application of the formula and that the State had overtaxed Mobil by failing to include the sales, payroll, and property values of the subsidiaries in the apportionment formula computations.[58] Thus, the Court left unresolved the question of whether the standard formula factors of the subsidiaries and affiliates paying *dividend* income to a taxed corporation in a unitary enterprise must be included in the apportionment formula.

54. *See id.* at 441-42.
55. *Id.* at 442.
56. *See supra* text accompanying note 45.
57. *See supra* note 25 and accompanying text.
58. *See* 445 U.S. at 461-62 (Stevens, J., dissenting). For other views that the apportionment factors in the formula should be adjusted by taking into account the property, payroll, and sales of the payor subsidiaries and affiliates, see Feinschreiber, *State Taxation of Foreign Dividends After* Mobil v. Vermont: *Adjusting the Apportionment Formula,* 6 INT'L TAX J. 267 (1980); Nackenson, *The Impact of* Mobil v. Vermont *on Interstate Taxation,* 6 INT'L TAX J. 323 (1980).

In addition to mounting the due process clause attack, the *Mobil* taxpayer also thought Vermont's tax constituted an impingement of the commerce clause, in that the tax impermissibly burdened both interstate and foreign commerce by exposing taxpayer's income to a substantial risk of multiple taxation.[59] Addressing the interstate commerce clause question first, the Court rejected taxpayer's efforts to establish a constitutional principle that a taxing state cannot include foreign source dividends in apportionable business income and that such income shall be attributed totally to the parent-payee's commercial domicile.[60] Since New York, the state of Mobil's commercial domicile, did not tax the dividends, taxpayer could not show *actual* multiple taxation among the states. To the Court the *risk* of multiple state taxation apparently was not enough. The Court commented that "there is nothing talismanic about the concepts of 'business situs' or 'commercial domicile' " that automatically makes those concepts constitutionally controlling in determining a single state that can tax income from intangibles.[61] The Court assumed that the state of commercial domicile does have a taxable grip on taxpayer's dividend income, but it saw no reason why that power should "be exclusive when the dividends reflect income from a unitary business, part of which is conducted" in states other than the state of commercial domicile.[62] In such a situation, the Court explained that the dividend income "bears relation to benefits and privileges conferred by several States."[63] When a business enterprise is unitary, the Court noted, apportionment is ordinarily the accepted method of dividing income from a multistate operation among the states.[64] In such circumstances, "separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale."[65] Since "these factors of profitability arise from the operation of the business as a whole, it becomes misleading," said the Court, "to characterize the income of the business as having a single indentifi-

59. 445 U.S. at 442.

60. For the reasons for allocating all dividends to the state of commercial domicile, see J. HELLERSTEIN, INTERSTATE TAXATION 547 (1983).

61. 445 U.S. at 445.

62. *Id.* at 445-46.

63. *Id.* at 446.

64. *Id.*

65. *Id.* at 438.

able 'source.' "[66]

In its impingement of foreign commerce challenge, taxpayer pressed the contention that because of the *risk* of multiple taxation abroad, allocation of foreign source dividend income to a single state is required at home.[67] Taxpayer relied on the rationale of *Japan Line, Ltd. v. County of Los Angeles*,[68] in which the Court upset a property tax that Los Angeles County levied on ocean-going, cargo-carrying vehicles of foreign commerce owned by a Japanese corporation domiciled in Japan and already subject to a Japanese property tax. The *Japan Line* Court used a two-pronged rationale in finding the tax on these instrumentalities of foreign commerce constitutionally impermissible. First, the Court concluded that it could not prevent duplicative taxation since it had no power over the taxing foreign jurisdiction of Japan. Second, the Court found the *Japan Line* tax impermissible because the tax prevented the federal government from speaking with one voice when dealing with foreign nations in commercial relations. The *Mobil* taxpayer urged that the Vermont tax violated both prongs of the *Japan Line* test.[69]

The *Mobil* Court did not find the *Japan Line* arguments persuasive, however, and it rejected the argument for a number of reasons. One principal reason, as the Court saw it, was that the *Mobil* taxpayer had attempted to focus attention on the effect of *foreign* taxation, when the effect of *domestic* taxation was the only real issue in *Mobil*.[70] The *Mobil* taxpayer had conceded, thought the Court, that states have taxing power over the foreign source income at issue when taxpayer claimed that the state of commercial domicile should be able to tax the foreign source dividends *in full*.[71] That concession, said the *Mobil* Court, meant that taxpayer "necessarily forgoes any contention that local duplication of foreign taxes is proscribed."[72] Furthermore, the Court pointed out that acceptance of taxpayer's argument, insisting on *total* allocation of its foreign source dividend income to the state of commer-

66. *Id.* To support this position, the Court relied on Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) (discussed *supra* notes 11-15 and accompanying text).

67. 445 U.S. at 446.

68. 441 U.S. 434 (1979).

69. For a fuller discussion of *Japan Line*, see P. HARTMAN, *supra* note 19, § 2:17; J. HELLERSTEIN, *supra* note 19, ¶ 4.10[2]. *See also infra* notes 257-94 and accompanying text.

70. 445 U.S. at 447.

71. *Id.*

72. *Id.*

cial domicile, would provide no guarantee of a lesser domestic tax burden on dividend income from foreign sources. By taxpayer's own argument and admission, total allocation would give the state of commercial domicile the power to tax the foreign source dividend income *in full*, without regard to the extent of taxation abroad.[73] In other words the Court felt that, under normal circumstances, income fairly apportioned among the states in which taxpayer conducted business would not necessarily be any more burdensome than a tax on the same income allocated in full to the state of commercial domicile.[74]

In sum, the *Mobil* Court rejected the *Japan Line* arguments because *Japan Line* concerned *actual* multiple taxation of *foreign* commerce, while *Mobil* concerned only the *potential* multiple taxation of commerce *among the states*. Further, as the *Mobil* opinion points out, *Japan Line* concerned a tax on *property* of a Japanese corporation conducting *foreign* commerce; in *Mobil*, the tax was on *income* of a United States corporation. To the *Mobil* Court this distinction seemed important,[75] as it did in the 1983 *Container* case.[76]

Less than three months after *Mobil*, the Court expanded and sharpened judicial thinking about the unitary business concept and tax apportionment in *Exxon Corp. v. Wisconsin Department of Revenue*.[77] Although the taxpayer in *Exxon* was a multinational corporation, that decision addressed taxation of multistate, rather than multinational, commerce. Taxpayer, organized under the laws of Delaware and with general offices located in Houston, Texas, was a vertically integrated petroleum company that performed only marketing operations in the taxing State of Wisconsin. Taxpayer's corporate structure consisted of three main functional departments—exploration and production, refining, and marketing—each operating independently of the others. Transfers among these independent functional departments were at "arms length" prices.[78] These three functional departments, however, operated under the supervision of a higher level of management.[79]

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73. *Id.*

74. *Id.* In *Mobil*, of course, allocation to the commercial domicile would have permitted taxpayer to escape all state taxation since the State of commercial domicile had no income tax that would apply to this income. *Id.* at 444.

75. *Id.* at 444-46.

76. 103 S. Ct. at 2952. *See infra* notes 281-99 and accompanying text.

77. 447 U.S. 207 (1980).

78. *See id.* at 212.

79. *See id.* at 224.

Taking the position that Exxon's petroleum operations constituted a unitary business, Wisconsin applied its three-factor (property, payroll, and sales) apportionment formula to taxpayer's total operating income.[80] Taxpayer reported *losses* from its activities in the taxing State, but had an overall profit from all of its operations.[81] Since taxpayer engaged in only marketing operations in the taxing State, it urged that these operations did not provide a sufficient nexus with the State to satisfy due process requirements. Consequently, taxpayer maintained, the taxing State lacked constitutional power to bring all three departments' corporate income within the tax base that was subject to formula apportionment, Specifically, taxpayer claimed that income from the out-of-state exploration and production departments should be geographically allocated entirely to the situs states. The inclusion of income from these operations, taxpayer argued, would violate the due process clause.

The *Exxon* Court turned back taxpayer's due process attack, finding that taxpayer's marketing operations in the taxing State constituted an integral part of one unitary business enterprise, and thus established a sufficient nexus to subject all of taxpayer's income to apportionment. In rejecting taxpayer's argument that separate functional accounting should be used to compute the income earned in the various states, the Court noted that such a method of attributing income fails to account for income arising from functional integration, centralization of management, and economies of scale.[82] While such accounting may be useful for internal auditing, said the Court, for tax purposes it is not required by the Constitution.[83]

Repeating from *Mobil* that the " 'linchpin of apportionability' " for state income taxation of an interstate enterprise is the " 'unitary-business principle,' "[84] the *Exxon* Court agreed with the State court that the Exxon enterprise constituted a unitary opera-

80. The taxing State did exclude from taxpayer's total income that income derived from the sale of crude oil and gas at the wellhead to third parties. *Id.* at 226 n.10.

81. In two earlier cases the Court found unitary operations and upheld application of apportionment formulae to taxpayers' total incomes, even though an individual *branch* of each business reported a loss. *See* Butler Bros. v. McColgan, 315 U.S. 501 (1942) (discussed *supra* notes 23-40 and accompanying texts); Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) (discussed *supra* notes 11-15 and accompanying text).

82. 447 U.S. at 222.

83. *Id.* at 222-23.

84. *Id.* at 223 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439-42). *See supra* note 43 and accompanying text.

tion. Taxpayer had not carried the burden of showing that its functional departments were "'discrete business enterprises,'"[85] whose incomes constitutionally lay beyond the reach of the apportionment statute. As the *Exxon* Court stressed, "While Exxon may treat its operational departments as independent profit centers, it is nonetheless true that this case involves a highly integrated business which benefits from an umbrella of centralized management and controlled interaction."[86] Among the considerations in the characterization of Exxon as a unitary enterprise was its central purchasing office in Houston, Texas, which purchased many of the items that taxpayer sold in the taxing State, and whose purpose was to increase overall profits by obtaining the benefit of bulk purchases and efficient allocation of supplies among dealers.[87] The Court riveted down the State's contention that Exxon's marketing activities in the taxing State constituted an integral part of its unitary business by quoting from the testimony of an Exxon official regarding "the important link among the three main operating departments":[88]

> "So, in the case of the petroleum industry . . . where you have high capital investments in refineries, the existence of an assured supply of raw materials and crude is important and the assured and stable outlet for products is important, and therefore . . . when these segments are under a single corporate entity, it provides for some assurance that the risk of disruptions in refining operations are minimized due to supply and demand imbalances that may occur from time to time."[89]

The *Exxon* taxpayer also had a commerce clause arrow in its quiver with which it undertook to shoot down the Wisconsin income tax. Taxpayer argued that the commerce clause, seemingly in order to prevent prohibited cumulative taxation, required that all income derived from its exploration and production department be allocated to the states where the production centers were located, and not be included in total net income for application of the apportionment formula. The Court disagreed.[90]

In sustaining the tax, the Court first measured the practical effect of the tax according to the four-pronged test formalized in *Complete Auto Transit, Inc. v. Brady*.[91] Applying the four guide-

85. 447 U.S. at 224 (quoting *Mobile*, 445 U.S. at 439).
86. *Id.*
87. *See id.*
88. *Id.*
89. *Id.* at 225 (quoting testimony in Appendix at 224-25).
90. *See id.* at 227-30.
91. 430 U.S. 274 (1977). That landmark case enunciated a four-pronged test for deter-

lines of that case, the *Exxon* Court concluded that the tax had a substantial nexus with the taxing State, was fairly apportioned, did not discriminate against interstate commerce, and was fairly related to the services provided by the taxing State.[92] The Court did not agree that the challenged taxing statute subjected taxpayer's interstate business to forbidden duplicative taxation by failing to allocate to the situs states all the income from exploration and production. Taxpayer had shown no *actual* multiple taxation, but only the *risk* of multiple tax burdens not borne by local business.[93] The *risk* of duplicative taxation was not a sufficient basis for striking down the tax on commerce clause grounds, concluded the Court.[94] Thus, the Court recognized that the situs states of taxpayer's production centers should be permitted to tax some, but not all, of the income derived from that production because the production centers were an integral part of a unitary business, part of which was conducted in other states that conferred benefits and protection on the business.[95]

III. *ASARCO* AND *Woolworth*

Prior to the appearance of *ASARCO, Inc. v. Idaho Tax Commission*[96] and *F.W. Woolworth Co. v. Taxation and Revenue Department*[97] on the judicial horizon, the states had been spectacularly successful in withstanding constitutional challenges to their efforts to impose income taxes on multistate and multinational enterprises by using formulary apportionment of corporate income. Relying on the premise that the "linchpin of apportionability" is the "unitary-business principle,"[98] the Court sustained the appor-

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mining valid taxation in interstate commerce. Under *Complete Auto Transit* no state tax concerning *interstate* operations will pass constitutional muster unless the tax satisfies each of the four parts of the test. The tax will fall unless it (1) is "applied to an activity with a substantial nexus with the taxing State"; (2) is "fairly apportioned"; (3) "does not discriminate against interstate commerce"; and (4) is "fairly related to the services provided by the [taxing] State." *Id.* at 279. For a fuller analysis of *Complete Auto Transit* by the author, see P. HARTMAN, *supra* note 19, § 2:17.

92. 447 U.S. at 228-30.

93. *See id.* at 228.

94. *See id.* at 228-29 & n.12.

95. *See id.* at 229. For further comments on *Exxon* by the author, see P. HARTMAN, *supra* note 19, §§ 9:28-:29. For other treatments of *Exxon*, see J. HELLERSTEIN, *supra* note 19, ¶ 8.11 [4][b]; Delap, *supra* note 42, at 203.

96. 458 U.S. 307 (1982).

97. 458 U.S. 354 (1982).

98. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 223 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439). *See supra notes* notes 43 & 84 and accompanying text.

tionment. The assailing taxpayers had met their Waterloo because not once, prior to *ASARCO* and *Woolworth*, had any of them carried the judicially imposed burden of proving that its multistate[99] or multinational[100] operation was a "discrete business enterprise"[101] and not a unitary business. Furthermore, more than a half century had passed since the Court had struck down a tax because the apportionment formula attributed to the taxing state income "out of all appropriate proportion to the business transacted by [taxpayer] in that State."[102]

In *ASARCO* and *Woolworth* the states received a major setback in their efforts to tax corporate income from multinational operations. The taxpayers in *ASARCO* and *Woolworth* took the position that, unlike the taxpayers in *Mobil*[103] and *Exxon*,[104] they had proven that their multijurisdictional enterprises were not a part of a unitary business, but instead were "discrete business enterprises." The Supreme Court agreed. Applying the unitary business principle the Court found that, for corporate income tax apportionment purposes, neither of the nondomiciliary corporations doing business in the taxing States conducted a unitary business with its out-of-state subsidiaries and affiliates. Consequently, the Court held in each case that the taxing State's inclusion within the apportionable tax base of certain income[105] from taxpayer's subsidiaries and affiliates violated the due process clause because the business activities of the income payors (subsidiaries and affiliates) were not sufficiently connected to the activities of the income recipient to constitute a unitary business. The Court thus converted the unitary business principle into a due process limitation on state taxing power.[106] Since the Court found no unitary business relationship in either *ASARCO* or *Woolworth*, it did not reach the controversial issue of the fairness of the apportionment formula.

ASARCO and *Woolworth* are noteworthy for two principal reasons. First, in those cases a taxpayer succeeded for the first

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99. *See Exxon*, 447 U.S. at 219; Moorman Mfg. Co. v. Bair, 437 U.S. 267, 269 (1978); Butler Bros. v. McColgan, 315 U.S. 501, 504 (1942).

100. *See* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439; Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 278 (1924).

101. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439.

102. Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931).

103. 445 U.S. 425 (1980).

104. 447 U.S. 207 (1980).

105. The income in question was from dividends, interest, and capital gains from the sale of stock. *ASARCO*, 458 U.S. at 328-30; *F.W. Woolworth*, 458 U.S. at 359.

106. *See The Supreme Court, 1981 Term*, 96 HARV. L. REV. 62, 87 (1982).

time in putting into the record *proof* sufficient to satisfy the Court that, for the purpose of corporate income taxation, taxpayer's multijurisdictional operations actually comprised discrete business enterprises. Second, one of the most significant aspects of these two cases is the Court's rejection on due process grounds of the virtually all-inclusive scope of the taxing states' concept of a unitary business. Because the taxing states in both cases had adopted the unitary concept in the Uniform Division of Income for Tax Purposes Act (UDITPA),[107] which is embodied in the Multistate Tax Compact,[108] the Court in effect declared the provisions of UDITPA pertaining to the unitary business principle unconstitutional as applied in those cases.

A. ASARCO

At issue in *ASARCO* was the constitutionality of Idaho's corporate income taxes levied on income that a nondomiciliary corporation received from five foreign-based corporations in which the corporation owned major interests. Taxpayer, incorporated in New Jersey and commercially domiciled in New York, engaged in the mining, smelting, and refining of nonferrous metals, such as copper, gold, silver, lead, and zinc, in a number of states. ASARCO received three types of intangible income—dividends, interest, and capital gains—from its five foreign-based subsidiaries,[109] none of which conducted any business within the taxing State. Using its version of UDITPA, Idaho apportioned "business"[110] income according to the three-factor formula of properly, payroll, and sales. In computing its tax on ASARCO's net income, the taxing State

107. 7A U.L.A. 93 (1978) [hereinafter cited as UDITPA].

108. *See* Multistate Tax Compact, art. IV, § 1(b), *reprinted in* 1 ST. & LOC. TAX. SERV., All States Unit (P-H) ¶¶ 6310, 6315.10 (1975). The adoption by Idaho, the taxing State in *ASARCO*, appears in IDAHO CODE §§ 63-3027-3701 (1976 & Supp. 1982). The adoption by New Mexico, the taxing State in *Woolworth*, is found in N.M. STAT. ANN. §§ 7-4-1 to -21 (1983).

109. Taxpayer owned about 53% of the stock of M.I.M. Holding, Ltd.; 34% of the stock of hoth General Cable and Revere Copper and Brass, Inc.; 49% of the stock of ASARCO Mexicana, S.A.; and 51.5% of the stock of Southern Peru Copper Corp. 458 U.S. at 309 n.2. The auditor of ASARCO's tax returns treated ASARCO and its six wholly owned subsidiaries as unitary and required a combined report with the parent. The treatment of these six subsidiaries was not an issue before the Supreme Court. *Id.* at 312.

110. Under its version of UDITPA, Idaho classified corporate income from intangible property as either "business" or "nonbusiness" income. "Business" income included income from intangible property when " 'acquisition, management, or disposition [of the property] constitute[s] integral or necessary parts of the taxpayers' trade or business operations.' " *Id.* at 310 (quoting IDAHO CODE § 63-3027 (1976 & Supp. 1981) (footnote omitted).

included this intangible income in ASARCO's tax base. ASARCO's challenge of the Idaho tax relied on two main due process and commerce clause arguments. Its threshold argument was that the taxing State could not include the dividends, interest, and capital gains in its taxable income because this income was not derived from a "unitary business." The activities of the five payors outside the taxing State, ASARCO claimed, were not functionally integrated with the activities of the taxpayer-recipient within the taxing state.[111] Taxpayer's alternative argument was that if the Court should find a unitary operation, then the tax still would contravene the due process and commerce clauses unless Idaho adjusted the regular apportionment formula to reflect the out-of-state property, payroll, and sales of the out-of-state subsidiaries and affiliates that generated the income.[112] The Court never reached this second argument since it found that no unitary operation existed. Hence, the state could not include dividend income from the foreign-based subsidiaries in taxpayer's tax base.

According to the rationale of earlier cases,[113] the existence of a unitary business relationship between ASARCO and the five subsidiaries and affiliates was an essential prerequisite to Idaho's taxation of this foreigu source income. Idaho agreed that the intangible income payors "were not engaged in a single unitary business with ASARCO."[114] Instead, to justify its taxation of this income, Idaho urged the Court to expand the concept of unitary business; the taxing State proposed that corporate purpose should define the unitary business principle.[115] Using its modified version of UDITPA, Idaho maintained that the intangible income in question should be treated as income from a unitary business simply because the intangible property was " 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.' "[116] In its oral argument Idaho urged that income from intangible property be considered part of a unitary business when the intangibles "contribute or relate to or are in some way in fur-

111. Brief for Appellant at 8-9, ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).

112. Brief for Appellant, *supra* note 111, at 9.

113. *See supra* notes 11-95 and accompanying text.

114. Brief for Appellee at 29, ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).

115. 458 U.S. at 325-26.

116. 458 U.S. at 326 (quoting Brief for Appellee, *supra* note 114, at 4); *see supra* note 110.

therance of the taxpayer's own trade or business."[117] Since the business use of the foreign source dividends constituted part of ASARCO's *own* unitary business of mining, smelting, and refining minerals, Idaho argued, the minimal connection to satisfy due process requirements was present.[118] Consequently, the taxing State concluded that it should treat this income the same as any other business income and, thus, could apportion the income among those states in which ASARCO conducted its unitary business.[119]

In reversing the Idaho Supreme Court's decision upholding the tax on ASARCO, the Court flatly rejected the taxing State's argument that the concept of a unitary business—with its concomitant doctrine of apportionability of income from intangible property—is applicable when the intangibles are simply " 'acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business.' "[120] The Court refused to accept Idaho's position that the use of an intangible asset in ASARCO's *own* unitary business was sufficient to make income from that asset apportionable to the taxpayer; in the Court's eyes, the taxing State's "definition of unitary business would destroy the concept" of unitary business as the Court had developed it.[121] The Court observed that "*all* of [ASARCO's] operations, including any investment made, in some sense can be said to be 'for purposes related to or contributing to the [corporation's] business.' "[122] "When pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all," thought the *ASARCO* Court.[123] To be sure, said the Court, "it is plain that the five dividend-paying subsidiaries 'add to the riches' of ASARCO. But it is also true that they are 'discrete business enterprise[s]' that—in 'any business or economic sense'— have 'nothing to do with the activities' of ASARCO in Idaho."[124] The Court instead took the position that the existence of a unitary business turns upon the relationship between the business of the payor of the income (the five subsidiaries and affiliates) and the recipient of the income (ASARCO).[125]

117. Transcript of Oral Argument of Appellee at 25, ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).

118. Brief for Appellee, *supra* note 114, at 4 (emphasis added).

119. *Id.* at 29.

120. 458 U.S. at 326 (quoting Brief for Appellee, *supra* note 114, at 4).

121. *Id.* at 326.

122. *Id.* (quoting Brief for Appellee, *supra* note 114, at 4).

123. *Id.* at 326.

124. *Id.* at 328 (quoting *Mobil,* 445 U.S. at 439-42).

125. For a succinct, clear-cut summary of the Court's position, see Hanson, ASARCO

The *ASARCO* Court purported to follow the principles articulated in *Mobil* and *Exxon* in deciding whether the State could include the disputed income at issue in ASARCO's taxable income for apportionment purposes.[126] The Court agreed that ASARCO had succeeded, where the taxpayers in *Mobil* and *Exxon* had failed, in its efforts to prove that the dividend payors were not part of a unitary business, but instead were "discrete business enterprises."[127] Thus, a significant aspect of *ASARCO* is the Court's conclusion that ASARCO—unlike the taxpayers in *Mobil* and *Exxon*—had placed in the record sufficient actual proof to convince the Court that ASARCO and its subsidiaries were not a unitary business for tax purposes. Also significant was the *ASARCO* Court's almost tötal reliance on findings of fact, principally by the trial court, to determine that a unitary business did not exist between ASARCO and its dividend-paying subsidiaries.

In finding no unitary business, the Court focused on two criteria—functional integration and management control. The main emphasis in the Court's opinion, however, seems to be on management control by ASARCO, rather than on functional integration between ASARCO and its five subsidiaries and affiliates. The *ASARCO* opinion appears to make the absence of *active* managerial control a key reason for the finding of no unitary business;[128] the *potential* ability to control and operate a company was not dispositive of the unitary issue, in the Court's view. The discussion of ASARCO's relationship with its subsidiary, Southern Peru[129]—which the Court thought presented the closest question of a unitary business[130]—illustrates the Court's emphasis on active managerial control. ASARCO, one of four shareholders of Southern Peru, owned 51.5% of its stock. The four shareholders bought 70-80% of Southern Peru's copper output, with about 35% of that output going to ASARCO under a long-term contract at published market prices, over which ASARCO had no control.[131] Approxi-

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and Woolworth—*Refining* Mobil *and the "Unitary Business" Test for Apportioning Intangible Income*, 1 J. STATE TAX'N 197, 201-04 (1982).

126. *See* Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 223; Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439. As discussed above, those cases enunciated the doctrine that the "linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Id. See supra* notes 43 & 84 and accompanying text.

127. 458 U.S. at 328.

128. *Id.* at 322-24.

129. *Id.* at 320-22.

130. *Id.* at 320.

131. *Id.* at 320-21.

mately 30% of Southern Peru's copper production went to European customers through Southern Peru Copper Sales Corporation, in which ASARCO owned 51.5% of the stock.[132] The entire staff of the Sales Corporation consisted of ASARCO employees, whom ASARCO reimbursed for sales services on a commission basis.[133]

If ASARCO had asserted its majority interest in Southern Peru, of course it could have controlled the management of that subsidiary. ASARCO, however, had entered into a management agreement, which the Court thought effectively insured that ASARCO would be unable to exercise actual control over the subsidiary. Under this agreement ASARCO had the power to name only six of the thirteen members on the board of directors of Southern Peru. Under Southern Peru's bylaws, however, eight votes were necessary to pass any resolution. Additionally, any change in Southern Peru's bylaws required a *unanimous* vote of all four shareholders.[134] To be sure, ASARCO could not directly *compel* affirmative action by Southern Peru, but ASARCO's power over Southern Peru, as Justice O'Connor pointedly observed in her vigorous dissent, "gave it unilateral veto power over all corporate decisions, including those supported unanimously by all other shareholders."[135] Thus, ASARCO's six members of the thirteen member board could stymie completely any affirmative board action, since eight votes were necessary to take action.

Because ASARCO had the power to *veto* all corporate business decisions, and because it had a stranglehold on 35% of Southern Peru's copper output, perhaps it was not necessary that ASARCO be in a position to exercise its power so openly, formally, and affirmatively in order to make that power felt or to have its wishes pursued. Nevertheless, to the Court, "control potential to manage" was not enough control to constitute a unitary business.[136] That the Court may not have given enough weight to ASARCO's negative control over Southern Peru might plausibly and realistically be argued. The *ASARCO* Court relied on conclusory, self-serving opinions by ASARCO officials that ASARCO did not "control Southern Peru in any sense of that term," and that Southern Peru did not "seek direction or approval from

132. *Id.* at 321 n.16.
133. *Id.*
134. *Id.* at 322.
135. *Id.* at 340 (O'Connor, J., dissenting) (footnote omitted).
136. 458 U.S. at 322.

ASARCO on major decisions."[137] Idaho did not dispute any of these facts, according to the Court.[138] The Court concluded, "In view of the findings and the undisputed facts, . . . ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business."[139]

The *ASARCO* Court professed to have been unable to find sufficient functional integration to warrant finding a unitary operation, since the "continuous flow and interchange of common products" that existed in *Exxon* and *Mobil* were absent.[140] As Justice O'Connor emphasized in dissent, however, ASARCO's control of Southern Peru "evidently helped to assure ASARCO of supplies of unrefined copper, since 35% of the entire copper output of Southern Peru was sold to ASARCO."[141] Additionally, ASARCO's 51.5% interest in Southern Peru Copper Sales Corporation, which sold approximately 30% of Southern Peru's copper supply to European customers,[142] assured ASARCO of a "continuous" supply of Southern Peru's output of refined copper and gave ASARCO power to control the sale of a substantial additional amount of Southern Peru's copper output. The Court previously had noted the importance of assured supplies and markets in *Exxon*; in finding a unitary operation, the *Exxon* Court pointed out that taxpaying business executives have recognized that assured and stable supplies and markets minimize risks of disruption of operations caused by " 'supply and demand imbalances that may occur from time to time.' "[143] Doubtless, such assurances of supplies and markets not infrequently are the reasons for these investments. Given that ASARCO and Southern Peru were in the same business, is it beyond the pale of reasonableness to suggest that ASARCO's grip on 35% of Southern Peru's copper output, when coupled with its absolute negative control over Southern Peru, could *assure* ASARCO of "stable supplies" of unrefined copper and, thus, could minimize risks of disruption caused by periodic imbalances of supply and demand? Justice O'Connor, dissenting, found this "assured sup-

137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.* at 329-30 n.24.
141. *Id.* at 343 (O'Connor, J., dissenting) (footnote omitted).
142. 458 U.S. at 321 n.16.
143. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 225 (quoting testimony in Appendix at 224-25).

plies" aspect of the case a cogent reason for deciding that ASARCO and Southern Peru did constitute a unitary operation.[144] Moreover, as the dissent properly pointed out, the burden rested on the *taxpayer* (ASARCO) to show that its holdings in the subsidiaries were not part of a unitary business enterprise.[145]

B. Woolworth

The Court heard *F.W. Woolworth Co. v. Taxation & Revenue Department*[146] in tandem with *ASARCO.* Like Idaho in *ASARCO,* New Mexico, the taxing State in *Woolworth,* had adopted a version of UDITPA[147] and had joined the Multistate Tax Compact.[148] Under the New Mexico version of UDITPA, "business" income was apportioned, as in *ASARCO,* using the three-factor formula of property, payroll, and sales.[149] Much like the statute in Idaho,[150] under the New Mexico statute apportionable "business" income included income from both tangible and intangible property "if the acquisition, management and disposition of the property constitute[d] integral parts of the taxpayer's regular trade or business operations."[151]

The *Woolworth* taxpayer, with principal place of business and commercial domicile in New York, engaged in retail business through chain stores in the United States and elsewhere. Additionally, Woolworth had four subsidiaries in several foreigu countries;

144. 458 U.S. at 343 (O'Connor, J., dissenting).

145. 458 U.S. at 334-35 (O'Connor, J., dissenting); *see, e.g.,* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439-40. For a lengthy, incisive, and sbarply critical analysis of *ASARCO,* see Floyd, *The "Unitary" Business in State Taxation: Confusion at the Supreme Court?,* 1982 B.Y.U. L. Rev. 465, 486-87 (asserting tbat because of ASARCO's negative control over and substantial supply relationship with Southern Peru, the Court was wrong in not finding a unitary relationship between ASARCO and Southern Peru). For further comment on *ASARCO* and *Woolworth* by the author, see P. Hartman, *supra* note 19, § 9:30 (Supp. 1983). For additional textual comments on *ASARCO* and *Woolworth,* see J. Hellerstein, *supra* note 19, ¶ 8.11[4][a], [c], [d], [e]. For legal periodical comments on *ASARCO* and *Woolworth,* see Delap, *supra* note 42, at 206; Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on* ASARCO *and* Woolwortb, 81 Mich. L. Rev. 157 (1982); Seago, *The Revitalization of the Unitary Business Principle—*ASARCO *and* Woolworth, 1 J. State Tax'n 101, 112 (1982); *The Supreme Court, 1981 Term, supra* note 106, at 86-96.

146. 458 U.S. 354 (1982).

147. N.M. Stat. Ann. §§ 7-4-1 to -21 (1982).

148. *Id.* §§ 7-5-1 to -7.

149. *Id.* § 7-4-10. *See* 458 U.S. at 357 n.3. For an explanation of the three-factor formula, see *supra* note 25.

150. *See supra* note 110.

151. N.M. Stat. Ann. § 7-4-2(A) (1981). *See* 458 U.S. at 357 n.2.

they, too, engaged in chain store retailing in those countries. None of the four conducted any business in the taxing State. Three of these subsidiaries were wholly owned, and in the fourth Woolworth owned a 52.7% interest. Because it operated stores in the taxing State of New Mexico, Woolworth was subject to that State's corporate income tax. In imposing its apportioned income tax on Woolworth, New Mexico had included in Woolworth's apportionable income the dividends that taxpayer had received from its four foreign subsidiaries doing business abroad under the Woolworth name.[152] In *Woolworth* the broad issue was the same as in *ASARCO*: whether New Mexico, consistent with the due process clause, had the power to tax as business income the dividend income from these foreign subsidiaries. The *Woolworth* taxpayer argued that the due process clause precluded New Mexico from including the foreign source dividends in Woolworth's apportionable business income. Alternatively, Woolworth argued—as did the *ASARCO* taxpayer—that if the dividends could be included, then the State must adjust the apportionment formula to reflect a pro rata portion of the property, payroll, and sales of the foreign subsidiaries paying the dividends. The Court never reached this second argument in *ASARCO* or *Woolworth.*

Reversing the New Mexico Supreme Court decision that upheld the tax, the United States Supreme Court held that the inclusion of the dividends from the four foreign subsidiaries in Woolworth's apportionable income contravened the due process clause. The *Woolworth* Court noted that after the State supreme court had identified the existence of a unitary business relationship as the "key question," that court had "proceeded to resolve this question largely by emphasizing the potentials of the relationship between Woolworth and its subsidiaries."[153] In essence, the

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152. Also included in Woolworth's taxable income was a sum known as "gross up," which is a figure that the federal government "deemed" Woolworth to have received for purposes of a foreign tax credit on its federal income tax calculation, but which Woolworth never actually received. 458 U.S. at 358. The same due process clause constraints that prevented New Mexico from taxing the foreign source dividends also prevented it from taxing the "gross up." *Id.* at 372-73.

153. 458 U.S. at 363. The New Mexico Supreme Court had quoted a United States Supreme Court case that upheld a federal excise tax on corporate income:

> The possession of large assets by subsidiaries is a business advantage of great value to the parent; "it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige."

Taxation and Revenue Dep't v. F.W. Woolworth Co., 95 N.M. 519, 529, 624 P.2d 28, 38

State court's rationale for dividend apportionment had been that the mere possession of large assets—Woolworth's holdings in the stock of the subsidiaries—might enhance Woolworth's credit standing and its purchasing power, thus enabling Woolworth to enlarge its operations and to acquire standing and prestige for its business. The *Woolworth* Court, however, rejected this reasoning and held that no unitary operation existed between Woolworth and its foreign subsidiaries. The Court felt that "[t]he state court's reasoning would trivialize this due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation.' "[154] Income from any source, the Court noted, is always a "business advantage" to a corporation.[155] That the nondomiciliary parent, Woolworth, derived some economic benefit from its ownership of stock was not enough. Consistent with its prior cases, the Court concluded that the proper due process inquiry looks to " 'the underlying unity or diversity of business enterprise.' "[156]

The Court in *Woolworth* nailed down the proposition that even complete ownership by a parent of a subsidiary is not enough to constitute a unitary enterprise. Woolworth, of course, had the *potential* power to operate the subsidiaries as integrated divisions of a single unitary business enterprise under Woolworth's "umbrella of centralized management and controlled interaction."[157] Owning a controlling interest in each of the subsidiaries, Woolworth could have elected all of the directors in three of the subsidiaries and a majority in the other one. The Court noted that in *ASARCO* it had declared that the *potential* to operate a company was not dispositive of the unitary business issue. Repeating traditional doctrine, the *Woolworth* Court observed that for a corporation to avoid dividend apportionment, the dividend income from its subsidiaries must be derived from " 'unrelated business activity' " that constitutes a " 'discrete business enterprise.' "[158] The Court relied on *Mobil* in emphasizing that the right of a state to tax dividends from foreign subsidiaries turns on whether the

(1981) (quoting Flint v. Stone Tracy Co., 220 U.S. 107, 166 (1911)).

The *Woolworth* Court pointed out that the State supreme court had relied erroneously on *Flint*, however, because the States are subject to limitations on their taxing powers that do not apply to the federal government. 458 U.S. at 363.

154. 458 U.S. at 363 (quoting Wallace v. Hines, 253 U.S. 66, 70 (1920)).

155. 458 U.S. at 363.

156. *Id.* (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 440).

157. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 224.

158. 458 U.S. at 362 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 223-24 (quoting *Mobil*, 445 U.S. at 439-42)).

dividend income results from certain factors of profitability—" 'functional integration, centralization of management, and economies of scale.' "[159] Thus, the *Woolworth* Court established these three "factors of profitability" as the polestar by which to steer in deciding whether a unitary business exists.

In its analysis of Woolworth's relationship with the four dividend-paying subsidiaries, the Court decided the "unitariness" issue by reference to actual record evidence bearing on the existence of the *Mobil* benchmarks of "functional integration, centralization of management, and economies of scale."[160] The Court first found little functional integration between Woolworth and its foreign subsidiaries.[161] Woolworth and its subsidiaries "engaged exclusively in the business of retailing,"[162] and the Court drew a sharp distinction between the retailing business and the "highly integrated business" of locating, processing, and marketing petroleum—one which the Court found to constitute a unitary business in *Exxon*.[163] In the *Woolworth* Court's opinion, the "evidence in [*Woolworth*] is that *no* phase of any subsidiary's business was integrated with the parent's."[164] To underpin this conclusion, the Court made a laundry list of business characteristics to show that no such integration existed. The Court was satisfied from the undisputed testimony that the subsidiaries were autonomous and independent of Woolworth in selection of store sites and in control over advertising; furthermore, each subsidiary had its own accounting department, financial staff, and legal counsel.[165] No doubt significant to the Court, Woolworth engaged in "no centralized purchasing, manufacturing, or warehousing of merchandise."[166] Seemingly, no intercompany sales of inventory took place.[167] Apparently of major importance to the Court, "each subsidiary was responsible for obtaining its own financing from sources other than [Woolworth]."[168] After weighing all of the relevant business char-

159. 458 U.S. at 364 (quoting *Mobil*, 445 U.S. at 438). "If such 'factors of profitablity' arising 'from the operation of the business as a whole' exist and evidence the operation of a unitary business," the Court continued, then "a State can gain a justification for its tax consideration of value that has no other connection with that State." *Id.*

160. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 438.

161. 458 U.S. at 364.

162. *Id.*

163. *Id.*

164. *Id.* at 365 (emphasis in original).

165. *Id.* at 365.

166. *Id.* (footnote omitted).

167. *Id.* at 365 & n.13.

168. *Id.* at 366 (footnote omitted). This factor later proved significant in *Container*:

acteristics, the Court concluded that the "record is persusasive that Woolworth's operations were not functionally integrated with its subsidiaries."[169]

Having concluded that the taxing State failed the litmus test of "functional integration," the Court directed its attention to the other two *Mobil* unitary business "factors of profitability"—"centralization of management" and "economies of scale."[170] The Court listed a number of characteristics that it thought showed the absence of "centralization of management" and other "economies of scale." Woolworth had no department devoted to overseeing the foreign subsidiaries' operations. With one exception, Woolworth and the subsidiaries had separate officers; Woolworth did not rotate or train personnel to operate the subsidiaries; Woolworth maintained no central merchandising training; the subsidiaries developed their own managers; each subsidiary possessed autonomy to determine its own retailing policies, based on local needs; and Woolworth did not review the tax returns of its subsidiaries.[171] Particularly significant was the absence of a centralized purchasing office, whose purpose would have been to " 'increase overall corporate profits through bulk purchases and efficient allocation of supplies among' " the subsidiaries.[172]

On the other hand, some aspects of Woolworth's operations were earmarks of unitariness. The upper echelons of management of Woolworth and its subsidiaries frequently communicated by mail, telephone, and teletype. Woolworth and some of the subsidiaries had a number of common directors. Decisions about major financial issues—for example, the amount of dividends to be paid by the subsidiaries and the creation of substantial debt—required approval by Woolworth, the parent. Additionally, Woolworth and its subsidiaries prepared and published consolidated financial statements.[173] Justice O'Connor, joined by Justices Blackmun and Rehnquist, dissented[174] relying on these indicators of a unitary operation. The *Woolworth* majority, however, thought that these

loans made by the taxpayer-parent (Container) to its subsidiaries, and guarantees of loans made by local lenders to the subsidiaries, suggested to the Court a flow of *value* between subsidiary and parent that indicated unitariness. *See* Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933, 2944. *See infra* notes 220-22 and accompanying text.

169. 458 U.S. at 366.

170. *Id.*

171. *Id.* at 367-68.

172. *Id.* at 370 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 224).

173. *Id.* at 369.

174. *Id.* at 373 (O'Conner, J., dissenting).

functions were part of the normal oversight activities that any parent gives to an investment in a subsidiary.[175] To the Court, "the parent company's operations are not interrelated with those of its subsidiaries so that one's 'stable' operation is important to the other's 'full utilization' of capacity."[176] Moreover, the *Woolworth* Court found a "notable absence of any 'umbrella of centralized management and controlled interaction'" among the parent (Woolworth) and the four foreign subsidiaries.[177] After weighing all the factors pertaining to unitariness, the Court concluded "on the basis of undisputed facts, that the four subsidiaries in question are not part of a unitary business under the principles articulated in *Mobil* and *Exxon*, and today reiterated in *ASARCO*."[178]

IV. THE *Container* DECISION

In *Container Corp. of America v. Franchise Tax Board*,[179] the Supreme Court of the United States sustained the constitutionality of California's application of the unitary business principle to the worldwide income of a United States based parent corporation and its foreign subsidiaries. The Court decided that a state may require an American parent corporation doing business in that state to combine all its own income with the income that its sub-

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175. 458 U.S. at 369. For a succinct analysis of *ASARCO* and *Woolworth*, setting forth the business factors that the Court used to resolve the unitary husiness issue, see Seago, *supra* note 145, at 112.

In two earlier cases in which the Court did find a unitary operation, it relied heavily on the economies resulting from a central buying division. *See* Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 224 (discussed *supra* notes 77-95 and accompanying text); Butler Bros. v. McColgan, 315 U.S. at 508 ("[T]he operation of the central buying division alone demonstrates that functionally the various branches are closely integrated.") (discussed *supra* notes 23-41 and accompanying text).

176. 458 U.S. at 370 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 218).

177. 458 U.S. at 372 (quoting *Exxon*, 447 U.S. at 224).

178. *Id.* at 369. For scholarly comments on *ASARCO* and *Woolworth* by an authority who writes quite extensively in tbe area of state and local taxation, see J. HELLERSTEIN, *supra* note 19, ¶ 8.11[4][a]-[h].

Some commentators have argued that *ASARCO* and *Woolworth* do not dictate that the unitary business principle should be the exclusive test for state taxation of all dividends that a taxed corporation receives, especially when the circumstances do not fit the *ASARCO* and *Woolworth* unitary business principle mold. For the author's views, see P. HARTMAN, *supra* note 19, § 9:30 (Supp. 1983). For additional comments, see J. HELLERSTEIN, *supra* note 19, ¶ 9.12[2]; Floyd, *supra* note 145, at 505; Hellerstein, *Reflections on* ASARCO *and* Woolworth, *supra* note 145, at 179; Pomp & Rudnick, *Federal Tax Concepts as a Guide for State Apportionment of Dividends: Life After* ASARCO, 17 TAX NOTES 411 (1982).

179. 103 S. Ct. 2933 (1983). The author also has discussed *Container* in P. HARTMAN, *supra* note 19, § 9:31 (Supp. 1984).

sidiaries operating in foreign countries generate, and then to apportion a certain percentage of that combined amount for state income tax purposes.

The taxpayer in *Container*, a Delaware corporation headquartered in Illinois and doing business in California and elsewhere, manufactured and distributed custom-ordered paperboard and paperboard-based packaging in the United States. Taxpayer conducted a vertically integrated operation, which included the production of paperboard from raw timber and wastepaper and its composition into finished products.[180] Although its operation was largely domestic, during the tax years in question taxpayer owned controlling interests in twenty foreign corporations organized and located in four Latin American countries and four European countries. Taxpayer's percentage of ownership of these foreign corporations ranged between 66.7% and 100%.[181] By and large, these foreign subsidiaries engaged in essentially the same line of business as the taxpayer-parent, although none of the subsidiaries conducted any business in the taxing State.[182]

Like a number of other states, California employed the unitary business principle and formula apportionment method of taxing corporations doing business both inside and outside the State.[183] The taxing State's apportionment formula was the common three-factor Massachusetts formula, based in equal parts on the proportion of a unitary business' total payroll, property, and sales located in the taxing state.[184] Over taxpayer's objections the taxing State treated the overseas subsidiaries as part of taxpayer's unitary business and required taxpayer to file a worldwide combined report of its own income and the incomes of all its subsidiaries.[185] The California State courts sustained the tax.

In its appeal to the Supreme Court of the United States, the objecting taxpayer (Container) claimed that the application of the State taxing scheme violated both the due process and the commerce clauses of the United States Constitution. The Court, however, upheld the tax as applied. In disposing of the *Container* con-

180. 103 S. Ct. at 2943.

181. *Id.* Container formed many of its own subsidiaries, but also acquired a few companies. Brief for Appellee at 7, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983).

182. 103 S. Ct. at 2943.

183. CAL. REV. & TAX. CODE §§ 25104, 25105 (West 1979) (noted in 103 S. Ct. at 2942 & n.5).

184. *See supra* note 25.

185. 103 S. Ct. at 2945.

troversy, the Court resolved the following principal issues, which this Article will examine seriatim:

A. Did Container Corporation and its foreign subsidiaries constitute a "unitary business" for purposes of state taxation, as required by the due process clause?
B. Did the taxing State's worldwide unitary method, through distortion of income attributable to the State by the formula, impose a tax on income earned outside the State, in violation of the due process and commerce clauses?
C. Did the taxing State's worldwide unitary method produce duplicative taxation of income or impair the foreign policy of the United States, in violation of the commerce clause?[186]

A. *Unitary Business*

The *Container* Court first addressed the issue of whether taxpayer and its foreign subsidiaries constituted a unitary business operation for tax purposes, as the due process clause requires.[187] Since the existence of a unitary operation is "the linchpin of apportionability,"[188] as a matter of due process a state, through the application of its apportionment formula, must not reach its tax talons beyond the boundaries of the "unitary business" enterprise. The Court has established clearly that when "the business activities of the [foreign subsidiaries and affiliates producing the dividend income] have nothing to do with the activities of the recipient [of that income] in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business."[189]

In addressing the unitary business issue, the Court began by noting that "the taxpayer always has the 'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed.' "[190] Ostensibly to reduce future challenges to state income tax systems by multijurisdictional cor-

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186. *See id.* at 2939.

187. *Id.* at 2945-48.

188. *See* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 439. As mentioned above, the Court subsequently quoted this language in Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 223; ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. at 317; and F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 362.

189. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 442. The absence of a "unitary business" actually precluded apportionment in F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), and in ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. at 307. *See supra* notes 96-178 and accompanying text.

190. 103 S. Ct. at 2945 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 221 (quoting Butler Bros. v. McColgan, 315 U.S. at 507 (quoting Norfolk & W. Ry. Co. v. North Carolina *ex rel.* Maxwell, 297 U.S. 682, 688 (1936)))).

porations, in *Container* the Court for the first time announced that it would defer to state court determinations about the existence of a unitary enterprise whenever "reasonably possible."[191] The Court assigned itself a two-fold task: "to determine whether the state court *applied the correct standards* to the case; and if it did, whether its judgment 'was *within the realm of permissible judgment.*' "[192]

After examining a number of findings by the California State court, the *Container* Court deemed the State court's decision that Container and its subsidiaries composed a unitary operation "within the realm of permissible judgment."[193] The Court first considered taxpayer's contention that the State court had employed an improper legal standard in reaching its conclusion. Taxpayer argued that the State court had treated the taxpayer's "potential" to control the operation of its subsidiaries as a dispositive factor in finding that a unitary business existed.[194] In *Woolworth*,[195] taxpayer argued, the Court had declared that taxpayer's *potential* power to control its subsidiaries was insufficient to warrant the finding of a unitary business; under *Woolworth* the control must be *actual*. The *Container* Court was not convinced by taxpayer's argument, however, and concluded that the State court properly relied on its finding that high officials of Container " 'gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practices.' "[196]

Next, the Court dismissed Container's argument that the State court had committed error in endorsing a State administra-

191. "It will do the cause of legal certainty little good if this Court turns every colorable claim that a state court erred in a particular application of those principles into a de novo adjudication, whose unintended nuances would then spawn further litigation and an avalanche of critical comment." 103 S. Ct. at 2946 (footnote omitted).

192. *Id.* at 2946 (emphasis added) (footnote omitted).

193. *Id.* at 2948. This deference to state court findings on the unitary business issue marks a shift in the Court's approach. In ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. at 307, the Court, relying on factual findings made by the State court, reversed the State court's conclusion that a unitary business operation existed. Also, in F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 354, the Court examined the evidence and reversed the State court's unitary business finding after concluding that the State court applied an improper legal standard in reaching its decision. *See supra* notes 109-78 and accompanying text.

194. 103 S. Ct. at 2947.

195. *See supra* notes 146-78 and accompanying text.

196. 103 S. Ct. at 2946 (quoting Container Corp. of Am. v. Franchise Tax Bd., 117 Cal. App. 3d 988, 998, 173 Cal. Reptr. 121, 127-28 (1981)). The Court explained that although potential control was not "dispositive" of the unitary business issue, it was, nonetheless, "relevant" to that question. 103 S. Ct. at 2946 n.16.

tive presumption that corporations engaged in the *same* line of business are unitary.[197] While agreeing that the presumption did enter into the State court's reasoning, the Court was of the opinion that the presumption was only one element among many that the State court had considered. Moreover, the Court proceeded to explain that the presumption was reasonable.

> When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use—either through economies of scale or through operational integration or sharing of expertise—of the parent's existing business-related resources.[198]

In wrapping up its analysis of whether the State courts had applied a proper standard, the Court examined Container's proposal that the Court adopt a "bright-line" rule requiring "a substantial flow of goods" between the corporations as a prerequisite to finding that a mercantile or manufacturing enterprise is unitary.[199] The adoption of a "substantial flow of goods" test would add much-needed certainty to this area, argued Container, and purportedly would reflect the reason for the development of formulary apportionment.[200] The Court, however, declined to adopt this test, specifically noting that "[t]he prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods."[201] The Court conceded that a prerequisite "flow of goods" test, as a policy matter, may be sensible, and that authority for such a requirement—despite the opposition of some commentators—does exist, but the Court saw no reason to impose a "substantial flow of goods" test on all the states as a requirement of constitutional law.[202] Instead, the Court repeated what it had said on a number of occasions: "a relevant question in the unitary busi-

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197. 103 S. Ct. at 2947.

198. *Id.*

199. *Id.*

200. Brief for Appellant at 47, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933.

201. 103 S. Ct. at 2947. Expressing what it regarded as the importance of the "flow of value," the Court said:

> In addition, the principles we have quoted require that the out-of-State activities of the purported " 'unitary business' " be related in some concrete way to the in-State activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.

103 S. Ct. at 2940.

202. *Id.* at 2947 n.17.

ness inquiry is whether 'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.' "[203] " '[S]ubstantial mutual interdependence' . . . can arise in any number of ways," said the Court; "a substantial flow of goods is clearly one but just as clearly not the only one."[204]

The *Container* opinion analyzes in considerable detail the aspects of the business relationship between taxpayer and its subsidiaries that throw light on the existence of a unitary business. Container claimed that it had a "relatively hands-off attitude"[205] in the management of its subsidiaries, and that there was a minimal flow of goods between taxpayer and its subsidiaries, with sales of materials from the parent to the subsidiaries accounting for only about one percent of the total purchases of the subsidiaries.[206] Taxpayer also stressed that the subsidiaries were relatively autonomous in matters of personnel and day-to-day management.[207]

The Court, however, found other aspects of the parent-subsidiary relationship which led it to conclude that Container and its foreign subsidiaries did constitute a unitary operation for tax purposes. During each of the tax years at issue, taxpayer had made sales, averaging over one million dollars per year, of raw material to most of the subsidiaries.[208] Also, during this period taxpayer had assigned a senior vice president and four other officers to oversee the operations of the subsidiaries.[209] The Court found that "these officers established general standards of professionalism, profitability, and ethical practices and dealt with major problems and long-term decisions," even though "day-to-day management of the subsidiaries . . . was left in the hands of local executives who were always citizens of the host country."[210] Additionally, Container "had a number of its directors and officers on the boards of directors of the subsidiaries, but they did not generally play an active

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203. *Id.* at 2947 (quoting F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 364 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 438)).

204. *Id.* at 2947 (quoting F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 371).

205. *Id.* at 2944 n.8.

206. *Id.* at 2943.

207. *Id.* at 2944.

208. Brief for Appellee, *supra* note 181, at 23.

209. 103 S. Ct. at 2944.

210. *Id.*

role in management decisions."[211]

Notwithstanding the measure of autonomy the subsidiaries enjoyed, the Court opined that "in certain respects, the relationship between [taxpayer] and its subsidiaries was decidedly close."[212] Taxpayer provided substantial financing to the subsidiaries through direct loans and guarantees of loans made by local lenders. The loans that taxpayer made or guaranteed amounted to approximately half of the subsidiaries' financing.[213] Container also provided the subsidiaries with substantial technical assistance. Taxpayer gave advice and furnished technical services—"know-how"—regarding manufacturing techniques, engineering, design, architecture, insurance, and cost accounting to a number of its subsidiaries.[214] Additionally, taxpayer assisted its subsidiaries in procuring equipment,[215] either by arranging for the purchase of new equipment[216] or from time to time by selling used equipment to the subsidiaries.[217] Further, the Court agreed with the State court's finding of " 'considerable interplay between [Container] and its foreign subsidiaries in the area of corporate expansion.' "[218] The Court concluded that it "need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business. Taken in combination, at least, they clearly demonstrate that the State court reached a conclusion " 'within the realm of permissible judgment.' "[219]

The Court emphasized as deserving particular mention two of the factors on which the State court relied in deciding the unitary issue. First, the Court stressed "the flow of capital resources from appellant to its subsidiaries through loans and loan guarantees."[220] The Court pointedly noted that there "is no indication that any of these capital transactions were conducted at arm's-length, and the *resulting flow of value is obvious*."[221] The Court observed that "capital transactions can serve either an investment function or an

211. *Id.* (footnote omitted).
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. The subsidiaries' new equipment purchases totalled $5 million to $7 million each year. Brief for Appellee, *supra* note 181, at 26.
217. 103 S. Ct. at 2944.
218. *Id.* at 2947 (quoting Container Corp. of Am. v. Franchise Tax Bd., 117 Cal. App. 3d 988, 997, 173 Cal. Rptr. 121, 127 (1981)).
219. *Id.* at 2948 (footnote omitted).
220. *Id.* at 2948 n.19.
221. *Id.* (emphasis added).

operational function"; transactions falling in the latter category generally indicate unitary operations. The Court pointed out that the purpose of Container's capital transactions with its subsidiaries clearly was to increase the growth and profitability of Container's overseas operations, rather than just to generate investment income.[222] The second factor that the Court regarded as noteworthy in establishing a unitary operation between taxpayer and its subsidiaries was "the managerial role played by appellant in its subsidiaries' affairs."[223] The Court pointed out that it had made clear in *Woolworth* that a unitary business finding could not be predicated merely on "the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary."[224] On the other hand, the Court recalled its holding in *Exxon*[225] that "mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding."[226] According to the *Container* majority, "the difference lies in whether the management role that the parent does play is grounded in its own operational expertise and its overall operational strategy."[227] To demonstrate that Container's management role suggested a unitary business, the Court concluded this aspect of the opinion by noting that the "business 'guidelines' established by [Container] for its subsidiaries, the 'consensus' process by which [Container's] management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by [Container], all point to precisely the sort of operational role [that the Court] found lacking in *F.W. Woolworth*."[228] In short, the *Container* Court relied on traditional judicial thinking in deciding whether a unitary business existed, by asking whether there were contributions to the income of the subsidiaries and affiliates resulting from functional integration, centralization of management, and economies of scale.[229] Specifically, the Court, however, also noted that "the prerequisite to a constitutionally acceptable finding of a

222. *Id.*

223. *Id.* at 2948 n.19.

224. F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 369.

225. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 224-25.

226. 103 S. Ct. at 2948 n.19.

227. *Id.*

228. *Id.*

229. *See id.* at 2947; F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. at 364; Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 438.

unitary business is a flow of *value*, not a flow of goods."[230] As the Container opinion indicates, the elastic concept of "flow of value" includes much more than the "flow of goods."

B. *Fairness of the Apportionment Formula*

Having determined that Container and its foreign subsidiaries constituted a unitary business, the Court turned to the question of whether the application of the three-factor apportionment formula was fair,[231] as both the due process and commerce clauses require.[232] The taxing State had combined all the worldwide income of Container and its foreign subsidiaries for apportionment and had included the property, payroll, and sales of Container and its foreign subsidiaries in its calculation of the percentage to be attributed to the taxing State. To unhinge the tax on the grounds of unfairness of apportionment, the complaining taxpayer in *Container* had the burden of proving that there was " 'no rational relationship between the income attributed to the [taxing] State and the intrastate values of the enterprise,' "[233] by showing that the income attributed to the taxing State was " 'out of all appropriate proportion to the business transacted in that State.' "[234]

In attacking the fairness of the apportionment in *Container*, taxpayer insisted that California's application of its three-factor apportionment formula to the worldwide income of Container and its foreign subsidiaries resulted in extraterritorial taxation of income by the taxing State in violation of the due process clause.[235] Taxpayer reasoned that the fairness of the three-factor formula depends on the premise that a dollar of payroll or property expended or used in one state, and a dollar of sales realized in that same state, normally should produce roughly the same amount of income as a dollar spent or realized in sales in other states.[236] That premise, taxpayer argned, is not true when the three-factor formula is applied to income generated in foreign countries. Hence, California's attempted extension of the three-factor formula beyond the

230. 103 S. Ct. at 2947 (footnote omitted).
231. 103 S. Ct. at 2948.
232. *Id.* at 2942.
233. *Id.* at 2948 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. at 220 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. at 437)).
234. 103 S. Ct. at 2948 (quoting Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. at 135).
235. Brief for Appellant, *supra* note 200, at 11.
236. *Id.* at 19.

borders of the United States produced a distorted and unfair result by attributing too great a share of the combined income of Container and its foreign subsidiaries to the taxing State.[237] Taxpayer attempted to demonstrate this distortion by presenting statistical evidence and expert testimony, based on separate accounting,[238] showing that Container's main foreign subsidiaries produced a larger amount of income per dollar of property, payroll, and sales than did Container's operations in the United States.[239] Because these overseas subsidiaries were more profitable than Container itself, taxpayer argued that the apportionment formula unfairly shifted this foreign source income to California for tax purposes.[240] Taxpayer also insisted that some of its foreign subsidiaries operated in developing countries where the costs of production were significantly lower than in the United States, primarily because of lower wage rates.[241] Moreover, Container argued, those lower wage rates were not offset by lower production.[242] Since wages were one of the three factors used in the apportionment formula, concluded taxpayer, the use of the formula unfairly inflated the amount of income attributed to the taxing State, where wages were high.[243] In short, because the worldwide combined apportionment by the taxing State failed to account for the lower wage rates and greater profitability of the operations of the foreign subsidiaries, taxpayer insisted that this apportionment method resulted in extraterritorial taxation of income actually earned in foreigu countries.[244]

The *Container* Court rejected this due process distortion argument. Addressing taxpayer's position that formula apportionment systematically distorted the true allocation of income between taxpayer and the subsidiaries, the Court responded that the profit

237. *Id.*

238. For an explanation of the separate accounting method of attributing income, see *supra* note 26.

239. Brief for Appellant, *supra* note 200, at 14, 18. In addition, taxpayer asserted that a comparison of the amount of income taxed by California with the sum taxed by the federal government further illustrated this distortion. Formula apportionment as applied to the worldwide income of Container and affiliates, urged taxpayer, attributed significantly more income to the domestic operations of Container for tax purposes than did the sophisticated accounting techniques that the Internal Revenue Service uses to compute income for federal income tax purposes. *Id.* at 16-17.

240. Official Transcript of Oral Arguments at 14, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983); Brief for Appellant, *supra* note 200, at 19.

241. Brief for Appellant, *supra* note 200, at 12-14.

242. *Id.* at 13.

243. *Id.* at 14.

244. *Id.* at 15.

figures that taxpayer relied on were based on the separate accounting method, "whose basic theoretical weaknesses justify resort to formula apportionment in the first place."[245] The Court noted that it had rejected a similar argument in *Mobil*, pointing out that whenever a unitary business exists,

> "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single indentifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required."[246]

The Court also rejected Container's argument that, since the wage rates were lower in the foreign countries where its subsidiaries operated than in the United States, the use of the formula unfairly inflated the amount of income apportioned to taxpayer's United States operation. The Court answered taxpayer's arguments:

> The problem with all this evidence, however, is that it does not by itself come close to impeaching the basic rationale behind the three-factor formula. [Container] and its foreign subsidiaries have been determined to be a unitary business. It therefore may well be that in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is also California payroll, as well as otber California factors, contributing—albeit more indirectly—to the same production. The mere fact that tbis possibility is not reflected in [Container's] accounting does not disturb the underlying premise of the formula apportionment method.[247]

Earlier, in the context of a different apportionment formula, the Court had addressed a similar challenge to the fairness of one of the factors in the formula. The Court pointed out that in the apportionment of the income of a unitary business operation, the formula employed must give adequate weight to the essential elements responsible for the earning of the income; the Court, however, noted that the propriety of the formula does not require that the factors employed be as productive in the taxing jurisdiction as they are for the business as a whole:

> The implications of the formula being what they are, a taxpayer does not escape the application of the statute by evidence directed to *only one* of the related terms. Its evidence to be effective must be directed to each of them alike, for only thus can the assumed relation between them be proved to be

245. 103 S. Ct. at 2948.
246. *Id.* at 2948-49 (quoting *Mobil*, 445 U.S. at 438) (citation omitted).
247. *Id.* at 2949.

unreal.[248]

Likewise, the *Container* Court noted that both "geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory."[249] The three-factor formula had gained wide approval, explained the Court, because it works to avoid the type of distortions in income attribution that were present in *Hans Rees'*.[250] The three factors—property, payroll, and sales— "appear in combination to reflect a very large share of the activities by which value is generated."[251]

The *Container* Court recognized that even the three-factor apportionment formula is necessarily imperfect. Giving one-third weight to each of the three elements in the formula is essentially arbitrary, thought the Court. Moreover, payroll, property, and sales arguably do not exhaust the entire set of factors relevant to the production of income. In addition, the correlation between each of the formula factors and income is by no means clear or exact.[252] Still, the Court said it had seen no evidence demonstrating that the margin of error inherent in the three-factor formula is greater than the margin of error in the kind of separate accounting that taxpayer urged upon the Court in seeking to upset the apportionment as constitutionally unfair.[253] Even according to taxpayer's own statistics purporting to show the "enormous distortions" produced by the taxing State's apportionment method, the three-factor formula attributed a mere fourteen percent more income to the taxing State than did Container's separate accounting method.[254] That fourteen percent distortion, thought the Court, was a "far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees'*."[255] In any event, concluded the Court, the distortion figure in *Container* was "a figure certainly within the substantial margin of error inherent in any method of attribut-

248. Norfolk & W. Ry. Co. v. North Carolina, 297 U.S. 682, 688 (1936) (emphasis added).

249. 103 S. Ct. at 2949.

250. *Id. See supra* notes 20-22 and accompanying text.

251. 103 S. Ct. at 2949.

252. *Id.* at 2949 & n.20.

253. *Id.* at 2950.

254. *Id.*

255. *Id.*

ing fincome among the components of a unitary business."[256]

C. Japan Line *and the Foreign Commerce Clause Issues*

After approving California's application of the unitary business principle and the three-factor apportionment formula to Container's worldwide income, the Court turned to two related—and perhaps the most significant—issues that remained: (1) did the California worldwide unitary method produce duplicative taxation of income in violation of the commerce clause; and (2) did the California worldwide unitary method impair the foreign policy of the United States in violation of the commerce clause?

To decide these commerce clause issues, the *Container* Court resorted to the guidelines that it had enunicated four years earlier in *Japan Line, Ltd. v. County of Los Angeles*.[257] In *Japan Line* the Court struck down a local property tax imposed on *foreign* commerce. The issue in that case, as the Court formulated it, was "whether instrumentalities of commerce that are owned, based, and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State."[258] In addition to considering the four-fold *Complete Auto Transit*[259] precepts for valid taxation of *interstate* commerce,[260] the *Japan Line* Court erected two other constitutional hurdles that a taxing state must clear for valid taxation when *foreign* commerce is concerned. The two additional considerations are: (1) whether the tax, notwithstanding its apportionment, creates a substantial risk of international tax multiplication;[261] and (2) whether the tax prevents the federal government from " 'speaking with one voice when regulating commercial relations with foreign governments.' "[262] In *Japan Line* the Court held that the tax contravened both of these commerce clause considerations and, thus, was invalid. Finding forbidden duplicative taxation, the Court observed that no authority in the United

256. *Id.* (citations omitted).

257. 441 U.S. 434 (1979).

258. *Id.* at 444.

259. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 287 (1977).

260. Under the four-pronged test of *Complete Auto Transit*, a tax may be applied only to activities that have a substantial nexus with the taxing state; the tax must be fairly apportioned; it must not discriminate against interstate commerce; and it must be fairly related to the services provided by the state. 430 U.S. at 279. *See supra* note 91 and accompanying text.

261. 441 U.S. at 451.

262. *Id.*

States can ensure fair apportionment when one of the taxing bodies is a foreign sovereign.[263] Tbe Court frankly recognized that it "is powerless to correct malapportionment of taxes imposed from abroad in foreign commerce."[264] The *Japan Line* Court also concluded that the tax *did* prevent the federal government from "speaking with one voice" in regulating foreign trade[265] and, therefore, "impair[ed] federal uniformity in an area where federal uniformity is essential."[266]

Applying the two *Japan Line* requirements to the facts of *Container*, the Court rejected taxpayer's argument that California's worldwide combined method of reporting violated one or both of the *Japan Line* precepts. In the most controversial aspect of *Container*,[267] a majority of Justices voted to uphold the tax against the contention that the *Japan Line* doctrines relegated the tax to the dustbin of commerce clause oblivion. The *Container* Court recognized that California's taxing system produced *actual double taxation*:[268] the foreign subsidiaries' income was subject both to unapportioned taxation in full by foreign nations, and to apportioned taxation in California as part of Container's unitary business.[269] In *Japan Line* the Court also had found actual double taxation; Japan already had taxed the vehicles of commerce that California was attempting to tax.[270] Nevertheless, the *Container* majority did not regard the existence of duplicative taxation as a valid objection to the California tax under the *Japan Line* doctrines. While agreeing that *Container* was similar to *Japan Line* in a number of important respects,[271] the Court still concluded that the *Container* tax was distingnishable from the tax in *Japan Line* in crucial ways.

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263. *Id.* at 447.

264. *Id.* at 454.

265. *Id.* at 452-54.

266. *Id.* at 448.

267. Justice Powell, joined by Chief Justice Burger and Justice O'Connor, vigorously dissented from the Court's decision upholding the *Container* tax on the grounds that the California tax violated both of the *Japan Line* precepts. *See* 103 S. Ct. at 2957 (Powell, J., dissenting).

268. 103 S. Ct. at 2951-52.

269. *Id.* at 2951.

270. 441 U.S. at 451-52.

271. 103 S. Ct. at 2951-52. The Court mentioned four similarities between the *Container* and *Japan Line* facts: (1) actual double taxation that (2) stemmed from the divergency in the taxing schemes of California and the foreign taxing authorities; (3) conformity of the foreign taxing method with accepted international practice; and (4) the federal government's preference for the internationally accepted method. *Id.*

At the outset, the Court noted the narrowness of the question presented in *Japan Line*: " 'whether instrumentalities of commerce that are owned, based, and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State.' "[272] The Court then proceeded to distinguish *Japan Line* on a number of grounds. First, the Court noted that the tax in *Japan Line* was a *property* tax; the *Container* tax was a tax on *income*. The Court pointed out that it had distinguished property taxation from income taxation in *Mobil*,[273] when it suggested that the "reasons for allocation to a single situs that often apply in the case of property taxation carry little force" in the case of income taxation.[274] As a second ground for distinction from *Japan Line*, the Court declared that the *Container* double taxation, although real, was not the "inevitable" result of the California taxing scheme. According to the Court, the double taxation in *Container* stemmed from a serious divergence between the taxing systems adopted by California and by the governments of the foreign countries in which Container's subsidiaries operated.[275] Each of the relevant foreign jurisdictions, as well as the federal government, had adopted what the Court designated as a "qualified separate accounting approach—often referred to as the 'arm's-length' approach—to the taxation of related corporations."[276] Describing the "arm's-length" approach, the Court explained that

> every corporation, even if closely tied to other corporations, is treated for most—but decidedly not all—purposes as if it were an independent entity dealing at arm's length with its affiliated corporations, and subject to taxation only by the jurisdictions in which it operates and only for the income it realizes on its own books.[277]

The Court compared the operation of the "arm's-length" approach and formula apportionment method and concluded that whether multiple taxation results from either method may vary from case to case.[278] The only sure way of avoiding double taxation, re-

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272. 103 S. Ct. at 2952 n.24 (quoting *Japan Line*, 441 U.S. at 444).
273. 445 U.S. at 444-45. *See supra* notes 42-76 and accompanying text.
274. 445 U.S. at 445.
275. 103 S. Ct at 2952.
276. *Id.* at 2950 (footnote omitted).
277. *Id.* at 2950.
278. Here, by contrast, we are faced with two distinct methods of allocating the income of a multi-national enterprise. The "arm's-length" approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of

marked the Court, would be to deny to the states the power to tax such foreign source dividend income of the subsidiaries at all.[279] No party in *Container* had suggested such a rule, and in the view of the Court, its obvious unfairness required no elaboration.[280]

The third difference between *Container* and *Japan Line*, as the *Container* Court saw it, was that the incidence of the "tax here falls, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States."[281] This third difference appeared very significant to the *Container* Court. The Court's reasoning in upholding the *Container* tax seems heavily dependent upon the identity of the taxpayer; the tax fell neither on a parent corporation of a foreign country nor on a corporation of foreign ownership, but rather fell on a corporation domiciled and headquartered in the United States. By contrast, in *Japan Line* the State imposed the tax on the property of a foreign-based (Japanese) corporation. Thus, *Container*, leaves open the question of whether the unitary business principle and worldwide apportionment will be applicable to foreign multinational corporations.[282] Shortly after *Container* the Court was afforded two opportunities to decide the issue of whether a state tax reaching income from a foreign parent can clear the constitutional hurdles. Unfortunately, the Court refused to hear either case.[283]

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income not being taxed at all is dependent solely on the facts of the individual case.

Id. at 2952 (footnote omitted). As an example of worldwide apportionment producing a result different from *Container*, the Court cited Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981), *prob. juris. noted sub nom.* Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 102 S. Ct. 564 (1982), *dismissed for lack of substantial federal question,* 103 S. Ct. 3562 (1983). In that case, "application of worldwide combined apportionment resulted in a refund to the taxpayer from the amount he had paid under a tax return that included neither foreign income nor foreign apportionment facters." *Container,* 103 S. Ct. at 2952 n.25. In fact, Caterpillar Tractor Co. filed an amicus curiae brief in the *Container* case *supporting* the *Container* tax.

279. 103 S. Ct. at 2953.

280. *Id.*

281. *Id.* at 2952. The Court "specifically left open in *Japan Line* the application of that case to 'domestically owned instrumentalities engaged in foreign commerce.'" *Id.* (quoting *Japan Line,* 441 U.S. at 444).

282. "We have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." *Id.* at 2952 & n.26; *see also id.* at 2955-56 & n.32.

283. *See* Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir.), *cert. denied sub nom.* Shell Petroleum, N.V. v. Franchetti, 104 S. Ct. 537 (1983); Alcan Aluminum Ltd. v. Franchise Tax Bd., 558 F. Supp. 624 (S.D.N.Y. 1983) (facts contained in 539 F. Supp. 512 (S.D.N.Y. 1982)), *aff'd without opinion,* No. 83-7236 (2d Cir. June 17, 1983), *cert denied,*

Although multiple taxation in the context of foreign commerce deserves to receive close scrutiny, observed the Court, that scrutiny must take into account the circumstances in which the duplicative taxation occurs and the options reasonably available to the taxing state.[284] Even if California were to adopt the "arm's-length" method of attributing income, as taxpayer urged, double taxation would not necessarily end, thought the Court.[285] Differing administrative rules under which the various foreign countries reallocate income among affiliated corporations make the elimination of the possibility of double taxation impossible, observed the Court.[286] Indeed, the *Container* Court felt that the use of the "arm's-length" method by California might "end up subjecting those corporations to more serious double taxation than would occur under formula apportionment."[287] Since California's method of formula apportionment does not lead "inevitably" to double taxation, the Court thought "it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation."[288] In short, by clear implication the Court in *Container* weakened its statement in *Japan Line* that " '[e]ven a slight overlapping of tax—a problem that might be deemed de minimis in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned.' "[289]

The *Container* Court next turned to the second inquiry that *Japan Line* suggested: a determination of whether the California apportionment in the context of international taxation " 'impair[ed] federal uniformity in an area where federal uniformity is essential,' "[290] and thus prevented the federal government from " 'speaking with one voice' " in regulating international trade.[291] The Court began with the principle that "if a state tax merely has foreign resonances, but does not implicate foreign affairs, [the Court] cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level

104 S. Ct. 705 (1984).

284. 103 S. Ct. at 2953.

285. *Id.*

286. *Id.* at 2953-54.

287. *Id.* at 2954 (footnote omitted).

288. *Id.* at 2954-55.

289. *Id.* at 2953 (quoting *Japan Line*, 441 U.S. at 456) (footnote omitted).

290. *Id.* at 2955 (quoting *Japan Line*, 441 U.S. at 448).

291. *Id.* (quoting *Japan Line*, 441 U.S. at 453).

mandates identical treatment by the States.' "[292] For a tax to be barred by the "one voice" aspect of the commerce clause, the Court observed, the tax *either* must implicate foreign policy issues that are the domain of the federal government *or* must violate a clear federal directive.[293] The Court thought the most obvious foreign policy implication of the questioned tax was the threat that it might offend foreign trading partners and lead them to retaliate against the nation as a whole.[294] Before addressing that potential threat, however, the Court acknowledged that it has little competence in determining when foreign nations will be offended, and "even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please."[295] This issue, in the Court's thinking, more properly should be the concern of the executive and legislative branches.[296]

Against the background of those disclaimers, the Court saw three factors that weighed heavily against the conclusion that the tax might lead to foreign retaliation. First, in the Court's opinion, the challenged tax did not create an " '*automatic* asymmetry' " in international taxation.[297] In other words, double taxation would not necessarily occur in every instance.[298] Second, California imposed the tax on a United States based corporation, not on a foreign entity whose taxation might stir up retaliation. Last, taxpayer was no doubt amenable to taxation by California in one way or

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292. *Id.* (quoting *Mobil Oil*, 445 U.S. at 448).

293. *Id.*

294. *Id.*

295. *Id.*

296. *Id.* at 2956.

297. *Id.* at 2955 (quoting *Japan Line*, 441 U.S. at 453).

298. California's taxation system seemingly has not been a heavy deterrent to investment in that State by foreign-*based* multinational corporations. A steady movement by multinational firms into the State has been occurring, although many of these firms, by locating in California, may subject themselves to taxation based on formula apportionment of their worldwide income. According to reports that the United States Census Bureau has published, California leads the nation in the number of foreign-based firms with two or more establishments; furthermore, California has increased its lead over other states since the Bureau began its series of reports in 1975. In 1980 California had 4,829 such foreign-owned establishments, compared to 1,999 in 1975. California's 1980 total was 1,130 more than second place New York's. BUREAU OF THE CENSUS, UNITED STATES DEP'T OF COMMERCE, SELECTED CHARACTERISTICS OF FOREIGN-OWNED U.S. FIRMS: 1980 Table 6 (1982); BUREAU OF THE CENSUS, UNITED STATES DEP'T OF COMMERCE, SELECTED CHARACTERISTICS OF FOREIGN-OWNED U.S. FIRMS: 1975-1976 Table 7, at 15 (1979); *see* Brief of Citizens for Tax Justice, as Amici Curiae in support of the California Franchise Tax Board at 22 & n.37, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983).

another; the amount of the tax Container pays, thought the Court, is much more a function of California's tax *rate* than of its method of attributing income to California for tax purposes.[299] Moreover, although the Court was aware that the tax might have foreign policy implications other than the threat of foreign retaliation, the Court viewed the Justice Department's failure to file an amicus curiae brief in opposition to the California tax as suggesting, when combined with all other considerations, that the California taxing system posed no serious threat to the foreign policy of the United States.[300]

Finally, the Court considered whether the tax violated a clear federal directive—that is, whether federal law had preempted the tax. The Court found no preemption, either by congressional statute or by treaty.[301] The Court heard no claim that federal tax statutes themselves provided a necessary preemptive force. The tax treaties that the United States had entered into with foreign nations did not control taxes imposed by the contracting nations on their own *domestic* corporations, and none of the treaties to which the United States was a party concerned the taxing activities of *states*.[302] Moreover, the Court pointed out that at least once in considering a proposed treaty, the Senate had rejected a provision in the treaty that would have restricted the power of the states to apportion worldwide income.[303] The Court reiterated its statement in *Mobil* that " 'Congress has long debated, but has not enacted,

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299. 103 S. Ct. at 2955-56. Regardless of the merits of these three arguments, the Court evidently underestimated the possibility of foreign retaliatory measures, or at least the magnitude of foreign criticism of its decision. Japan, Canada, and the countries in the European Economic Community all communicated to the Department of State their criticisms of the unitary method of taxation. *See* Brief of Shell Petroleum, N.V., app. at 54a-89a, Shell Petroleum, N.V. v. Franchetti, 104 S. Ct. 537 (1983) (collecting correspondence from foreign diplomats concerning the unitary method of taxation), *denying cert. to* Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir. 1983).

300. 103 S. Ct. at 2956. The Solicitor General did submit to the Court a brief opposing a state's worldwide formula apportionment contested in Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981), *prob. juris. noted sub nom.* Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 102 S. Ct. 564 (1982), *dismissed for lack of substantial federal question,* 103 S. Ct. 3562 (1983). *See* 103 S. Ct. at 2956 n.33. President Reagan ordered the Justice Department not to file an amicus brief supporting a petition for rehearing of *Container* and instead recommended an alternative approach. President Reagan proposed a high-level task force to develop a compromise settlement of the long-standing disputes among states, multinationals, and U.S. trading partners. Unitary Taxes: *Supreme Court Declines to Rehear Case Upholding California's Corporate Unitary Tax,* DAILY REPORT FOR EXECUTIVES (BNA) No. 197, at G-1 (Oct. 11, 1983).

301. 103 S. Ct. at 2956-57.

302. *Id.* at 2956.

303. *Id*; [2 Tax Treaties] FED. TAXES ¶ 89,001, at p. 89,003, ¶ 89,003, at pp. 89,006-07.

legislation designed to regulate state taxation of income,' "[304] including legislation governing worldwide apportionment. Thus, the *Container* Court concluded that the California tax at issue was neither preempted by federal law nor fatally inconsistent with federal policy.[305]

D. The Container *Dissent*

Justice Powell, with whom Chief Justice Burger and Justice O'Connor joined,[306] vigorously dissented. The dissent did not consider whether taxpayer and its subsidiaries constituted a unitary operation; nor did it consider the fairness of the apportionment formula. The dissent focused entirely on whether the *Container* tax violated the commerce clause.[307] To the dissent, the tax in issue violated both precepts of *Japan Line*—that is, the tax inevitably led to double taxation, and seriously implicated foreign policy issues that must be left to the federal government.[308] The distinctions that the majority drew between *Japan Line* and *Container* were not acceptable to the dissenting Justices. As the dissent saw it, the principles used to strike down the *Japan Line* tax also should have been fatal to the tax in *Container.*[309]

Addressing the first facet of the *Japan Line* doctrine, the dissent took the position that the Court's reasoning in *Container* had serious weaknesses regarding duplicative taxation of Container's foreign source income. Justice Powell's dissenting opinion notes that the Court conceded that international double taxation is particularly disfavored; the dissent further pointed to the Court's concession that double taxation did exist in *Container* because California had adopted a taxing system (worldwide formula apportionment) that significantly departed from the internationally accepted arm's-length method, which the foreign countries where the subsidiaries operated had adopted and which the United States government favored.[310] Moreover, the Court agreed with Justice Powell's dissent that the *Container* tax on foreign source income deserved close scrutiny.[311]

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304. 103 S. Ct. at 2956 (quoting *Mobil,* 445 U.S. at 448).
305. *Id.* at 2957.
306. *Id.* at 2957-61.
307. *Id.* at 2957 (Powell, J., dissenting).
308. *Id.* (Powell, J., dissenting).
309. *Id.* (Powell, J., dissenting).
310. *Id.* (Powell, J., dissenting).
311. *Id.* at 2957 (Powell, J., dissenting).

While the majority agreed that double taxation actually existed in *Container* and, thus, warranted close scrutiny, the Court nevertheless upheld the tax on the ground that, because of differing administrative rules and accounting practices of various countries, California would not necessarily reduce double taxation by adopting the arm's-length separate accounting method.[312] To the dissent, this argument by the Court failed to recognize the fundamental difference between the *actual* double taxation that existed in *Container* and the *risk* of double taxation that remains under an arm's-length system.[313]

In his disagreement with the Court, Justice Powell emphasized that double taxation existed because California's attribution method was different in its basic assumptions from the method used by all the countries where taxpayer's subsidiaries operated. The dissent asserted that California's formula had no necessary relationship to the amount of income earned in a given jurisdiction as calculated under the arm's-length method.[314] In fact, argued Justice Powell, formula apportionment attributes a higher proportion of income to jurisdictions with higher wage rates, property values, and sales.[315] "To the extent that California is such a jurisdiction," the dissent insists, "the formula inherently leads to double taxation."[316]

The two differing views of the Court and of Justice Powell in dissent seem to point out a significant development and change in the area of multiple taxation. In a forthright manner the Court and dissent both recognized that not all duplicative taxation is constitutionally proscribed. The question now simply is how much will be judicially tolerated—a matter of degree. What type of judicial Richter scale will be used by the Court to determine the constitutionally acceptable amount of multiple taxation? Moreover, just how high on the judicial Richter scale must the seismic international taxation disruption reading register before the questioned

312. *Id.* at 2953.

313. *Id.* at 2957-58. (Powell, J., dissenting).

314. *Id.* at 2958 (Powell, J., dissenting).

315. *Id.* (Powell, J., dissenting).

316. *Id.* (Powell, J., dissenting). As discussed above, the Court disagreed with this facet of Justice Powell's dissent, noting that double taxation in *Container*, "although real, was not the 'inevitabl[e]' result" of California's worldwide apportionment system of taxing income. *Id.* at 2952. "Whether the combination of the two methods [arm's-length and formula apportionment] results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case." *Id.* (footnote omitted). *See supra* notes 283-88 and accompanying text.

tax crumbles under the weight of the constitutional multiple burdens attack?

The dissenters not only thought that the *Container* tax was forbidden by the double taxation prong of the *Japan Line* test, but also believed that the tax was an unconstitutional impingement of the second aspect of *Japan Line* because the tax seriously implicated foreign policy issues that should be left to the federal government. Thus, Justice Powell would not have permitted California to apply its apportionment formula to Container's operation because California's method was contrary to the federal government's preference for the arm's-length method, used not only by the federal government but also by the foreign countries where Container's subsidiaries operated.[317] As Justice Powell saw it, "California has rejected accepted international practice in favor of a tax structure that is fundamentally different in its basic assumptions."[318] The dissent reasoned that California could conform to international practice simply by basing its apportionment calculations on the income that Container reported on its federal tax return, using the arm's-length method.[319] Justice Powell recognized, as did the Court,[320] that even if California adopted the arm's-length method of attributing income, differences in applying that method—for example, the use of different accounting principles—still could lead to double taxation.[321] In Justice Powell's opinion, however, these types of differences in application, although presently tolerated in practice, are not inherent in the arm's-length system. While such disagreements in applying the arm's-length method may be unavoidable, they nevertheless can be resolved through international negotiations in Justice Powell's opinion.[322]

317. The arm's-length method that the federal government uses has not escaped substantial criticism. For a comparison of the unitary method and the arm's-length method, and specifically for a look at the inadequacies of the arm's-length method, see Note, *Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code*, 89 HARV. L. REV. 1202 (1976).

318. 103 S. Ct. at 2959 (Powell, J., dissenting).

319. *Id.* at 2957 n.1 (Powell, J., dissenting).

320. *Id.* at 2953.

321. *Id.* at 2958 (Powell, J., dissenting).

322. *Id.* at 2958-59 (Powell, J., dissenting).

The *Container* majority saw the matter in a somewhat different light: "[W]e have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by [taxpayer]." *Id.* at 2949-50. Too, as discussed above, the *Container* Court adhered to the traditional view that unitary formula apportionment is

The dissent also attacked the majority's suggestion that California could impose the same tax burden on taxpayer under the arm's-length system simply by increasing the general tax rate.[323] To the majority the amount of tax Container paid was much more the function of the California tax rate than the method of attributing income.[324] The dissent's response pointed out the troublesome political and constitutional ramifications of the majority's suggestion. The State could hardly raise the tax rate applicable to Container alone, or even to all corporations engaged in foreign commerce, without encountering constitutional attacks under the commerce and equal protection clauses, in the opinion of the dissenters.[325] If California raised the tax rate applicable to Container, the State would have to raise the tax rate for all corporations similarly situated—a course of action that political restraints make infeasible.[326]

A judicial mandate that states adopt the arm's-length method of attributing income for tax purposes would require the Court to take judicial action it has not been willing to take: dictating to the states how they must draft their tax statutes.[327] The Court, however, clearly has indicated that Congress possesses power to require uniformity among the states in their taxation of interstate commerce. The Court has declared that

> the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.[328]

Container suggests that the Court, as well as the dissent, is trying to balance the competing revenue demands of the states, in getting their fair share of taxes from income earned by multinational corporations, against the corporate taxpayer's interest in avoiding multiple taxation, as well as the demands of the Federal

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necessary because separate accounting may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. *Id.* at 2948-49. *See supra* note 246 and accompanying text.

323. 103 S. Ct. at 2960 (Powell, J., dissenting).

324. *Id.* at 2956.

325. *Id.* at 2960 & n.6 (Powell, J., dissenting).

326. *Id.* at 2960 (Powell, J., dissenting).

327. In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), the Court refused, in the absence of legislation by Congress, to require Iowa to compute its corporate net income under the three-factor formula in order to prevent an overlap in the computation of taxable income. *Moorman* held that tbe Constitution does not require such a result. *Id.* at 277-78.

328. *Id.* at 280.

Government that economic growth and harmonious international relations not be strangled with unreasonable, hampering state taxes that would create retaliation and trade wars among nations. The majority and the dissent, however, seem to be poles apart on whether the Court satisfactorily achieved this worthy objective in *Container*.[329]

E. Container's *Reserved Issues*

The *Container* decision expressly reserved for future consideration the related issues of the states' power to tax foreign parents of domestic subsidiaries and the states' power to tax domestic parents owned by foreign interests. The Court already has been presented with two cases in which it could have addressed these issues, but the Court refused to hear either case.[330] In many ways, the *Container* decision was significantly less controversial than a decision on the reserved issues necessarily would be. Some of the problems raised in *Container* are exacerbated when the legal incidence of the tax falls not on a domestic corporation but on a foreign entity. In particular, problems relating to (1) the taxation of foreign source income; (2) possible frustration of United States foreign commerce; (3) increased risks of international double taxation; and (4) overallocation of income to the states due to noncompatibility of domestic and foreign apportionment factors would be significantly more difficult to handle in the two reserved situations than in *Container* itself.[331]

One particularly sensitive issue raised in the reserved situations concerns the states' demands for information about the foreign corporation's operations. Vast amounts of information, of course, are required to ensure that the foreign corporation's income is correctly stated and that its apportionment factors (such

329. For comments on *Container*, see Delap, *supra* note 42, at 210; *The Supreme Court, 1982 Term*, 97 HARV. L. REV. 70, 112-17 (1983); Note, *State Taxation of Foreign Source Income Through Worldwide Combined Reporting*, 17 VAND. J. TRANSNAT'L L. 95 (1984). For critical comment, see Elliott & Cohen, *Court Gives States Right To Tax Multinational Earnings*, LEGAL TIMES, July 25, 1983, *reprinted in* M. CAPLIN & R. ELLIOTT, STATE TAXATION OF MULTI-NATIONAL CORPORATIONS AFTER CONTAINER CORP.: CORPORATE STRATEGIES TO DEAL WITH WORLDWIDE UNITARY TAX 3 (1983) [hereinafter cited as AFTER CONTAINER CORP.].

330. *See* Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir), *cert. denied sub nom.* Shell Petroleum, N.V. v. Franchetti, 104 S. Ct. 537 (1983); Alcan Aluminum Ltd. v. Franchise Tax Bd., 558 F. Supp. 624 (S.D.N.Y. 1983) (facts contained in 539 F. Supp. 512 (S.D.N.Y. 1982)), *aff'd without opinion*, No. 83-7236 (2d Cir. June 17, 1983), *cert. denied*, 104 S. Ct. 705 (1984).

331. *See* GAO REPORT, *supra* note 4, at 31.

as property, payroll, and sales) are appropriately valued. In certain situations, these information requests may run afoul of foreign corporate secrecy laws,[332] and in all situations the requests will impose heavy administrative burdens on the foreign corporations.

Generally, in cases concerning domestic taxation of foreign corporations or of domestic corporations of foreign control, information necessary to satisfy state auditors likely will be in the control of foreign subsidiaries. These subsidiaries will not be particularly amenable to expending the time and resources necessary to provide their American counterparts with the required information.[333] Meanwhile, the states, in light of the Court's newly enunciated doctrine that it will defer to the decision of the state court on the unitary issue,[334] the Court's presumption in favor of the validity of an assessed tax, and the long-established doctrine that the onus is on the corporation to produce sufficient information to prove that the state's assessment is not fair, will be in a stronger position than ever.[335]

Container's reserved situations certainly call for careful balancing of all the interests concerned. Perhaps the Court is taking the only reasonable course available—a hands-off approach as far as feasible. Most assuredly in the reserved situations and perhaps in general, the issue of state taxation of foreign source income through application of formula apportionment demands congressional attention. The problem may become so thorny and of such magnitude that Congress may find it necessary to respond to the demand.[336]

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332. *See* AFTER CONTAINER CORP., *supra* note 329, at 3.

333. *See id.*

334. *See supra* notes 191-92 and accompanying text.

335. *See* Brief of Petitioner at 24, Shell Petroleum, N.V. v. Franchetti, 104 S. Ct. 537 (1983), *denying cert. to* Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir. 1983) ("The imposition of huge penalties on Shell Oil is a patent device to coerce [the foreign parent] into obtaining the demanded data at tremendous expense and providing it to the Board. Indeed, Shell Oil is being held hostage to coerce [the parent] to submit to the Board's demands.").

336. For a description of legislative proposals by Congress relating to limitations on state taxation of interstate business and foreign source corporate income, see Description of S. 983 and S. 1688 Relating to State Taxation of Interstate and Foreign Source Income, Prepared for Use of the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance (June 24, 1980), *reprinted in* AFTER CONTAINER CORP., *supra* note 329, at 80.