Corporate Income Tax

NOTE: This is a copy of the Alaska Supreme Court decision "Sjong vs. Dept. of Revenue" which Rep. Martin referred to at the July 21, 1986 Tax Policy Committee Meeting.

Cite as, Alaska, 622 P.2d 967

John K. SJONG, Appellant,

v.

STATE of Alaska, DEPARTMENT OF REVENUE, Appellee.

No. 4255.

Supreme Court of Alaska.

Jan. 23, 1981.

Taxpayer, a nonresident crab fisherman, appealed from an order of the Superior Court, First Judicial District, Thomas B. Stewart, J., upholding the State's assessment of net income tax against him. The Supreme Court, Burke, J., held that: (1) there was sufficient nexus to justify imposition of tax; (2) nonresident crab fisherman was not exempt from tax under interstate income law; (3) apportionment formula was valid; and (4) the Superior Court did not abuse its discretion in awarding attorney fees to the State.

Affirmed.

1. Taxation ⟹956

In order for the State to constitutionally tax a nonresident, the nonresident must be sufficiently involved in local events to forge some definite link, some minimum connection sufficient to satisfy due process requirements. U.S.C.A.Const. Amend. 14.

2. Taxation ⟹956

Where the state of Alaska was giving something to nonresident crab fishermen fishing off coast of Alaska in international waters for which he could ask a return, i. e., supplies, employment, and a market for sale of goods, and taxed income of fisherman was derived from sources in the State, there was sufficient nexus to justify imposition of income tax. AS 43.20.010–43.20.350; AS 43.20.130(e), (e)(1) (Repealed); U.S.C.A. Const. Amend. 14.

3. Commerce ⟹74.15

Under commerce clause, net income from interstate operations of foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within taxing state forming sufficient nexus to support the tax. U.S.C.A.Const. Art. 1, § 8, cl. 3.

4. Commerce ⟹62.75

A state may not impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business relative to interstate business. U.S.C.A.Const. Art. 1, § 8, cl. 3.

5. Appeal and Error ⟹761

Where a point is not given more than cursory statement in argument portion of brief, the point will not be considered by the Supreme Court.

6. Commerce ⟹74.15

In order to qualify for exemption from imposition of net income tax under the interstate income law, a business must solicit orders which are sent out of state for approval and then make deliveries into the state. 15 U.S.C.A. § 381(a).

7. Commerce ⟹74.15

Activities of nonresident crab fisherman who fished off coast of Alaska in international waters and sold catch to Alaska processors was not exempt under the interstate income law from paying Alaska's net income tax, although activities of fisherman in state allegedly consisted solely of delivery of goods previously ordered under contracts negotiated outside of the state. 15 U.S.C.A. § 381(a).

8. Commerce ⟹62.80
Constitutional Law ⟹285.2
Taxation ⟹1005

Apportionment formula is valid under due process and commerce clauses only if, as a tax measure, it assigns to the state income that can reasonably be said to result from activities or properties within its borders. U.S.C.A.Const. Art. 1, § 8, cl. 3; Amend. 14.

9. Taxation ⟹1083

Heavy burden is placed on a taxpayer challenging a state's allocation of his income for taxation purposes to prove by clear and cogent evidence that income attributed to state is out of all appropriate proportion to business transacted in that state or has led to a grossly distorted result.

10. Constitutional Law ⟹285.2

Taxation ⟹1005

Due process does not prohibit a tax apportionment formula which considers out-of-state activity in evaluating local activity of taxpayer. U.S.C.A.Const. Amend. 14.

11. Taxation ⟹956

Alaska's net income tax apportionment formula taking into account sales, property and payroll of nonresident was merely calculated to assign to the State that portion of net income reasonably attributable to business done in the State and as such was constitutional. U.S.C.A.Const. Art. 1, § 8, cl. 3; Amend. 14.

12. Taxation ⟹1005

In light of failure of taxpayer, a nonresident crab fisherman, to show that tax assessment was out of all appropriate proportion to business transacted in the State as a result of the State's use of port-day formula rather than voyage-day formula in the apportionment formula, employment of port-day formula was upheld.

13. Taxation ⟹1075

A 90% allocation of nonresident crab fisherman's income to the State did not produce gross distortion in apportionment of his net income tax, although over 95% of his business activity was conducted outside the State, as all of fisherman's sales were made in the State. AS 43.20.130(e)(1) (Repealed).

14. Taxation ⟹962

Because allocution formula was constitutional on its face and had not produced grossly distorted result in assessment of nonresident crab fisherman's net income tax liability, apportionment formula was valid. AS 43.20.010–43.20.350.

15. States ⟹215

In action involving assessment of net income tax against nonresident, trial court's award of attorney fees to the State was not an abuse of discretion. AS 43.20.010–43.20.350.

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Before RABINOWITZ, C. J., and CONNOR, BURKE and MATTHEWS, JJ.

OPINION

BURKE, Justice.

This case involves the constitutionality of the Alaska Net Income Tax Act, AS 43.20.010–.350, as applied to non-resident crab fishermen who fish off the coast of Alaska in international waters and sell their catch to Alaska processors. Appellant John K. Sjong, on behalf of eleven other Washington State fishermen, claims that the State of Alaska has no jurisdiction to tax his net income, and that to do so would violate the due process and commerce clauses of the United States Constitution, and section 381 of the Interstate Income Act.[1]

John K. Sjong is a commercial king crab fisherman who resides in the State of Washington. He has fished commercially for at least ten years, and for eight of those years he has owned and operated his own fishing vessel. His fishing vessel is licensed, registered, and harbored in Washington with Seattle as its designated home port. He fishes exclusively in the international waters surrounding Alaska[2] and sells

1. 15 U.S.C. § 381 (1976).

2. Sjong testified at the revenue board hearing that he operates his fishing vessel between 5 and 150 miles from the coast line of Alaska. As provided by 43 U.S.C. § 1312 (1976), a state "may extend its seaward boundaries to a line three geographical miles distant from its coast line."

his catch only to Alaska processors and canneries.

In preparation for the fishing season, Sjong outfits his vessel and hires a crew in Seattle. Most of the crew members are Washington residents, but should a crew member quit or become sick during the season, emergency replacements will be hired in Alaska. Provisions are also taken on in Washington. Although Sjong tries to take enough food and fuel to last the entire voyage, he often purchases fresh food and extra fuel while in port in Alaska.

Prior to journeying to the fishing grounds, Sjong negotiates a market and a price for his catch in Seattle with representatives of various processing companies. Once the fishing season starts, Sjong will come into an Alaska port once every ten to fifteen days to deliver his catch to a processing plant. At that time, possession as well as risk of loss and title is transferred from the fisherman to the processors. Payment for the catch is made in Seattle after the fishing season has ended.

Depending upon the extent of his catch, Sjong will make anywhere from twenty to thirty trips into port each season to sell his crab. While in port, he obtains supplies which enable him to continue his fishing activities; the most important being bait which is purchased from the local canneries and processors. Sjong also enters Alaska ports to obtain emergency medical treatment for sick or injured crew members, or to have emergency repairs performed on his equipment. The ports are also open to his vessel in case shelter is ever needed from storms.

On October 10, 1974, the Alaska State Department of Revenue notified Sjong that they had assessed his personal net income tax for the years 1970, 1971, and 1972, and that he owed $32,481.89 in unpaid taxes. Pursuant to AS 43.20.280,[3] Sjong applied for a hearing on the matter. The Department concluded that Sjong had sufficient minimum contacts with the state to be subject to the net income tax statutes, that his activities in the State were not exempt from taxation under the Interstate Income Law, and that the exact amount of his tax would be determined by the apportionment formula provided for in the state tax statutes. Sjong appealed the Department's decision to the superior court; again, all issues were resolved against him and the taxation was upheld.

In this appeal he raises four arguments in opposition to the taxation of his net income: (1) the tax violates the fourteenth amendment due process clause; (2) the tax violates the commerce clause; (3) the tax violates section 381 of the Interstate Income Act; and (4) the apportionment formula employed by the state results in an unfair allocation of his income.

I. DUE PROCESS

[1] The first issue on appeal is whether the taxation of Sjong's net income constitutes a taking of property without due process of law. The fourteenth amendment

3. AS 43.20.280 (repealed in 1976) provided:

(a) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department within 60 days from the date of the notice required to be given to him by the department, giving notice of the grievance, and request a hearing. At the hearing the department may subpoena witnesses and may administer oaths and make inquiries necessary to determine the amount of the tax due to the state, and if a correction is warranted, the department shall make the correction after the hearing.

(b) Within 30 days after hearing and decision by the department, the taxpayer may file a complaint in the superior court in the judicial district in which he resides, naming the department as defendant, setting out the facts, and stating reasons why the action is erroneous, and praying relief from it, and the clerk of the court shall issue summons in the regular manner....

AS 43.20.280 was repealed in 1976 by ch. 166, § 3 SLA 1976 and has been replaced by AS 43.05.240. A number of changes in the tax law were made in 1976, but since this case was initially brought under the old tax statutes, those statutes then in effect will govern the resolution of this matter.

due process clause[4] limits states from extending their powers of taxation beyond their borders. As such, any attempt to tax extra-territorial values would be an unconstitutional taking of property. In order for a state to constitutionally tax a non-resident, the non-resident must be "sufficiently involved in local events to forge 'some definite link, some minimum connection' sufficient to satisfy due process requirements." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 465, 79 S.Ct. 357, 366, 3 L.Ed.2d 421, 431 (1959), *quoting Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344- , 74 S.Ct. 535, 538–539, 98 L.Ed. 744, 748 (1954). John Sjong contends that his contacts with the state are so minimal that there is an insufficient nexus upon which to base a tax.

In determining what constitutes sufficient minimum contacts for the purposes of taxation, the Supreme Court has adopted the following basic test first stated in *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 61 S.Ct. 246, 85 L.Ed. 267 (1940): "That test is . . . whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. *The simple but controlling question is whether the state has given anything for which it can ask return.*" 311 U.S. at 444, 61 S.Ct. at 250, 85 L.Ed. at 270–71 (emphasis added). As we stated in *North Slope Borough v. Puget Sound Tug & Barge*, 598 P.2d 924, 928 (Alaska 1979):

> Due process requires that a tax be related "to opportunities, benefits, or protection conferred or afforded" by the taxing authority and such a relationship exists "if the tax is fairly apportioned to the commerce [there] carried on." *Ott v. Mississippi Valley Barge Line Co.*, 336 U.S. 169, 174 [69 S.Ct. 432, 434], 93 L.Ed. 585, 589 (1949).

Therefore, our task is to determine whether the protections, opportunities, and benefits given to Sjong by the state provide a sufficient nexus to uphold the taxation of his net income.[5]

[2] As the record in the case indicates, Sjong makes approximately twenty to thirty trips per season into various Alaska ports to sell and deliver his catch of crab to processors and canneries. While in port, Sjong purchases any and all needed supplies and, among other things, makes use of emergency services when necessary.

Sjong argues that all of the services and benefits alluded to by the state are available to any person who travels interstate and should not be the basis for the imposition of a tax. What must be recognized, however, is that unlike the services rendered to an ordinary traveler, the services, benefits, and protections offered to Sjong are directly related to generating his income. Without the opportunity to purchase fresh bait and supplies, he would be severely hampered in his ability to continue his fishing ventures. Further, the availability of emergency medical services, repair facilities, and crew replacement in Alaska clearly benefits his business operations, as does the opportunity to sell his crab without the expenditure and delay of a lengthy trip.

It is precisely this notion, that the benefits afforded to the taxpayer are directly

4. The due process clause of the fourteenth amendment provides:

> Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S.Const. Amend. XIV, § 1.

5. In previously decided cases, contacts which were adjudged to be sufficient to uphold taxation included: maintaining a leased office and several salesmen within a state to solicit orders, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959); registering as a corporation to do business within a state, *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 61 S.Ct. 246, 85 L.Ed. 267 (1940); and maintaining a sales service office in the state which served five other states, *Williams v. Stockham Valves & Fittings, Inc.*, 358 U.S 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1950). *See also* the cases cited in note 15 *infra*.

related to "business income generation," which is central to a resolution of this issue. In *Alaska v. Petronia*, 69 Wash.2d 460, 418 P.2d 755 (1966), the Washington State Supreme Court applied this concept in upholding Alaska's taxation of the net income of a nonresident seaman employed on a vessel in Alaskan waters.

As in the instant case, the Washington Supreme Court was faced with the question of whether Petronia had sufficient minimum contacts with the State of Alaska so that taxation of his income would not violate due process. By applying the business income generation concept, the court determined that there were sufficient contacts to justify imposition of a net income tax.

> The defendants argue that ... the benefits afforded seamen are *de minimus*; ... that virtually the only benefits available from the state of Alaska to seamen such as the defendants are the protection and benefits they are afforded by the state when they are on shore in strictly a tourist or recreational capacity.
>
> This argument ... is impressive; however, it overlooks a most significant element considered in applying the test of benefits in determining minimum connections. Probably the most significant benefits in the eyes of these defendant seamen are the wages they contemplated receiving for their services during the course of the vessel's voyage. The business productivity generated by Alaska was accountable for the wages earned by the defendants when they were in Alaskan waters.

418 P.2d at 758.

The court went on to conclude: "We are satisfied that the benefits of employment afforded by this economic activity of the state of Alaska constituted minimum connections within the rule to avoid a denial of due process under the Fourteenth Amendment to the United States Constitution." *Id.* at 759.

Similarly, the state in this case has argued that Sjong is also a direct beneficiary of the economic activity of the state. As Sjong testified, he fishes only off the Alaska coast and sells exclusively to Alaska processors. His income is derived solely from the market Alaskan canneries and processors provide for his fishing skills. Indeed, his crab fishing might be rendered totally uneconomic if he were foreclosed from selling to Alaskan processors and had to return to Seattle to sell his catch.

The main distinction between the instant case and the situation described in the *Petronia* case is that Petronia earned his income while employed on a vessel in Alaskan waters. Here, Sjong catches crab outside of Alaska in international waters and then sells them within the state. We do not believe this distinction presents a significant difference, for even though Sjong fishes in international waters, the activities of the state have a substantial effect on his activities. As the state has pointed out, the particular industry which Sjong is involved in, the crab industry, has been fostered by the policies of the state and protected by its various police powers. *See State v. Bundrant*, 546 P.2d 530 (Alaska 1976), *rehearing denied*, 547 P.2d 838 (Alaska 1976).[6]

What is of primary significance in determining the legality of the tax is whether the income was derived from sources in the state. AS 43.20.035(a) states that the income of non-residents is taxable income when it is "attributable to sources in the state." Since Sjong's income is derived from the sale of crab to Alaska processors, that income should be subject to the income tax. Where the crab were actually caught makes no difference.

Sjong also contends that income is earned where the skill is employed to earn that income. In *Petronia*, for example, that portion of Petronia's work performed while his ship was in Alaskan waters was considered to have been income earning and taxable in

6. In *State v. Bundrant*, we upheld certain state laws and regulations relating to crab fishing beyond the three-mile state jurisdictional limit in the Bering Sea on the grounds that the State had a legitimate objective in regulating the taking of crab outside the State in order to conserve the crab resources existing within the State. *Id.* at 554.

Alaska. Applying the same reasoning, Sjong claims that since the labor to catch the crabs was employed in international waters, no taxable income can be attributed to the state. This argument, however, fails to draw a distinction between income which is the direct result of an individual's labor, and income derived from the sale of goods, such as crab. Absent a sale, the skill and labor used to catch crab would result in no profit or income to the individual.

In *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, 45 S.Ct. 82, 69 L.Ed. 282 (1924), the United States Supreme Court upheld a state franchise tax assessment based on sales within the State of New York by a British corporation that manufactured ale outside the state. The corporation argued that because it was not incorporated in New York and did not maintain its principal place of business there, New York could not levy a tax merely by reason of its having sales in the state. The Supreme Court said that where "its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York . . . —the process of manufacturing resulting in no profits until it ends in sales,—the state was justified in attributing to New York a just proportion of the profits." 266 U.S. at 282, 45 S.Ct. at 84, 69 L.Ed. at 287. Similarly, the process of fishing results in no profits until the catch is sold to processors in Alaska.[7]

Sjong also argues that the actual sale of the crab catch takes place in Washington, *i.e.*, the contract is negotiated in Washington and payment is made there. The only sale-related activity occurring in Alaska is the delivery of the goods, and delivery alone should not subject him to taxation. In support of this he cites the Supreme Court's decision in *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 74 S.Ct. 535, 98 L.Ed. 744 (1954), where the Court held that a Delaware store could not be held liable for Maryland use taxes on merchandise sold to Maryland residents because of a lack of minimum contacts. The only contact that the store had with the taxing state was that its truck occasionally entered the state to deliver the previously ordered goods. Sjong argues that since his boat enters the state only to make deliveries, this should not constitute a sufficient nexus to uphold taxation.

The situation in *Miller Brothers* is to be distinguished from the case at bar. First, in *Miller Brothers* the delivery truck entered the state sporadically; it did not make all deliveries. All sales were made outside the state, and the sales made to Maryland residents constituted only a portion of the total of Miller Brothers' overall sales. Here, the taxpayer admits that he has been fishing in Alaska for ten years, and sells exclusively to Alaska processors. His principal source of income is the money which he receives in payment for crab delivered to those processors. The amount of business activity is certainly more substantial than that in *Miller Brothers*.

Second, more than "mere delivery" of goods is taking place within Alaska. What in fact is occurring is the consummation of the *sale* of Sjong's crab. AS 43.20.130(e)(1)[8] states that "[s]ales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser . . . inside this state . . . ." Therefore, a sale has taken place when the crab

7. In the alternative, Sjong argues that no income is earned until payment is made and since all payments were made in Seattle, no income should be attributed to the state. Various courts have held, however, that the actual place where income payments are turned over to the taxpayer is not determinative of the source of the income for purposes of state income tax. *See Petition of Union Elec. Co. of Mo.*, 349 Mo. 73 161 S.W.2d 968, 972 (1942); *In re Kansas City Star Co.*, 346 Mo. 658, 142 S.W.2d 1029, 1039 (1940). Furthermore, a taxpayer cannot escape a tax on income from sources within the state by billing from the outside or by setting up his machinery so that the income is paid to him in another state. *Gross Income Tax Div. v. Bartlett*, 228 Ind. 505, 93 N.E.2d 174, 177 (1950).

8. AS 43.20.130(e) repealed by ch. 70, § 13, SLA 1975. However, since this case was instituted under the prior tax statutes, those statutes then in effect will govern the resolution of this matter.

are delivered to the processor in Alaska under a previously negotiated contract.[9]

In conclusion, because the state is giving something for which it can ask in return, in the form of supplies, employment, and a market for sale of goods, and the taxed income is derived from sources in the state, there appears to be a sufficient nexus to justify imposition of the tax.

II. COMMERCE CLAUSE

[3] The commerce clause of the United States Constitution [10] places restraints upon the taxing power of states similar to those of the due process clause. In fact, these two constitutional limits overlap to a great extent. The courts, however, have usually placed considerations of minimum contacts and sufficient nexus under the due process heading, while questions regarding the proper apportionment of income to the taxing state and the discriminatory impact of taxes are covered by the Commerce Clause. *Central Greyhound Lines v. Mealey,* 334 U.S. 653, 661, 68 S.Ct. 1260, 1265, 92 L.Ed. 1633, 1640 (1948). *See also Moorman Manufacturing Co. v. Bair,* 437 U.S. 267, 277–79, 98 S.Ct. 2340, 2346–2348, 57 L.Ed.2d 197, 207–08 (1978). Hence, "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the [tax]." *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 452, 79 S.Ct. 357, 359, 3 L.Ed.2d 421, 424 (1959).

The test used by the United States Supreme Court to determine the validity of a tax under the Commerce Clause was recently expressed in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977). There, four factors were analyzed to determine the validity of the tax: (1) whether the activity taxed had a sufficient nexus with the taxing state; (2) whether the tax is fairly related to benefits provided by the state to the taxpayer; (3) whether the tax was fairly apportioned to local activities; and (4) whether it discriminated against interstate commerce. As the nexus consideration and questions of the relationship to services provided by the state has been dealt with in the previous due process discussion *supra,* and the apportionment question will be discussed *infra,* the only issue which we will consider here is whether the tax discriminates against interstate commerce.

[4, 5] A state may not "impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business" [relative to interstate business]. *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 329, 97 S.Ct. 599, 606, 50 L.Ed.2d 514, 524 (1977), *quoting Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421, 427 (1959). There appears to be no indication that this situation is present here. As neither party has briefed this argument, this point will not be considered [11] and whether the commerce clause will be violated by imposition of the state net income tax

9. Under the Uniform Commercial Code the transaction which occurs in Alaska constitutes a sale. UCC § 2–106(1) provides that a "sale consists in the passing of title from the seller to the buyer for a price." Commenting on this section one authority states: "The transfer of title is the essential element or the distinguishing characteristic of a sale of goods." R. Anderson, Uniform Commercial Code § 2–106, § 2–106:5 at 235 (2d ed. 1970). In testimony before the Department of Revenue, Sjong's attorney said: "I think for the purposes of what we're discussing, the risk of loss passes at the time the crab is delivered. So I would say that title of the crab is with the vessel until such time as it is delivered to the processor."

10. The commerce clause is set forth in article I of the United States Constitution: "The Congress shall have the power to . . . regulate commerce with foreign nations, and among the several states, and with the Indian tribes; . . ." U.S. Const. art. I, § 8.

11. Where a point is not given more than a cursory statement in the argument portion of a brief, such point will not be considered by the supreme court. *Lewis v. State,* 469 P.2d 689 (Alaska 1970). *See also Kristich v. State,* 550 P.2d 796 (Alaska 1976); *Miller v. City of Fairbanks,* 509 P.2d 826 (Alaska 1973).

should be determined in light of the other overlapping areas of discussion.

III. INTERSTATE INCOME LAW EXEMPTION

Sjong's third argument in support of his contention that there is no jurisdiction to tax him is that the State is prohibited from taxing his activities under section 381(a) of the Interstate Income Law.[12] Public Law 86–272 was enacted in 1959 as a congressional limitation on the Supreme Court's decision in the *Northwestern States* case,[13] in response to a tremendous outcry from interstate businesses who saw themselves potentially subject to numerous state and local taxes.[14]

The pertinent part of section 381 states: *Imposition of net income tax*

> *Minimum standards*
>
> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State ....

The only case in which the United States Supreme Court has interpreted the Interstate Income Law is apparently *Heublein, Inc. v. South Carolina Tax Commission*, 409 U.S. 275, 93 S.Ct. 483, 34 L.Ed.2d 472 (1972). The holding of that case, however, actually had very little to do with section 381. *Heublein* concerned a South Carolina liquor regulation and the interaction between that regulation, section 381, and the twenty-first amendment to the United States Constitution.[15] The Court concluded that even though the regulation required an interstate business to undertake activities within the taxing state which would take it beyond the ambit of section 381 protection, the state was not deliberately attempting to structure its regulations so as to justify imposition of a tax. The regulation was held valid and "§ 381 does not apply." 409 U.S. at 284, 93 S.Ct. at 489, 34 L.Ed.2d at 480.

Of the lower court cases which have interpreted Public Law 86–272, practically all have been concerned with interpretation of the word "solicitation." The strongest line of cases comes from decisions of the Oregon Supreme Court. The first case, *Smith, Kline & French Laboratories v. State Tax Commission*, 241 Or. 50, 403 P.2d 375, 377 (1965), interpreted the term broadly by holding that it included all "lesser, included phases" of solicitation, such as pre-solicitation promotional work, so that such activities alone would not cause an interstate business to lose its section 381 exemption. The Oregon Supreme Court has, however, in subsequent decisions, significantly narrowed its interpretation of this key term, and has excluded from interstate tax exemption any activities not directly leading to the placing of orders.[16]

12. Pub.L. 86–272, codified at 15 U.S.C. §§ 381–384 (1976).

13. 358 U.S. 450, 79 S.Ct. 357, 3 L.Ed.2d 421 (1959).

14. *See* S.Rep. No. 658, 86th Cong., 1st Sess., *reprinted in* [1959] U.S. Code Cong. & Ad. News, pp. 2548, 2549–50.

15. The twenty-first amendment gives to the states power to regulate sales of alcoholic beverages. Section 2 of the amendment provides that "[t]he transportation or importation into any State ... for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S.Const. amend. XXI.

16. For example, in *Olympia Brewing Co. v. Dep't. of Revenue*, 266 Or. 309, 511 P.2d 837 (Ore.1973), *cert. denied*, 415 U.S. 976, 94 S.Ct. 1561, 39 L.Ed.2d 872 (1974), the presence of beer kegs by which retailers could dispense draft beer destroyed the section 381(a) exemption and was sufficient to justify imposition of the state corporation income tax. Other activi-

Sjong contends that because his activities in the state consist solely of the delivery of goods previously ordered under contracts negotiated outside of the state, he should be exempt from taxation. He argues that section 381(a) should not be read so narrowly as to require all those activities described in the section to be present for exemption from taxation. He relies heavily on *Smith, Kline* to support this view. However, as the Oregon court's interpretation of the basic holding of *Smith, Kline* has narrowed considerably, we feel his reliance on a broad construction of section 381(a) is untenable.

[6, 7] In their decisions, the superior court and revenue board held that in order for an interstate business to qualify for a section 381(a) exemption, the business activities must conform strictly to the language of the statute. We agree with this interpretation of section 381(a); that in order to qualify for the exemption, a business must solicit orders, which are sent out of state for approval, and then make deliveries into the state. Since Sjong's acts concern only the third part of the described activity—deliveries—it does not come within the statutory exemption.

Looking at the original legislative intent, this would seem to be a correct interpretation. As the bill was originally passed to cover the types of activities litigated in the *Northwestern States* case, and the activities there consisted of in-state solicitation coupled with out-of-state approval and delivery, the mere act of delivery should not be sufficient to bring an interstate business within the scope of section 381(a) coverage. In fact, the Senate Report specifically states, "[t]o qualify, however, all such orders must be sent outside the State for approval or rejection, and if approved, must be filled by shipment or delivery from a point outside the State." [17] This seems to indicate exactly what types of activities were intended to be protected by the bill. To interpret Sjong's activities as falling within the exemption of section 381(a) would controvert the legislative intent.

Furthermore, what is occurring in the case at bar is not the mere delivery of goods, but also the sale of tangible personal property within the state, and such sales are not covered by the section 381(a) exemption either. In conclusion, Sjong's activities go beyond the solicitation and delivery requirements of section 381, and are not exempt under the Interstate Income Law.

IV. THE APPORTIONMENT FORMULA

Having determined that the state has jurisdiction to tax Sjong's net income, the next issue we must address concerns the proper apportionment of the tax. Sjong contends that the apportionment formula adopted by the Department results in an unfair allocation of his income to the state.

[8] The purpose of apportionment is to ensure that only activities within the taxing state are subject to taxation. An apportionment formula is valid under the due process and commerce clauses only if, as a tax measure, it assigns to a state income that can reasonably be said to result from activities or properties within its borders. *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 462, 79 S.Ct. 357, 364, 3 L.Ed.2d 421, 429–30 (1959). In analyzing the apportionment formula, we utilize a two-step process. First, we must address the question of whether the apportionment formula as a whole is constitutional. Second, if it is found to be acceptable, it must then pass the test of fairness as applied to the individual taxpayer's situation. *Norfolk & Western Railway Co. v. North*

ties which the court found went beyond solicitation included: replacing and servicing damaged merchandise, *Miles Laboratories, Inc. v. Dep't of Revenue,* 274 Or. 395, 546 P.2d 1081 (1976); holding consultations and contracts for sale of goods, *Iron Fireman Mfrg. Co. v. State Tax Comm'n,* 251 Or. 227, 445 P.2d 126 (1968); and collection by salesmen of initial deposits on merchandise, *Herff Jones Co. v. State Tax Comm'n,* 247 Or. 404, 430 P.2d 998 (1967). For a discussion on the Oregon line of cases, *see* Hartman, *"Solicitation" and "Delivery" Under Public Law 86-272: An Uncharted Course,* 29 Vand.L.Rev. 353, 364–77 (1976).

17. [1959] U.S. Code Cong. & Ad. News, p. 2548.

Carolina, 297 U.S. 682, 685, 56 S.Ct. 625, 627, 80 L.Ed. 977, 980 (1936).

Concerning the first step, the United States Supreme Court, in reviewing appeals on the proper allocation and apportionment of taxes, has refused to impose strict constitutional restraints on a state's apportionment formula. Recognizing the artificiality of such formulas, the Court states a readiness to sustain any formula reasonably designed to determine the net income attributable to business done in the taxing state. "[R]ough approximation rather than precision" is sufficient. *International Harvester Co. v. Evatt*, 329 U.S. 416, 422, 67 S.Ct. 444, 447, 91 L.Ed. 390, 395 (1947), *citing Illinois Central Railroad Co. v. Minnesota*, 309 U.S. 157, 161, 60 S.Ct. 419, 422, 84 L.Ed. 670, 674 (1940). "Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments." *International Harvester Co. v. Evatt*, 329 U.S. at 422–23, 67 S.Ct. at 447, 91 L.Ed. at 395.

[9] Therefore, a heavy burden is placed on a taxpayer challenging a state's allocation of his income to prove by "clear and cogent evidence" that the income attributed to the state is "out of all appropriate proportion to the business transacted ... in that State," or has "led to a grossly distorted result." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 274, 98 S.Ct. 2340, 2345, 57 L.Ed.2d 197, 205 (1978), *quoting Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135, 51 S.Ct. 385, 389, 75 L.Ed. 879, 908 (1931) and *Norfolk & Western Railroad Co. v. Missouri Tax Commission*, 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201, 1208 (1968).

In the original assessment of the tax, the Department of Revenue relied on Revenue Ruling 74–2 [18] which stated:

> It must be remembered that the fishing vessel must have actual business activity in more than one taxing jurisdiction to apportion. The mere fact that a boat winters in Seattle or some other port does not give it nexus in that state ... If all fish products are taken in international waters and sold in Alaska only, apportionment shall not apply and all income from fishing is to be reported to Alaska....

On the basis of this Ruling, the Department originally refused to apportion Sjong's income and allocated the entire sum to the State. Following Sjong's protest, hearings were held and sufficient contacts with the State of Washington were found to require apportionment. The Department employed the formula outlined in AS 43.20.130(a),[19] resulting in an allocation of approximately 85–92% of Sjong's income to the State for the years in question.

The apportionment formula takes into consideration three factors: Sales, property, and payroll. AS 43.20.130(e)(1) provides that "sales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser ... inside this state regardless of the f.o.b. point or other conditions of the sale ...." The Department concluded: "The crab are tangible personal property delivered to a purchaser within Alaska and regardless of the other conditions of the sale (for instance, a market negotiated outside the State) are assignable to Alaska for purposes of the sale factor." Because all of the sales of crab were made in Alaska, 100% of sales was allocated to the state.

18. Revenue Ruling 74–2, dated February 20, 1974, was promulgated in response to a request from Sjong on the question of the proper allocation and apportionment of income to the state from fishing operations. Revenue Ruling 74–2 is reprinted in [1974] Alaska Tax Reports (CCH) ¶ 200–160.

19. AS 43.20.130(a) (repealed ch. 70, § 13, SLA 1975) provided:

> (a) All business income which cannot be directly apportioned and allocated to this state shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Applying the standard provided in AS 43.20.130(g),[20] the property factor was calculated on the basis of the "port-day" method. This consists of a ratio of the number of days spent in ports inside the state to the total number of days spent in ports inside and outside the state. For purposes of fishing vessels, the port-day method excludes idle time between fishing seasons or between charters, but does include time spent stocking the boat with supplies and readying it for departure on a fishing voyage, cleaning it up after a voyage, and time spent delivering fish and taking on additional supplies during the fishing season.

The hearing examiner noted two alternative means of calculating the payroll factor:

> [W]here the income producing activity is attributable to the operation of a vessel on the high seas as in fishing activities, . . . the payroll of employees engaged in operating the vessels, should be assigned to the State pursuant to the "port day" method . . . . [but] where the port day method does not reasonably approximate the value of wages accountable for by the business generated by Alaska, the payroll factor should be determined by reference to the corresponding sales of fish or crab.

Relying on the provisions of AS 43.20.-130(g), the hearing examiner also apportioned the payroll factor pursuant to the port-day method. However, the Department of Revenue rejected the examiner's calculation and chose to adopt a different means of apportionment. In light of the fact that the earnings of the fishing crew were directly dependent upon the sale of the catch of crabs, the Department calculated the payroll factor on the basis of sales in Alaska, *i. e.*, 100%.

[10, 11] Sjong contends that since more than 95% of his business activity is conducted outside of Alaska, a formula which allocates approximately 85–92% of his income to the state is manifestly unfair. The courts, however, have upheld allocations which take into account income earned outside of the taxing state's borders, so long as the values can be "reasonably attributable" to activities occurring within the taxing state. In *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445, 61 S.Ct. 246, 250, 85 L.Ed. 267, 271 (1940), the Court said there was nothing unconstitutional about a tax which is contingent upon events brought to pass without a state, so long as there is a nexus between such tax and transactions within a state for which the tax is an exaction. Due process does not prohibit a formula which considers out-of-state activity in evaluating the local activity. *International Harvester Co. v. Evatt*, 329 U.S. at 423, 67 S.Ct. at 447, 91 L.Ed. at 395. So, in the instant case, the mere fact that the sales of crab in Alaska are contingent upon negotiations in Seattle and crab fishing in international waters should not act to invalidate the tax. Our task is not to determine whether this formula is the best method of apportioning income, but merely whether it is fairly calculated to assign to the state that portion of net income reasonably attributable to the business done in the state. This it seems to have done.

The second step is to determine whether the formula as applied to the individual taxpayer has produced a fair apportionment. The taxpayer has made two challenges to the apportionment scheme. He first challenges the employment of the port-day formula in calculating the property fac-

20. AS 43.20.130(g) (repealed ch. 70, § 13, SLA 1975) provided:

> (g) The value of vessels operating on the high seas and compensation of employees engaged in operating the vessels shall be apportioned to the state in the ratio which the number of days spent in ports inside the state bears to the total number of days spent in ports inside and outside the state. The term "days spent in ports" does not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction of service. Days in port are computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to, and inside the state and compensation of employees so engaged are apportioned to the state in the ratio which the number of days during which the services are rendered inside the state bears to the total number of days during which the services are rendered inside and outside the state.

tor, and argues that a voyage-day formula be used in its place. The "voyage-day" formula would apportion the vessel's income on the basis of a ratio of the number of days in the state to the number of days inside and outside of the state. *See Luckenbach Steamship Co. v. Franchise Tax Board*, 219 Cal.App.2d 710, 33 Cal.Rptr. 544, 547 (1963). This, he claims, would take into consideration time spent making repairs on the boat, and negotiating a market for his crab catch; factors which the "port-day" formula does not take into account.

[12] Sjong has not shown that the port-day method results in a gross distortion of his tax. True, he has argued that one formula may be slightly fairer than the other and may better represent his particular activities, but courts do not usually invalidate an assessment unless the tax is "out of all appropriate proportion to the business transacted ... in that state." *Hans Rees' Sons v. North Carolina*, 283 U.S. 123, 135, 51 S.Ct. 385, 389, 75 L.Ed. 879, 908 (1931). This he has not shown, and in light of his failure to do so, the employment of the port-day formula should be upheld.

[13] Sjong's second argument is that the Department should not have allocated 100% of the sales and payroll to the state when over 95% of his business activity is conducted outside the state. The statute in question, AS 43.20.130(e)(1) provides that "Sales of tangible personal property are in this state if (1) the property is delivered or shipped to a purchaser ... inside this state." All of Sjong's sales are made in Alaska and a 90% allocation of income to the state does not produce a gross distortion. In fact, failure to allocate sales to the state in which they are made would greatly underrepresent the extent of the taxpayer's activities within the state.

Finally, under AS 43.20.140,[21] the Department had the discretion to base the payroll factor on sales if it determined the port-day formula did not fully represent the extent of the taxpayer's business activity in the state. Given that Sjong's earnings were dependent upon sales, it is hard to conclude that there was no reasonable basis for its decision.

[14] Because the allocation formula is constitutional on its face, and has not produced a grossly distorted result in the assessment of Sjong's tax liability, we hold the Department's apportionment formula valid.

V. ATTORNEY'S FEES

The final issue in this appeal is whether the superior court abused its discretion in awarding $1,775 to the state for its attorney's fees. Because he had a statutory right to appeal the decision of the taxing authority to the superior court,[22] Sjong contends that the court erred. He relies upon our decision in *Crisp v. Kenai Peninsula Borough School District*, 587 P.2d 1168 (Alaska 1978).

In *Crisp*, we reversed an award of attorney's fees against a dismissed tenured teacher in his unsuccessful appeal to the superior court from his employer's decision to terminate his contract.[23] In our opinion, we stated: "Given Crisp's statutorily guaranteed right to contest his dismissal in the courts, we think it would be manifestly unreasonable to penalize the exercise of that right by allowing an award of *any* attorney's fees to the school district." *Id.* at 1169 (footnote omitted) (emphasis in original).

Upon further reflection we realize that our statement in *Crisp* may be subject to misinterpretation. In that case we were influenced by the importance of the right being asserted. In a very real sense Crisp's entire future was at stake, due to the damage likely to be done to his professional

21. AS 43.20.140 is repealed by ch. 70 § 13, SLA 1975.

22. *See* note 3, *supra*.

23. AS 14.20.205 provides tenured teachers a right to judicial review of their termination as follows:

> *Judicial review*. If a school board reaches a decision unfavorable to a teacher, the teacher is entitled to a de novo trial in the superior court. However, a teacher who has not attained tenure rights is not entitled to judicial review according to this section.

reputation by the school board's action. Because of this we concluded that the risk of liability for the employer's attorney's fees was an impermissible burden to place on one in Crisp's position. 587 P.2d at 1170, n. 7.

There are a multitude of administrative decisions, however, including the one in the case at bar, having consequences far less significant. Many of these decisions are appealable to the courts. As to these, the rule announced in *Crisp* does not apply. In such cases the courts may continue to assess reasonable attorney's fees against the losing party. *See* Rules 29(d) and 45, Alaska R.App.P.; *Kodiak Western Alaska Airlines, Inc. v. Bob Harris Flying Service, Inc.*, 592 P.2d 1200, 1204–05 (Alaska 1979).

[15] Since we are unable to say that the superior court's award of attorney's fees in this case amounted to an abuse of discretion, we uphold the award.[24]

The judgment of the superior court is AFFIRMED.

WEST KEY NUMBER SYSTEM

GOLDIES, INC., Appellant,

v.

ALASKA HOTEL & RESTAURANT EMPLOYEES HEALTH AND WELFARE FUND, Alaska Hotel and Restaurant Employees Pension Trust and Legal Trust, Appellees.

No. 5078.

Supreme Court of Alaska.

Feb. 6, 1981.

Suit was brought to recover payments allegedly owing to union trust funds. The Superior Court, Third Judicial District, Anchorage, Milton M. Souter, J., granted summary judgment for the trust funds, and employer appealed. The Supreme Court, Matthews, J., held that: (1) employer's obligation to pay into union trust fund was part of its employees' compensation, and thus actions of union in failing to perform condition of collective bargaining agreement whereby union orally agreed to attempt to organize and picket employer's competitor, whether or not such condition was legal, did not defeat employer's obligation to make employee benefit contributions, and (2) there was no error in award of liquidated damages.

Affirmed.

1. Labor Relations ⚷131.4

Employees, as beneficiaries of trust funds, were third-party beneficiaries of collective bargaining agreement between union and employer under which employer was required to make monthly payments to the trust funds.

2. Labor Relations ⚷131.6

Employer's obligation to pay into union trust funds was part of its employees' compensation, and thus actions of union in failing to perform condition of collective bargaining agreement whereby union orally agreed to attempt to organize and picket employer's competitor, whether or not such condition was legal, did not defeat employer's obligation to make employee benefit contributions; employer's remedy was to sue the union for damages or seek rescission of the agreement.

3. Labor Relations ⚷131.6

Invalidity or illegality of a collective bargaining agreement does not alter employer's duty to make employee benefit contributions.

24. Sjong also argues that because this appeal involves a question of genuine public interest brought in good faith, it would constitute an abuse of discretion to award attorney's fees against a losing party. *Gilbert v. State*, 526 P.2d 1131, 1136 (Alaska 1974). A tax dispute which primarily concerns the taxpayer's own tax liability is not the type of public interest suit contemplated in *Gilbert*. Such is the case here.

INCOME TAX IN ALASKA
AN OVERVIEW

Joint Special Committee on State's Tax Policy

Deborah Vogt
Assistant Attorney
General

I. Introduction: three components to income tax liability
   A. What is income?
   B. How much income was earned in Alaska?
   C. What is the tax rate?

II. The tax rate.
   A. Historical overview, individual and corporate.
   B. Rate applied to federal tax liability vs. federal taxable income.

III. What is income?
   A. Legal parameters.
   B. Corporate vs. individual
   C. Federal piggybacking.
      1. Advantages
      2. Disadvantages
         a. Federal "tax subsidies"
         b. Book income vs. federal taxable income
      3. What Alaska has done; current law
      4. The new federal tax bill.

IV. How much income was earned in Alaska?
   A. Description of the two major methods: separate accounting and formula apportionment.
      1. Examples and hypotheticals.
   B. Historical development of formulas - unitary theory.
      1. Combination
      2. Worldwide vs. water's edge.
   C. What Alaska has done.
      1. UDITPA
      2. MTC
      3. Separate accounting for oil and gas.
   D. AS 43.21
      1. Why the legislature adopted AS 43.21
      2. How it worked
      3. The litigation
         a. The 1981 legislation
            1. Repeal of separate accounting
            2. Modified apportionment

INCOME TAX RATES IN ALASKA
State and Territory

Year	Individuals	Corporations
1949	10% of Fed. tax	10% of Fed. tax
1955	12½% of Fed. tax	12½% of Fed. tax
1957	14% of Fed. tax	18% of Fed. tax
1961	16% of Fed. tax	18% of Fed. tax
1964	3.2% - 14.56% of income (graduated)	5.4% & 3.96% surtax of income (surtax on income over $25,000)
	(retroactively repealed)	
1965	16% of Fed. tax	18% of Fed. tax
1975	3% - 14.5% of income (graduated)	5.4% & 4% surtax (surtax on income over $25,000)
1980 (June)	3% - 14.5% of income (graduated) (1/3 of income exempt for each prior year of filing)	5.4% & 4% surtax (surtax on income over $50,000)
1980 (Sept.)	repealed	
1981		2% - 11% (graduated to $4,000,000)
1982		1% - 9.4% (graduated to $90,000)

HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)

Total Gross Income (Sales):		$16,000
Total Payroll Cost:	$4,000	
Total Other Costs:	$8,000	
Total Net Income from Three Stores:		$4,000

STATE A		STATE B		STATE C		TOTAL	
Payroll:	$1,000	Payroll:	$1,000	Payroll:	$2,000	Payroll:	$4,000
Property:	$10,000	Property:	$10,000	Property:	$20,000	Property:	$40,000
Sales:	$4,000	Sales:	$4,000	Sales:	$8,000	Sales:	$16,000

STATE A TAX LIABILITY

$$\frac{\dfrac{\text{State A Payroll} = \$1{,}000}{\text{Total Payroll} = \$4{,}000} + \dfrac{\text{State A Property} = \$10{,}000}{\text{Total Property} = \$40{,}000} + \dfrac{\text{State A Sales} = \$4{,}000}{\text{Total Sales} = \$16{,}000}}{3}$$

$$\frac{1/4 \ \& \ 1/4 \ \& \ 1/4}{3} = \frac{3/4}{3} = \frac{1}{4} \quad X \quad \$4{,}000 = \$1{,}000$$

STATE C TAX LIABILITY

$$\frac{\dfrac{\text{State C Payroll} = \$2{,}000}{\text{Total Payroll} = \$4{,}000} \quad \dfrac{\text{State C Property} = \$20{,}000}{\text{Total Property} = \$40{,}000} \quad \dfrac{\text{State C Sales} = \$8{,}000}{\text{Total Sales} = \$16{,}000}}{3}$$

$$\frac{2/4 \ \& \ 2/4 \ \& \ 2/4}{3} = \frac{6/4}{3} = \frac{1}{2} \quad X \quad \$4{,}000 = \$2{,}000$$

SEPARATE ACCOUNTING FOR
HYPOTHETICAL RETAIL SALES TAXPAYER
(in thousands)

Example 1

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$2,000	$2,000	$4,000	$8,000
Net income:	$1,000	$1,000	$2,000	$4,000

Example 2

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$2,500	$2,500	$3,000	$8,000
Net income:	$ 500	$ 500	$3,000	$4,000

Example 3

	STATE A	STATE B	STATE C	TOTAL
Gross income:	$4,000	$4,000	$8,000	$16,000
Costs				
Payroll	$1,000	$1,000	$2,000	$4,000
Other	$3,000	$3,000	$2,000	$8,000
Net income:	$ 00	$ 00	$4,000	$4,000

APPORTIONMENT FOR HYPOTHETICAL VERTICALLY INTEGRATED TAXPAYER (Example 1)

This taxpayer manufactures a product in State A. The product is then transfered to State B for marketing and sale. There are no sales of the product in State A; all of the product is transfered to the marketing operation in State B. The product costs $4.00 per unit to produce, and an additional $4.00 of distribution and marketing costs are incurred. The product sells retail for $10.00 per unit. 1000 units are produced. In this example, the manufacturing operation "sells" the product to the marketing operation at a "transfer value" of $5.00 per unit. This transfer value is reflected as income to the manufacturing operation, and a cost to the marketing unit.

SEPARATE ACCOUNTING

STATE A		STATE B		TOTAL	
Gross income (transfer value X 1000):	$5,000	Gross income (retail sales X 1000):	$10,000	Gross income (retail sales X 1000):	$10,000
Cost of production:	$4,000	Cost of goods:	$ 5,000	Cost of production:	$ 4,000
		Sales costs:	$ 4,000	Sales costs:	$ 4,000
NET INCOME:	$1,000		$ 1,000		$ 2,000

APPORTIONMENT BY THREE FACTOR FORMULA

For simplicity, assume that all of the corporation's property is in State A (the manufacturing plant), all of the sales are in State B, and that one half the payroll is in each state.

	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	1/2 X $2,000 = $1,000	1/2 X $2,000 = $1,000

APPORTIONMENT FOR HYPOTHETICAL VERTICALLY INTEGRATED TAXPAYER (Example 2)

In this example, the only change from the previous example is that the taxpayer books the "sale" of the product from the manufacturing operation to the marketing operation at $4.00 instead of $5.00.

SEPARATE ACCOUNTING

STATE A		STATE B		TOTAL	
Gross income (transfer value X 1000):	$4,000	Gross income (retail sales X 1000):	$10,000	Gross income (retail sales X 1000):	$10,000
Cost of production:	$4,000	Cost of goods:	$ 4,000	Cost of production:	$ 4,000
		Sales costs:	$ 4,000	Sales costs:	$ 4,000
NET INCOME:	$ 00		$ 2,000		$ 2,000

APPORTIONMENT BY THREE FACTOR FORMULA

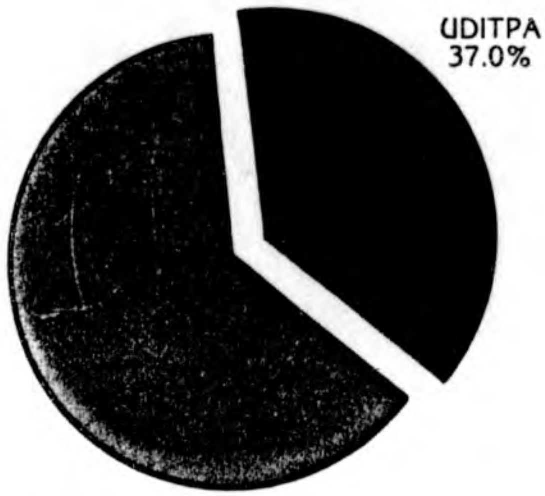
Since the bookkeeping change of the transfer value did not change the formula factors, the formula calulation remains unchanged:

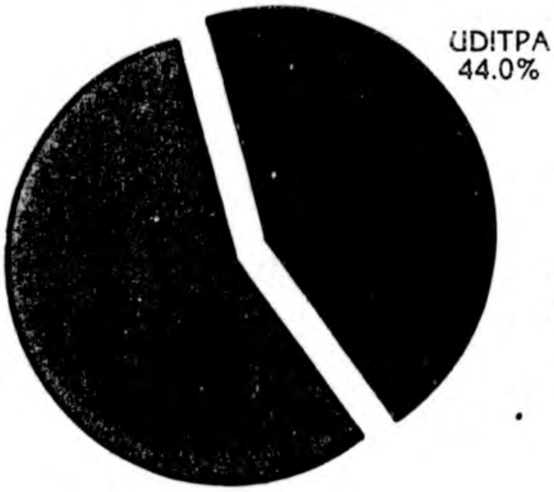
	STATE A	STATE B
Payroll:	1/2	1/2
Property:	1/1	0
Sales:	0	1/1
Factor average:	1/2	1/2
Taxable income:	1/2 X $2,000 = $1,000	1/2 X $2,000 = $1,000

UDITPA Tax Base As A Percentage of Prudhoe Bay Net Income

From Exxon Estimates (1976—1990)

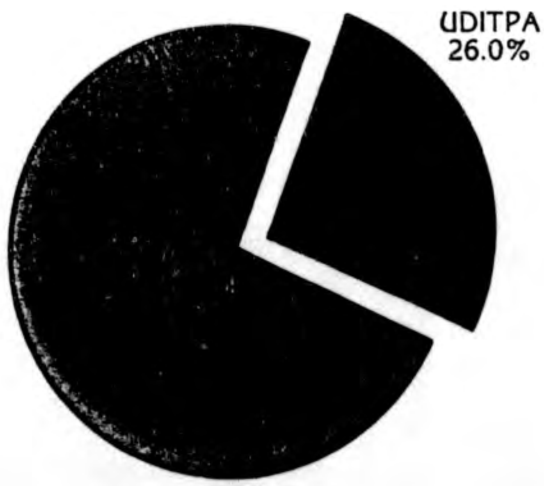
L.H. Doc. 7-036, File 26 at 13(R. 4348)
L.H. Doc. 7-037, File 26 at 18, 21(R. 4367, 4370)
See R. 16955





As Estimated By Arthur Anderson (Life of Field)

L.H. Doc. 8-080, File 13 at Exhibit VIII(a) (R. 2899)
See R. 16955—16956

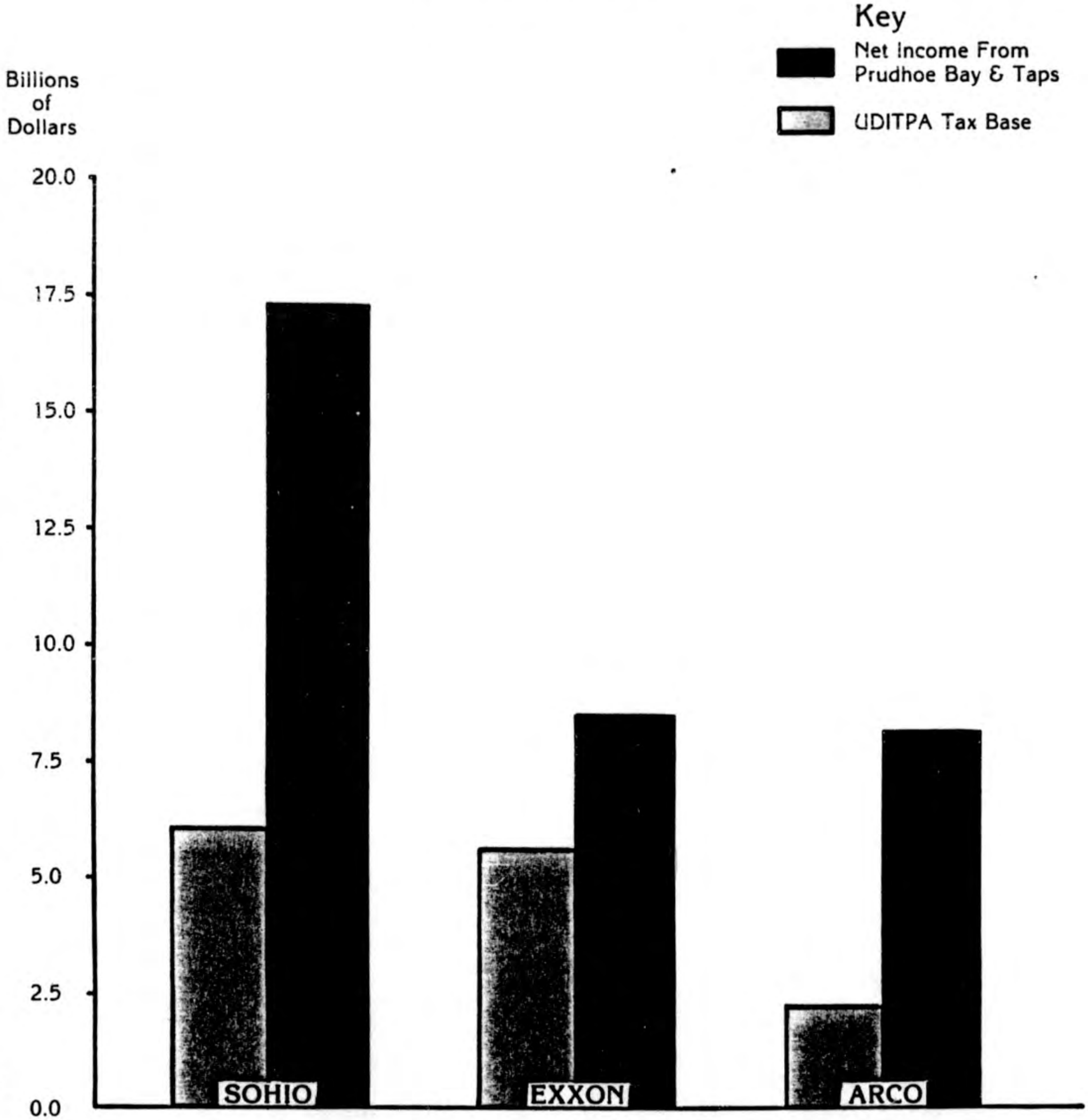


As Estimated By W.J. Levy & Assoc. From Sohio Submission One (1978)

L.H. Doc. 6-124, File 50 at 1-4(R. 8527-8530)
See R. 16954-16955

CHART 3

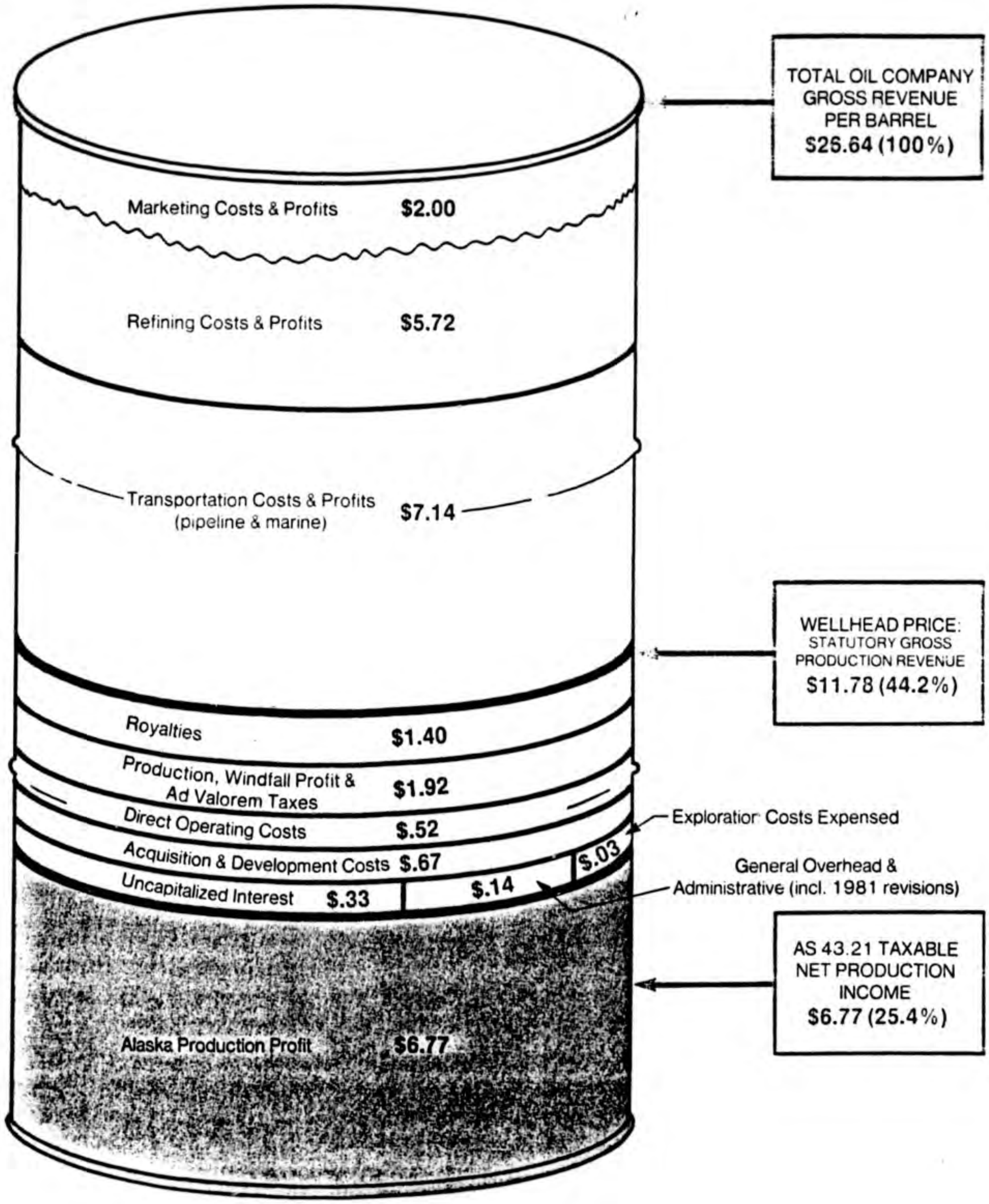
Net Income From Prudhoe Bay and Taps
Compared With UDITPA Tax Base
(Life of Field)



Source: Arthur Anderson Study, Exhibit VIII(a)(R. 2899)

CHART 4

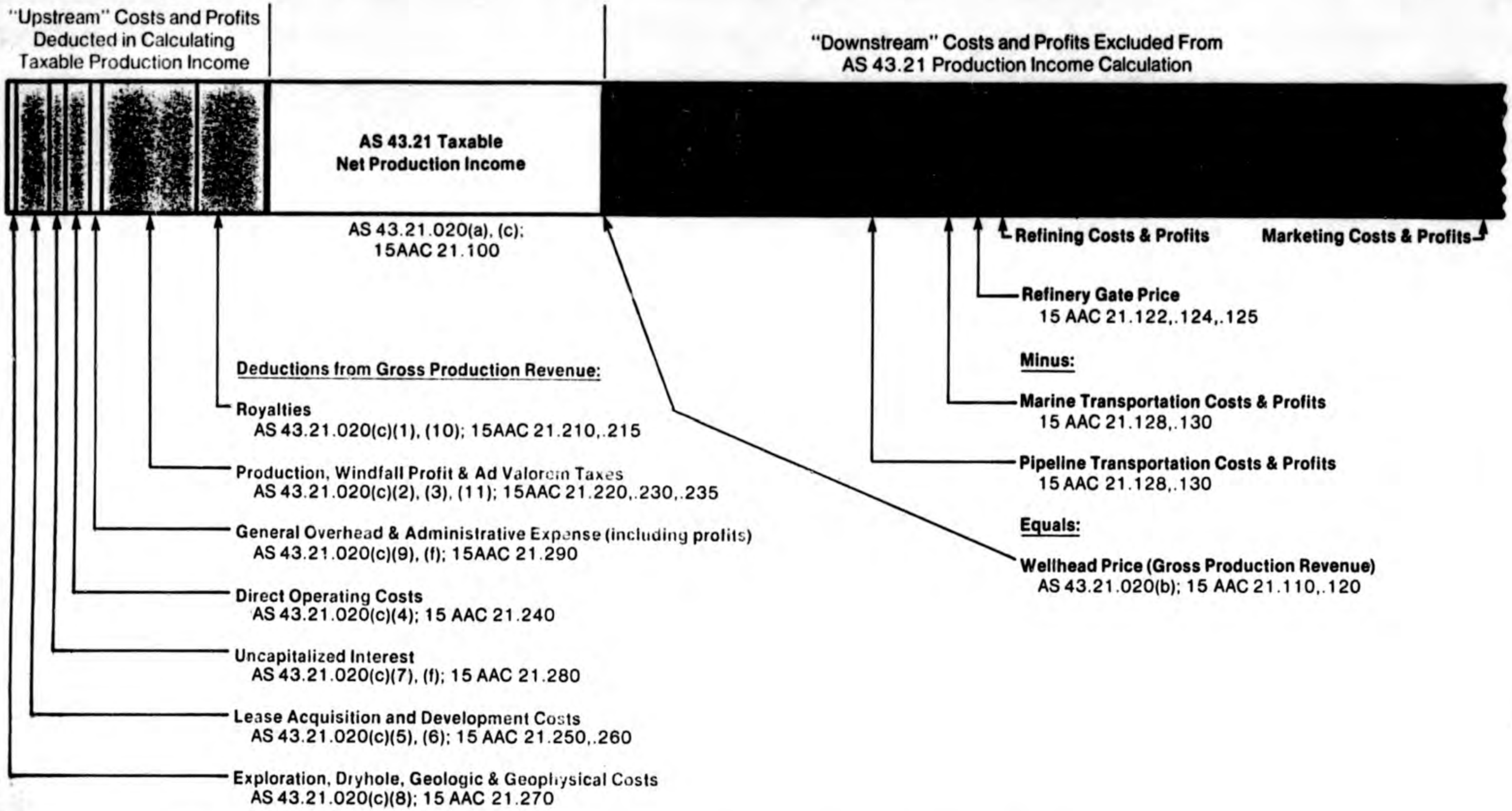
ESTIMATED REVENUES AND COSTS PER BARREL OF ALASKAN CRUDE OIL 1978 - 1980



SOURCE: Deakin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

CHART 1

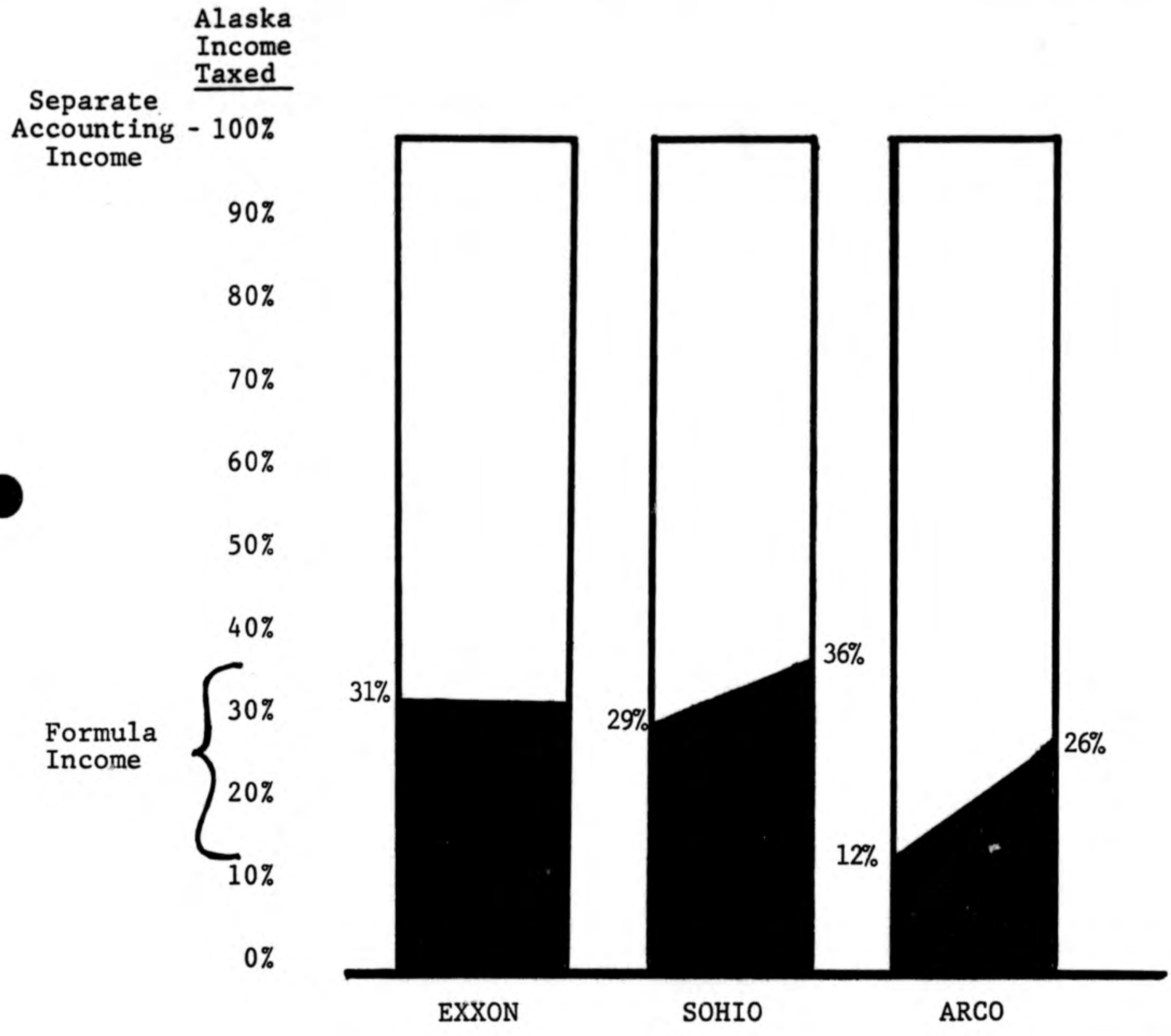
AS 43.21 TAXABLE NET PRODUCTION INCOME CALCULATION EXCLUDES ALL COSTS AND PROFITS OF UPSTREAM AND DOWNSTREAM ACTIVITIES



NOTE: Segments of bar are proportioned by approximate values for these taxpayers for 1978 - 1980. SEE Deakin 2d Supplemental Affidavit ¶ 15, R. 16917, 16929.

CHART 2

TAXPAYERS' CALULATIONS OF
FORMULA INCOME AS A PERCENTAGE OF
SEPARATE ACCOUNTING INCOME
1978 - 1981



ROGOVIN, HUGE & LENZNER
A PROFESSIONAL CORPORATION

November 13, 1985

MEMORANDUM

TO: Deborah Vogt

FROM: Michael D. Lowe
Jeffrey Blattner

RE: Research Regarding Other States' Corporate Income Taxes

You requested that we research three questions regarding other states' corporate income tax systems:

1. What is the status of worldwide unitary combination among the states since Container Corp.?

2. What industries besides oil and gas production are subject to exceptional (i.e., non-PSP) apportionment and allocation techniques among the states?

3. What is the range of state corporate tax rates?

The following are the results of our research.

The Decline of Worldwide Unitary Combination

Recent activity among the states and by the Federal Government illustrates the highly unsettled nature of state corporate division-of-income rules. It also reveals a strong trend away from the comprehensive application of formula apportionment through worldwide unitary combination.

In mid-1972 thirteen states used worldwide combined formula apportionment for unitary corporate taxpayers.[1/] The remaining states with corporate income taxes conformed to federal and international practice by applying arm's-length separate accounting at the United States "water's edge".

Shortly after the 1983 Container Corporation decision upheld California's application of worldwide combination to a U.S.-based unitary corporate taxpayer, the President convened a Working Group of federal, state and business representatives to assess growing foreign government and taxpayer resistance to worldwide unitary combination. By August 1984, when the Working Group recommended to the President that federal incentives be enacted to discourage states from extending their apportionment formulas beyond the water's edge,[2/] the number of states applying worldwide combination had dropped to twelve.[3/] In the sixteen months since the Working Group issued its report, another six former worldwide combination states have limited their formula apportionment systems by adopting arm's-length separate accounting at

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1/ Those states were Alaska, California, Colorado, Idaho, Illinois, Indiana, Massachusetts, Montana, New Hampshire, New York, North Dakota, Oregon and Utah. GAO, "Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving" at 66, GAO/GGD-82-38, July 1, 1982.

2/ "Final Report of the Worldwide Unitary Taxation Working Group" at ii, August 1984.

3/ Alaska, California, Colorado, Florida, Idaho, Indiana, Massachusetts, Montana, New Hampshire, North Dakota, Oregon, and Utah. Rosapepe, Multistate Tax Commission research paper at 3-10, September 1985.

the water's edge.[4/] In addition, five of the remaining six worldwide combination states have legislation proposing water's edge under consideration.[5/]

On November 8, 1985, the President announced his intention to introduce legislation requiring adherence to the water's edge limitation on state apportionment systems.[6/] Earlier this year, Sen. Mathias reintroduced as S.1113[7/] a bill that appears to be consistent with the President's intentions.

Industries Subject to Special Allocation and Apportionment Rules

The attached chart (Attachment 3) lists examples of industries that are given treatment different from the prevailing PSP formula in certain PSP states. Particularly notable are

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4/ Four states adopted legislation either requiring the water's edge method or eliminating combined reporting. See Colo. Rev. Stat. § 39-22-303 (1985); 1984 Fla. Laws Spec. Sess. A, Chap. 84-549; Ind. Code Ann. §§ 6-3-2-2, 6-3-2-2.4 (West Supp. 1985); 1984 Or. Laws Spec. Sess. Chap. 1. The Utah Tax Commission replaced worldwide unitary combination with water's edge combination by regulation. Utah Tax Comm. Rule A12-02-F8A (May 15, 1985). The Massachusetts Supreme Judicial Court held that the Commissioner of Revenue lacked statutory authority to require worldwide unitary combination. Polaroid Corp. v. Comm'r of Revenue, 393 Mass. 490, ___, 472 N.E. 2d 259, ___ (1984).

5/ The most recent bills proposing abolition of worldwide unitary combination are California: S.B. 85, Reg. Sess. (1985); Idaho: S.B. 1145, 48th Leg. 1st Reg. Sess. (1985); Montana: S.B. 330, 49th Leg., Reg. Sess. (1985); New Hampshire: H.B. 431, Reg. Sess. (1985); North Dakota: S.B. 2343, 49th Leg., Reg. Sess. (1985).

6/ Statement by the President, White House Press Secretary (Nov. 8, 1985). See Attachment 1.

7/ 99th Cong., 1st Sess. (1985). See Attachment 2.

Oregon's separate accounting for multistate construction businesses, Mississippi's separate accounting for natural resource producers, and the widespread use of modified formulas for financial and insurance companies, and pipeline and transportation companies. We did not include the oil and gas production examples with which we are already quite familiar. The blanks in the "Apportionment" column on the chart represent industry-state combinations for which the allocation or apportionment cannot be determined from secondary sources. We can examine the statutes and regulations themselves if any of them interest you.

Range of State Corporate Tax Rates

The range of corporate income tax rates for states with a flat percentage rate tax is from 2.35% in Michigan to 11.5% in Connecticut. States with multiple-tier tax structures vary in range. For instance, the range in the Arkansas tax is from 1% on the first $3 million to 6% on earnings above $25 million. In Arizona the range is from 2.5% on the first million dollars to 10.5% on earnings over $6 million. States with taxes greater than those levied in Alaska on sizeable income include Arizona (10.5%), California (9.6%), Connecticut (11.5%), the District of Columbia (10% + 5% surtax), Iowa (12%), Minnesota (12%), New York (10%), North Dakota (10.5%), Pennsylvania (9.5%), and West Virginia (9.75% effective 7/1/87). Prentice-Hall, State and Local Taxes, All States Unit ¶222 (1985). See Attachment 4.

Let us know if we can provide any additional backup or elaboration on these or other points.

Attachments

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release — November 8, 1985

STATEMENT BY THE PRESIDENT

Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the concept of legislation that would:

1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement"); and

2. Address the question of equitable taxation of foreign source dividends.

We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. I am also instructing the Secretary of the Treasury to pursue enactment of the domestic "spreadsheet" legislation, which has been previously proposed, and which is designed to assist nonunitary states with tax enforcement respecting multinational corporations in order to promote full taxpayer disclosure and accountability.

Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach.

# # #

99TH CONGRESS
1ST SESSION

S. 1113

To amend the Internal Revenue Code of 1954 to clarify the extent to which a State, or political subdivision, may tax certain income from sources outside the United States.

IN THE SENATE OF THE UNITED STATES

MAY 9 (legislative day, APRIL 15), 1985

Mr. MATHIAS introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

To amend the Internal Revenue Code of 1954 to clarify the extent to which a State, or political subdivision, may tax certain income from sources outside the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) chapter 77 of the Internal Revenue Code of 1954 (relating to miscellaneous provisions) be amended by adding at the end thereof the following new section:

"SEC. 7518. INCOME OF CORPORATIONS ATTRIBUTABLE TO FOREIGN CORPORATIONS.

"(a) IN GENERAL.—Where two or more corporations are members of the same affiliated group of corporations—

"(1) for purposes of imposing an income tax on any corporation which is a member of such group, no State, or political subdivision thereof, may take into account, or include in income subject to such tax, any amount of income of, or attributable to,

"(2) any other corporation which is a member of such group and which is a foreign corporation,

unless such amount is includable in the gross income of the corporation described in paragraph (1) for purposes of chapter 1 (including any amount includable in gross income under subpart F of part III of subchapter N of chapter 1) for the taxable year in which or with which the taxable period (for purposes of State or local law) ends.

"(b) INCOME TAX DEFINED.—For purposes of this section, the term 'income tax' means any tax which is imposed on, according to, or measured by net income.

"(c) AFFILIATED GROUP DEFINED.—For purposes of subsection (a), the term 'affiliated group' means a common parent corporation and one or more chains of corporations connected through stock ownership with such common parent corporation.

"(d) CERTAIN CORPORATIONS TREATED AS FOREIGN CORPORATIONS.—For the purpose of this section, a domestic corporation shall be treated as a foreign corporation if under section 861(a)(2)(A) a dividend received from such corporation in the taxable year referred to in subsection (a) would not be treated as income from sources within the United States.

"(e) CERTAIN DIVIDENDS PAID OR DEEMED PAID.—

"(1) DIVIDENDS EXCLUDED FROM TAX.—If a corporation receives in any taxable year a dividend from a foreign corporation (or is by application of section 951 treated as having received such a dividend), in imposing an income tax on such corporation no State, or political subdivision thereof, may tax, or otherwise take into account—

"(A) in the case of a dividend received from a corporation with respect to which an election under section 936 is in effect for the taxable year in which such dividends are paid, the amount of deduction allowed by section 243,

"(B) in the case of a dividend received from a corporation described in subsection (d) which is not described in paragraph (A), more than the lesser of—

"(i) the amount of the dividend exclusive of any amount of dividend determined under paragraph (3), or

"(ii) the amount by which the dividend plus any amount of dividend determined under paragraph (3) exceeds the excluded portion of the dividend determined in accordance with paragraph (2).

"(C) in the case of a dividend received from any other foreign corporation more than the lesser of—

"(i) the amount of the dividend (exclusive of any amount determined under section 78), or

"(ii) the amount by which the dividend plus any amount determined under section 78 exceeds the excluded portion of the dividend determined in accordance with paragraph (2).

"(2) EXCLUDED PORTION OF A DIVIDEND.—The excluded portion of any dividend shall be determined by multiplying the amount of the dividend (including any amount of dividend determined under section 78 or paragraph (3)) by a fraction—

"(A) the numerator of the fraction shall be the sum of—

"(i) the total amount of tax withheld from all such dividends at the source.

"(ii) the total amount of tax which by application of section 902 or section 960 to all such dividends, the domestic corporation is deemed to have paid, and

"(iii) the total amount of tax deemed paid by application of paragraph (3).

"(B) The denominator of the fraction shall be 46 percent of all such dividends.

"(3) SPECIAL RULE WITH RESPECT TO DIVIDENDS RECEIVED FROM DOMESTIC CORPORATIONS TREATED AS FOREIGN UNDER SUBSECTION (d).—A corporation that receives a dividend which is described in subparagraph (B) of paragraph (1) shall—

"(A) treat as a dividend for purposes of subparagraph (B) of paragraph (1), and

"(B) treat as a tax deemed paid for purposes of subparagraph (A) of paragraph (2), foreign income taxes which such other corporation has paid or deemed paid in the same proportion on or with respect to the accumulated profits of such corporation from which such dividend was paid, which the amount of such dividend bears to the amount of such accumulated profits in excess of all income taxes (other than those deemed paid).

For purposes of this section, only a tax for which a credit against tax would be allowable under section

901 (determined without regard to the limitations in section 904 and 907) shall be taken into account.".

Nothing in this section shall subject any dividend, other income item or portion thereof to taxation if such taxation is otherwise prohibited by any law, or rule of law, of the United States.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable periods (for purposes of State or local law) beginning after December 31, 1986.

(d) AMENDMENT OF THE TABLE OF SECTIONS.—The table of sections for chapter 77 of such Code is amended by adding at the end thereof the following new item:

"Sec. 7518. Income of corporations attributable to foreign corporations."

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Alternative Methods of Income Apportionment By Industry in States that Usually Apportion Corporate Income According to a 3-factor Formula

Industry	State	Apportionment	Authority
Construction (multistate businesses)	Oregon	Separate Accounting	ORE. P-H ¶65.325.10
Financial Organizations	Alabama	-------------	ALA. REG. 31.2(2)
	California (manager-distributor investment advisor of mutual fund)	Two-factor payroll and revenue formula	CAL. REV. AND TAX'N CODE §25101
	Illinois	One-factor business income formula	ILL. REV. STAT. Ch. 120 §3-304(c)
	Louisiana (Loan Business)	Two-factor salary and loan formula	LA. REV. STAT. ANN. §47:245(E)(WEST)
	North Dakota	Two-factor wage and receipts formula	Tax Form
	Pennsylvania (investment companies)	One-factor gross receipts formula	PA. STAT. ANN. §7401.3
	Wisconsin	-------------	WIS. STAT. ANN. §71.07(2)(e)

Industry	State	Apportionment	Authority
Insurance Companies	Connecticut	One-factor "gross direct premiums" formula	CONN. GEN. STAT. §212-218(a)
	Florida	One-factor "direct premiums" formula	FLA STAT §214.72
	Illinois	One-factor "direct premiums" formula	ILL. REV. STAT. Ch. 120 §3-304(b)(1)
Intangibles	Georgia	One-factor gross receipts formula	GA. CODE 91A 3611(d)(1)(a)
	South Carolina	One-factor gross receipts formula	Instructions for tax form
Interstate Bridges	Missouri	One-half of income	MO. REV. STAT. §143.451
Manufacturing	Hawaii	Two-factor payroll and property formula	HAWAII REG. 16(c), 16(c)(3)-(4).

Industry	State	Apportionment	Authority
Manufacturing and Retail Sales	Mississippi	--------------	MISS REG. §1.27-7-23(7)(h)
Natural Resource Producers	Mississippi	Separate Accounting	MISS. REG. §1.27-7-23(7)(0
Copper and Nickel	Minnesota	Standard 3-factor formula for these industries only; lesser of standard 3-factor formula for all other industries	MINN. STAT. ANN. §290.19 Subd. 1(1), §290.19(2)(West)
Pipeline Companies	Alaska	Two-factor property and extraction formula	AK. STAT. §43.20.050-150
	Florida	One-factor revenue mileage formula	FLA. TAX LAW §214.73
	Kentucky	One-factor sales formula	KY. TAX LAW ¶278
	Michigan	One-factor revenue mileage formula	MI. TAX LAW §7.558(58)

Industry	State	Apportionment	Authority
Pipeline Companies (Cont.)	North Carolina	One-factor sales formula	N.C. TAX LAW §105-130.4
	Pennsylvania	Ratio of revenue ton miles, revenue barrel miles or revenue cubic foot miles within and outside the state	PA. ADMIN. CODE §7401(c)(1 (1971)
	South Carolina	One-factor "miles" formula	Instructions for tax forms
Public Service Corporations	Georgia	-------------	GA. CODE §91A-3614
Public Utilities	Alabama	-------------	ALA. REG. 31-2(2)
	Wisconsin	-------------	WIS. STAT. ANN. §71-07(2)(
Research and Development Companies	Massachusetts	Wage-factor exclusion	MASS. GEN. LAWS ANN. Ch. 63, §38(e)(West)
"Retailers, Wholesalers, Service Companies and Lessors"	Mississippi	One-factor sales formula	MISS. REG. 1.27-7-23(7)(n)

Industry	State	Apportionment	Authority
Telephone/Telegraph Companies	Mississippi	One-factor gross operating revenue formula	MISS. REG. §1.27-23(7)(1)(
	Missouri	One-factor investment formula	MO. REV. STAT. §143.451
Transportation (Generally)	Florida	One-factor "revenue miles" formula	FLA. STAT. §214.72
	Illinois	One-factor "revenue miles" formula	ILL. REV. STAT. Ch. 120 §3-304(d)
	Louisiana	Two-factor property and gross income formula	LA. REV. STAT. ANN. §47:245(A)(West)
Air Carriers	Connecticut	Three-factors based on arrivals and departures, revenue tons and originating revenue	CONN. GEN. STAT. §12-244
	Louisiana	Two-factor property and gross income formula	LA. REV. STAT. ANN. §47:245(E)(West)

Industry	State	Apportionment	Authority
Air Carriers (Cont.)	South Carolina	One-factor "tons" formula	Instructions on tax form.
	Wisconsin	-------------	----------
Express Service	Mississippi	One-factor gross operating revenue formula	MISS. REG. §1.27-23(7)(1)(
Motor Carriers	Connecticut	One-factor "miles operated" formula	CONN. GEN. STAT. §12-218(3)(c)
	Florida	One-factor revenue mileage ratio	VA. CODE §58-151,050
	Mississippi	One-factor miles formula	MISS. REG. §1.27-23(7)(K)
	New York	Two-factor miles and and weight group formula	N.Y. TAX LAW §503
	Pennsylvania	One-factor revenue mileage ratio	PA. ADMIN. CODE §401-2(b) (1971)

Industry	State	Apportionment	Authority
Motor Carriers (Cont.)	South Carolina	One-factor miles formula	Instructions on tax form.
	Virginia	One-factor vehicle mileage formula	VA. CODE §58-151,050
	Wisconsin	-------------	--------
Passenger Carriers	Missouri	One-factor miles formula	MO. REV. STAT. §143.451
Railroads	Georgia	-------------	GA. CODE §91A-3614
	Mississippi	One-factor gross operating revenue formula	MISS. REG. §1.27-13(7)(1)(1
	Missouri	One-factor property formula	MO. REV. STAT. §143.451

CORPORATION INCOME—RATES, RETURNS, PAYMENTS

¶222 How much and when. This chart gives the income tax rates on business corporations, due dates and filing extensions, and to whom paid.

Col. A RATES and MINIMUM TAX	Col. B RETURN & PAY DATES (1, 8)	Col. C INSTALLMENTS DUE (2)	Col. D TO WHOM
ALA. 5%	Mar.15 (14, 31)		Dept. Rev.
ALASKA 1%, 1st 9,000; 2%, $10-$20M; $20-$30M, 3%; $30-$40M, 4%; $40-$50M, 5%; $50-$60M, 6%; $60-$70M, 7%; $70-$80M; 8%; $80-$90M, 9%; over $90M 9.4% (11, 37)	Mar. 15(34)		Dept. Rev.
ARIZ. 2.5% 1st $1M; 4% 2nd $1M; 5% 3rd $1M; 6.5% 4th $1M; 8% 5th $1M; 9% 6th $1M; 10.5% over $6M (43).	Apr. 15 (14, 31)		Dept. Rev.
*ARK. 1% 1st $3M; 2% 2nd $3M; 3% next $5M; 5% next $14M; 6% over $25M (37)	May 15 (14, 32)		Dir. Fin. & Admin.
CALIF. 9.6%. Min. $200 (3, 37)	Mar. 15 (3)		Franch. Tax Bd.
COLO. 5% (annual rate reduction see (16)) (37)	Apr. 15 (31)		Dept. Rev.
CONN. 11.5% (17, 30)	Mar. 31 (32)		Comr. Rev. Serv.
DEL. 8.7%	Apr. 1 (14)		Div. Rev.
D.C. 10% + 5% surtax eff for tax year or part starting after 9-30-84 Min. $100. (37)	Mar. 15 (31)		Dept. Fin. & Rev.
FLA. 5.5%	Apr. 1 (4, 14, 31)		Dept. Rev.
GA. 6%	Apr. 15 (14, 31)		Comr. Rev.
HAWAII 5.85% 1st $25M; 6.435% bal. (24,37)	Apr. 20 (31, 33)		Tax. Dist. or Dept. Tax.
IDAHO 7.7% (22, 37)	Apr. 15 (31)		Tax Comn.
ILL. 4%	Mar. 15 (14, 27)		Dept. Rev.
IND. 3% (10)	Apr. 15 (14)		Dept. Rev.
IOWA 6% 1st $25M; 8% next $75M; between $100M to 10%; over $250M and over 12% (38)	Apr. 30 (33)		Dept. Rev.
*KANS. 4.5% + 2.25% surtax on over $25M (37)	Apr. 15 (14, 31)		Dir. Tax.
*KY. 3% on 1st 25M; 4% on 2nd $25M; 5% on next $50M; 6% on next $150M; 7.25% over $250M(18)	Apr. 15 (31)		Rev. Cabinet
LA. 4% 1st $25M; 5% 2nd $25M;	May 15 (14, 31)		Dept. Rev.

Col. A RATES and MINIMUM TAX	Col. B RETURN & PAY DATES (1, 8)	Col. C INSTALLMENTS DUE (2)	Col. D TO WHOM
6% next $50M; 7% next $100M; 8% over $200M			& Tax.
ME. 3.5% on 1st $25M; 7.93%. $25M-$75M; 8.33%. $75M-$250M; 8.93% over $250M	Mar. 15 (1, 14, 32)		State Tax Assr.
MD. 7%	Mar. 15 (31)		State Comptr.
MASS. *Excise:* $2.60 per $M on tangible values or net worth + 9.5% (incl. 14% surtax) of net income; $228 min. *Income:* 5%	Mar. 15 (32)		Comr. Rev.
*MICH. 2.35% (13, 37)	Apr. 30 (14)		Dept. Treas.
MINN. 6% on 1st $25M; 12% on bal. (36, 37)	Mar. 15 (31, 33)	(28)	Comr. Rev.
MISS. 3% 1st $5M; 4% next $5M; 5% on bal	Mar. 15 (14, 32)		Tax Comn.
*MO. 5% (37)	Apr. 15 (14, 31)		Dir. Rev.
MONT. 6.75%. Min. $50 (9, 37)	May 15 (33)		Dept. Rev.
NEBR. 4.75% 1st $50M; 6.65% over $50M (25)	Mar. 15 (31, 33)		Dept. Rev.
N.H. 8.25% (eff 7-1-85; 8% eff 7-1-87(6)	Mar. 15 (26, 32)		Dept. Rev. Admn.
N.J. 9% (15)	Apr. 15 (31, 33)		Div. Tax.
N.MEX. 4.8% on 1st $1 million; $48M plus 6% on 2nd $1 million; $108M plus 7.2% over $2 million	Mar. 15 (14, 31)		Rev. Div.
*N.Y. 10%. Min. $250 (17, 23)	Mar. 15 (33)		Tax Comn.
N.C. 6%	Mar. 15 (33)	(5)	Sec'y. Rev.
N.DAK. 3% on 1st $3M; 4.5%, next $5M; 6%, next $12M; 7.5%, next $10M; 9%, next $20M; $10.5% over $50M (37)	Apr. 15 (14, 48)		Tax Comr.
*OHIO. 5.1% on 1st $25M plus 9.2% over $25M, see (19). Min. $50.	Mar. 30 (14, 31)		State Treas.
OKLA. 5% (eff for tax years begun after 1984; *was* 4%)	March 15 (14, 31)		Tax Comn.
*OREG. 7.5%. Min. $10 (37)	Apr. 15 (14, 31)		Dept. Rev.
*PA. 9.5% (eff for calendar and fiscal years starting 1985 and later; was 10.5%)	Apr. 15 (31)		Dept. Rev.
R.I. 8% (17, 29) Min. $100.	Mar. 15 (31, 33)		Tax Admr.
S.C. 6%	Mar. 15 (32)		Tax Comn.
TENN. 6%	Apr. 1 (32)		Dept. Rev.

Col. A RATES and MINIMUM TAX	Col. B RETURN & PAY DATES (1, 8)	Col. C INSTALLMENTS DUE (2)	Col. D TO WHOM
UTAH. 5%. Min. $100 (21. 37)	Apr. 15 (31. 33)		Tax Comn.
VT. 6% on 1st $10M; 7.2% on next $15M; 8.4% next $225M; 9% over $250M min. $75 ($50)(44)	Mar. 15 (14. 32)	(7)	Comr. Taxes
VA. 6% (40)	Apr. 15 (14. 31)		Dept. Tax
W.VA. 6% on 1st $50M; 7%. over $50M (flat tax of 9.75% eff 7-1-87) (42)	Mar. 15 (14. 31)		Tax Dept.
WIS. 7.9% (39)	Mar. 15 (14. 31)		Dept. Rev.

NOTES to chart ¶222—continued (corresponding to parenthetical numbers in chart):

* Local taxes may also be imposed on corporate income.

(1) Fiscal year returns due on corresponding months for calendar returns.

(2) Later installments are due in these months after return date.

(3) *Calif.*—Added 2.5% tax on preference items. Extension to file up to 7 mos. may be granted.

(4) *Fla.*—Returns due 1st of 4th mo. after tax year close (4-1) or 15 days after due date (without extensions) for filing Fed return. Up to $5,000 of net income is exempt.

(5) *N.C.*—If $50.01-$400, two installments (3-15, 9-15); over $400, four installments (3-15, 6-15, 9-15 and next 12-15); 6% interest on deferred payments.

(6) *N.H.*—Business profits tax on corporations, partnerships, individuals, orgs.

(7) *Vt.*—Pay ½ with return and ½ in 90 days after if tax $501—$2,500.

(8) Due in full with return unless installments permitted (see Col. C). Extensions of time to file don't normally extend time to pay. Many states require filing of tentative returns and payment of estimated final tax liability.

(9) No minimum for direct income tax.

(10) *Ind.*—Supplemental corporate net income tax: 4%. Gross income tax: 0.31.25% for 1985 on wholesale-retail sales & transient lodgings, reduced by 0.0125% annually till tax phased out after 2009; all others, 1.25% reduced by 0.05% annually till phased out after 2009.

(11) *Alaska.*—Personal holding cos., 12.6%; capital gains alternative tax, 4.5%. Minimum tax on preference items, 18% of Fed tax rate. Accumulated earnings tax: 4.95%, 6.93% on over $100,000.

(12) *Me.*—Plus 15% of Fed tax on tax preference items (not capital gains).

(13) *Mich.*—Single business tax imposed on corporations, individuals, partnerships and unincorporated businesses, estates and trusts with business activity instate.

(14) Fed Okd extension accepted. *Plus* 15 days in Fla. (total not over 6 mos.) but state request needed & Ohio (after initial state extension); 30d in Ind., Kans., Pa., Va. but state request needed 60d in Mich.

(15) *N.J.*—Direct income tax: 7.25% (see ¶240 for net worth tax rate).

(16) Colo. rate reductions for tax year begun in: *1981*—$25M net income, reduction is 1% of Colo. net income; *1983 thru 1987*, no reductions; *1988 and later:* 1st $25M, 2.5% (3% for '89; 3.5% eff 1990); 2nd $25M, 2% (2.5%, '89; 3%, eff '90); 3rd $25M. 1% (1.5%, '89; 2%, eff '90); 4th $25M, ½% (½%, '89; 1% eff '90).

(17) Added tax on oil cos.: Conn.—2% tax on oil cos.' gross earnings. R.I.—1% of gross earnings (repealed 1-1-86). N.Y.—2¼% eff 4-1-84 on oil cos. gross receipts (pass-on-to-consumers). Pa.—Added 60 mills on oil cos.' petroleum revenues.

(18) Ky.—Top rate of 7.25% (was 6% on over $100M) is eff for tax years begun after 7-31-85.

(19) *Ohio.*—Basis B rate if higher Basis A rate of 5.82 mills times portion of stock value determined per value of capital, surplus, undivided profits and reserves applies. *Sur-*

NOTES to chart ¶222—continued

tax is imposed at 5.4% of net income tax; 2.7% for 1987 tax year; no surtax after 1987. *Litter tax* (imposed thru 1991): 1st Tier—all corps. pay added .11% tax and .22% on over $25,000 taxable income and .00014 mills on net worth; max. tax, $5,000. 2nd Tier—Mfrs. or sellers of litter stream products (5% of total sale or such sales instate over $10 million by mfrs.) pay added tax at .22% on over $25,000 taxable income; .00014 mills on net worth; max., $5,000. *Minimum* tax, $50.

(20) *Okla.*—Foreign corps. (per IRC) pay 5% instead of 30% as used in IRC.

(21) No minimum for direct tax.

(22) *Idaho.*—Min. $20.

(23) *N.Y.*—Other minimums: (a) 10% of apportioned income plus compensation; (b) 1.78 mills on value of apportioned business and investment capital. *Added tax:* 0.9 mills per $1 subsidiary capital. Surcharge in Metropolitan Transit District, 17% of tax for years ending on or after 12-31-83 but pre-12-31-86.

(24) *Haw.*—Capital gains alternative tax, 3.08%

(25) *Nebr.*—Rates pre-1984: 5%; 7% on over $50,000.

(26) *N.H.*—15th of 4th mo. for businesses not filing U.S. corporation returns.

(27) State extension needed if no Fed extension or if added tax due; note (31) also applies.

(28) 3-month deferment allowed for 1/2 tax due after credits and estimates.

(29) *R.I.*—Alternative tax, if larger, 40¢ per $100 of net worth.

(30) *Conn.*—Plus plus tax equal to higher of amount by which 31/100 mill per $1 or corporate excess exceeds 10% tax. Min. tax $100. Max. $100,000. Added tax for companies taking Fed dividends paid deductions is (a) above; max. tax $10,000 or 5/10 mill, if less. Min. tax $100.

(31) Filing extension up to 6 mos. allowed unless otherwise shown—request generally due before return due date. Up to 30 Fed extension (if longer) in La.; to 30 days in Wis.; 60 days (plus 30d added to Fed ext.) in Pa.; 2 mos. in Ohio; 3 mos. in Colo.; 90 days in Ala. and Haw.; 7 mos. in Minn. and Nebr.; 12 mos. in N.M.; 18 mos. in W.Va.

(32) Reasonable extension of time to file if request filed—usually before return due date. In Ark., period is 90d plus 90d in extraordinary cases.

(33) Automatic extension to file—90 days in Haw., Minn.; Utah (file Fed extension request); 3 mos. in Iowa, Nebr., N.Y. (to 6 mos. after 1985 tax yr) and R.I.; 1—6 mos. in Mont, N.J. and N.Y. (starting 1986 tax yr); 1-9 mos. N.C.

(34) *Alaska.*—Fed extension requirements and periods (IRC §6081(b)) followed.

(35) *Ill.*—$1,000 standard deduction allowed. Added personalty replacement tax: 2.5% on corporations; 1.5% on S corporations, partnerships and trusts.

(36) Plus tax on tax preference items (apportioned) at 40% of Fed tax (repealed eff for tax yrs begun after 12-31-83). (Minn.)

(37) Multistate Tax Compact member. State rates set under Compact provision requiring optional tax for small taxpayer (only instate activity sales, not over $100,000 annually, and not owning or renting instate property). Colo. 1/2%; Haw. 1/2%; Idaho 1%; Mich. 1/5%; Mont. 1/2%; N.M. 3/4%; N.Dak. 6/10% to $20,000, 8/10% over $20,000-$55,000, 1% on $55,000-$100,000; Oreg. 1/4% (1/8% if return on sales under 5%); Utah 1/2%. No rates set in other compact states: Ark., Calif., D.C. Kans., Minn. and Mo.

(38) *Iowa*—Plus 70% of Fed minimum tax on tax preference items.

(39) 10% Surtax (repealed starting 1984 tax year). (Wisc.)

(40) *Va.*—Oil cos. pay 3% excise tax. Report, pay by last day of calendar month.

(41) *Fla.*—Added 2.2% (applicable to tax years starting after 8-31-84; *was* 2%) emergency excise tax on specified Fed ACRS writeoffs.

(42) *W.Va.*—Rate drops by 0.15% each year until 9% eff. for tax yrs. begun after 6-30-92. Temporary 15% surtax expired (tax years beginning 6-30-85).

(43) *Ariz.*—Alternative tax (6.4%) on net capital gains (eff after 12-31-85).

(44) Vt.—Eff for tax years starting 12-31-87: 5.5% on 1st $10M; 6.6% on next $15M; 7.7% next $225M; 8.25% over $250,000.

Syllabus

CONTAINER CORPORATION OF AMERICA v. FRANCHISE TAX BOARD

APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, FIRST APPELLATE DISTRICT

No. 81-523. Argued January 10, 1983—Decided June 27, 1983

California imposes a corporate franchise tax geared to income. It employs the "unitary business" principle and formula apportionment in applying that tax to corporations doing business both inside and outside the State. The formula used—commonly called the "three-factor" formula—is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales that are located in the State. Appellant paperboard packaging manufacturer is a Delaware corporation headquartered in Illinois and doing business in California and elsewhere. It also has a number of overseas subsidiaries incorporated in the countries in which they operate. In calculating for the tax years in question in this case the share of its net income that was apportionable to California under the three-factor formula, appellant omitted all of its subsidiaries' payroll, property, and sales. Appellee Franchise Tax Board issued notices of additional assessments, the gravamen of which was that appellant should have treated its overseas subsidiaries as part of its unitary business rather than as a passive investment. After paying the additional assessments under protest, appellant brought an action for a refund in California Superior Court, which upheld the additional assessments. The California Court of Appeal affirmed.

Held:

1. California's application of the unitary business principle to appellant and its foreign subsidiaries was proper. Pp. 175-180.

(a) The taxpayer has the burden of showing by "clear and convincing evidence" that the state tax results in extraterritorial values being taxed. This Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary business." The Court's task is 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 a permissible judgment. Pp. 175-176.

(b) Here, there is no merit to appellant's argument that the Court of Appeal in important part analyzed the case under the incorrect legal standard. Rather, the factors relied upon by the court in holding that appellant and its foreign subsidiaries constituted a unitary business—

which factors included appellant's assistance to its subsidiaries in obtaining equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the considerable interplay between appellant and its subsidiaries in the area of corporate expansion, the substantial technical assistance provided by appellant to the subsidiaries, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries—taken in combination clearly demonstrate that the court reached a conclusion "within the realm of permissible judgment." Pp. 177–180.

2. California's use of the three-factor formula to apportion the income of the unitary business consisting of appellant and its foreign subsidiaries was fair. Appellant had the burden of proving that the income apportioned to California was out of all appropriate proportions to the business transacted in the State. This burden was not met by offering various statistics that appeared to demonstrate not only that wage rates are generally lower in the foreign countries in which appellant's subsidiaries operate but also that those lower wage rates are not offset by lower levels of productivity. It 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 a California payroll, as well as other California factors, contributing to the same production. The mere fact that this possibility is not reflected in appellant's accounting does not disturb the underlying premises of the formula apportionment method. Pp. 180–184.

3. California had no obligation under the Foreign Commerce Clause to employ the "arm's-length" analysis used by the Federal Government and most foreign nations in evaluating the tax consequences of intercorporate relationships. *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, distinguished. Pp. 184–197.

(a) The double taxation occasioned by the California scheme is not impermissible. Due in part to the difference between a tax on income and a tax on tangible property, California would have trouble avoiding double taxation of corporations subject to its franchise tax even if it adopted the "arm's-length" approach. Moreover, the California tax does not result in "inevitable" double taxation. 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 sometimes has the same result. Pp. 189–193.

(b) The California tax does not violate the "one voice" standard established in *Japan Line*, *supra*, under which a state tax at variance with federal policy will be struck down if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. Three factors weigh strongly against the conclusion that the tax might lead to significant foreign retaliation. The tax does not create an *automatic* "asymmetry" in international taxation, it is imposed on a domestic corporation and not on a foreign entity, and even if foreign nations had a legitimate interest in reducing the tax burden of domestic corporations, appellant is amenable to be taxed in California one way or another and the tax it pays is more the function of California's tax rate than of its allocation method. Moreover, the California tax is not pre-empted by federal law or fatally inconsistent with federal policy. There is no claim that the federal tax statutes themselves provide the necessary pre-emptive force. The requirement of some tax treaties that the Federal Government adopt some form of arm's-length analysis in taxing the domestic income of multinational enterprises is generally waived as to taxes imposed by each of the contracting nations on its own domestic corporations. Tax treaties do not cover the taxing activities of States. And Congress has never enacted legislation designed to regulate state taxation of income. Pp. 193–197.

117 Cal. App. 3d 988, 173 Cal. Rptr. 121, affirmed.

BRENNAN, J., delivered the opinion of the Court, in which WHITE, MARSHALL, BLACKMUN, and REHNQUIST, JJ., joined. POWELL J., filed a dissenting opinion, in which BURGER, C. J., and O'CONNOR, J., joined, *post*, p. 197. STEVENS, J., took no part in the consideration or decision of the case.

Franklin C. Latcham argued the cause for appellant. With him on the briefs was *Prentiss Willson, Jr.*

Neal J. Gobar, Deputy Attorney General of California, argued the cause for appellee. With him on the brief was *George Deukmejian*, Attorney General.*

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*Briefs of *amici curiae* urging reversal were filed by *Marlow W. Cook*, *Lee H. Spence*, and *Robert L. Ash* for Allied Lyons p. l. c. et al.; by *J. Elaine Bialczak* for Coca-Cola Co.; by *George W. Beatty* and *William L. Goldman* for Colgate-Palmolive Co.; by *James H. Peters*, *Paul H. Frankel*, and *Jean A. Walker* for the Committee on State Taxation of the Council of State Chambers of Commerce; by *Valentine Brookes* and *Lawrence V. Brookes* for EMI Limited et al.; by *William H. Allen*, *John B. Jones, Jr.*, and *Mark I. Levy*, for the Financial Executives Institute; by *Neil Papiano* and *Dennis A. Page* for Firestone Tire & Rubber Co.; and by *Jeffrey G. Balkin*, *pro se*, for Jeffrey G. Balkin et al.

Briefs of *amici curiae* urging affirmance were filed by *David H. Leroy*, Attorney General of Idaho, *Theodore V. Spangler, Jr.*, Deputy Attorney

JUSTICE BRENNAN delivered the opinion of the Court.

This is another appeal claiming that the application of a state taxing scheme violates the Due Process and Commerce Clauses of the Federal Constitution. California imposes a corporate franchise tax geared to income. In common with a large number of other States, it employs the "unitary busi-

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General, and *David L. Wilkinson*, Attorney General of Utah, for the State of Idaho et al.; by *Tyrone C. Fahner*, Attorney General, *Fred H. Montgomery*, Special Assistant Attorney General, and *Lloyd B. Foster* for the State of Illinois; by *Michael J. Rieley*, Special Assistant Attorney General, for the State of Montana; by *Jeff Bingaman*, Attorney General, and *Lisa Gillard Gmuca*, Assistant Attorney General, for the State of New Mexico; by *Robert Abrams*, Attorney General, *Francis V. Dow*, Assistant Attorney General, and *Peter H. Schiff* for the State of New York; by *Robert O. Wefald*, Attorney General, and *Kenneth M. Jakes*, Assistant Attorney General, for the State of North Dakota; by *Dave Frohnmayer*, Attorney General, *Stanton F. Long*, Deputy Attorney General, *William F. Gary*, Solicitor General, and *Theodore W. de Looze*, Assistant Attorney General, for the State of Oregon; by *William D. Dexter*, *Wilson Condon*, Attorney General of Alaska, *James R. Eads, Jr.*, *J. D. MacFarlane*, Attorney General of Colorado, *Carl R. Ajello*, Attorney General of Connecticut, *Richard S. Gebelein*, Attorney General of Delaware, *David H. Leroy*, Attorney General of Idaho, and *Theodore V. Spangler, Jr.*, Deputy Attorney General, *Linley E. Pearson*, Attorney General of Indiana, *Robert T. Stephan*, Attorney General of Kansas, *Francis X. Bellotti*, Attorney General of Massachusetts, *Frank K. Kelley*, Attorney General of Michigan, *Warren R. Spannaus*, Attorney General of Minnesota, *John Ashcroft*, Attorney General of Missouri, *Paul L. Douglas*, Attorney General of Nebraska, *Gregory H. Smith*, Attorney General of New Hampshire, *Jeff Bingaman*, Attorney General of New Mexico, *Rufus L. Edmisten*, Attorney General of North Carolina, *M. C. Banks*, Deputy Attorney General, *Robert O. Wefald*, Attorney General of North Dakota, and *Albert R. Hausauer*, Assistant Attorney General, *Dave Frohnmayer*, Attorney General of Oregon, and *David L. Wilkinson*, Attorney General of Utah, for the Multistate Tax Commission et al.; by *Richard B. Geltman* and *Tany S. Hong*, Attorney General of Hawaii, for the National Governors' Association et al.; by *Charles F. Brannan* for the National Farmers Union; for Citizens for Tax Justice et al.; and by *Frank M. Keesling*, *pro se*.

Briefs of *amici curiae* were filed by *Lloyd N. Cutler* and *William T. Lake* for the Government of the Kingdom of the Netherlands; by *John J. Easton, Jr.*, Attorney General, and *Paul P. Hanlon* for the State of ness" principle and formula apportionment in applying that tax to corporations doing business both inside and outside the State. Appellant is a Delaware corporation headquartered in Illinois and doing business in California and elsewhere. It also has a number of overseas subsidiaries incorporated in the countries in which they operate. Appellee is the California authority charged with administering the State's franchise tax. This appeal presents three questions for review: (1) Was it improper for appellee and the state courts to find that appellant and its overseas subsidiaries constituted a "unitary business" for purposes of the state tax? (2) Even if the unitary business finding was proper, do certain salient differences among national economies render the standard three-factor apportionment formula used by California so inaccurate as applied to the multinational enterprise consisting of appellant and its subsidiaries as to violate the constitutional requirement of "fair apportionment"? (3) In any event, did California have an obligation under the Foreign Commerce Clause, U. S. Const., Art. I, §8, cl. 3, to employ the "arm's-length" analysis used by the Federal Government and most foreign nations in evaluating the tax consequences of intercorporate relationships?

I

A

Various aspects of state tax systems based on the "unitary business" principle and formula apportionment have pro-

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Vermont; by *Francis D. Morrissey* and *Peter B. Powles* for the Canadian Imperial Bank of Commerce et al.; by *Don S. Harnack* and *Richard A. Hanson* for Caterpillar Tractor Co.; by *Joanne M. Garvey* and *Roy E. Crawford* for the Committee on Unitary Tax; by *John S. Nolan* for the Confederation of British Industry; by *Norman B. Barker* for Gulf Oil Corp.; by *Anthon S. Cannon, Jr.*, for the International Bankers Association in California et al.; by *Kenneth Heady* for Phillips Petroleum Co.; by *John R. Hupper* and *Paul M. Dodyk* for Shell Petroleum N. V.; by *Norman B. Barker* and *Dean C. Dunlavey* for Sony Corp. et al.; and by *Joseph H. Guttentag, Carolyn E. Agger*, and *Daniel M. Lewis* for the Union of Industries of the European Community.

voked repeated constitutional litigation in this Court. See, *e. g.*, *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U. S. 307 (1982); *F. W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U. S. 354 (1982); *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, 447 U. S. 207 (1980); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425 (1980); *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267 (1978); *General Motors Corp.* v. *Washington*, 377 U. S. 436 (1964); *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U. S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920).

Under both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, "tax value earned outside its borders." *ASARCO*, *supra*, at 315. In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. See *Mobil Oil Corp.* v. *Commissioner of Taxes*, *supra*, at 438; *Butler Bros.* v. *McColgan*, *supra*, at 507–509; *Underwood Typewriter Co.* v. *Chamberlain*, *supra*, at 121. For this reason and others, we have long held that the Constitution imposes no single formula on the States, *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 445 (1940), and that the taxpayer has the "'distinct burden of showing by "clear and cogent evidence" that [the state tax] results in extraterritorial values being taxed . . . .'" *Exxon Corp.*, *supra*, at 221, quoting *Butler Bros.* v. *McColgan*, *supra*, at 507, in turn quoting *Norfolk & Western R. Co.* v. *North Carolina ex rel. Maxwell*, 297 U. S. 682, 688 (1936).

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise. See generally *Mobil Oil Corp.*, *supra*, at 438–439, and sources cited. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction. This Court long ago upheld the constitutionality of the unitary business/formula apportionment method, although subject to certain constraints. See, *e. g.*, *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell*, 283 U. S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, *supra*; *Underwood Typewriter Co.* v. *Chamberlain*, *supra*. The method has now gained wide acceptance, and is in one of its forms the basis for the the Uniform Division of Income for Tax Purposes Act (Uniform Act), which has at last count been substantially adopted by 23 States, including California.

B

Two aspects of the unitary business/formula apportionment method have traditionally attracted judicial attention. These are, as one might easily guess, the notions of "unitary business" and "formula apportionment," respectively.

(1)

The Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities—even on a proportional basis—unless there is a "'minimal connection' or 'nexus' between the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Exxon Corp.* v. *Wisconsin Dept. of Revenue*, *supra*, at 219–220, quoting *Mobil Oil Corp.* v. *Commissioner of Taxes*, *supra*, at 436, 437. At the very least, this set of principles imposes the obvious and largely self-executing limitation that a State not tax a purported "unitary business" unless at least some part of it is conducted in the State. See *Exxon Corp.*, *supra*, at 220; *Wisconsin* v. *J. C. Penney Co.*, *supra*, at 444. It also requires that there be some bond of ownership or control uniting the purported "unitary business." See *ASARCO*, *supra*, at 316–317.

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. See generally *ASARCO*, *supra*, at 317; *Mobil Oil Corp.*, *supra*, at 438–442. In *Underwood Typewriter Co.* v. *Chamberlain*, *supra*, we held that a State could tax on an apportioned basis the combined income of a vertically integrated business whose various components (manufacturing, sales, etc.) operated in different States. In *Bass, Ratcliff & Gretton*, *supra*, we applied the same principle to a vertically integrated business operating across national boundaries. In *Butler Bros.* v. *McColgan*, *supra*, we recognized that the unitary business principle could apply, not only to vertically integrated enterprises, but also to a series of similar enterprises operating separately in various jurisdictions but linked by common managerial or operational resources that produced economies of scale and transfers of value. More recently, we have further refined the "unitary business" concept in *Exxon Corp.* v. *Wisconsin Dept. of Rev-*

enue, 447 U. S. 207 (1980), and *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U. S. 425 (1980), where we upheld the States' unitary business findings, and in *ASARCO Inc.* v. *Idaho State Tax Comm'n*, 458 U. S. 307 (1982), and *F. W. Woolworth Co.* v. *Taxation & Revenue Dept.*, 458 U. S. 354 (1982), in which we found such findings to have been improper.

The California statute at issue in this case, and the Uniform Act from which most of its relevant provisions are derived, track in large part the principles we have just discussed. In particular, the statute distinguishes between the "business income" of a multijurisdictional enterprise, which is apportioned by formula, Cal. Rev. & Tax. Code Ann. §§25128–25136 (West 1979), and its "nonbusiness" income, which is not.[1] Although the statute does not explicitly require that income from distinct business enterprises be apportioned separately, this requirement antedated adoption of the Uniform Act,[2] and has not been abandoned.[3]

A final point that needs to be made about the unitary business concept is that it is not, so to speak, unitary: there are variations on the theme, and any number of them are logically consistent with the underlying principles motivating the approach. For example, a State might decide to respect for-

[1] Certain forms of nonbusiness income, such as dividends, are allocated on the basis of the taxpayer's commercial domicile. Other forms of nonbusiness income, such as capital gains on sales of real property, are allocated on the basis of situs. See Cal. Rev. & Tax. Code Ann. §§25123–25127 (West 1979).

[2] See generally *Honolulu Oil Corp.* v. *Franchise Tax Board*, 60 Cal. 2d 417, 386 P. 2d 40 (1963); *Superior Oil Corp.* v. *Franchise Tax Board*, 60 Cal. 2d 406, 386 P. 2d 33 (1963).

[3] See the opinion of the California Court of Appeal in this case, 117 Cal. App. 3d 988, 990–991, 993–995, 173 Cal. Rptr. 121, 123, 124–126 (1981). See also Cal. Rev. & Tax. Code Ann. §25137 (West 1979) (allowing for separate accounting or other alternative methods of apportionment when total formula apportionment would "not fairly represent the extent of the taxpayer's business activity in this state").

mal corporate lines and treat the ownership of a corporate subsidiary as *per se* a passive investment.[4] In *Mobil Oil Corp.*, 445 U. S., at 440–441, however, we made clear that, as a general matter, such a *per se* rule is not constitutionally required:

> "Superficially, intercorporate division might appear to be a[n] . . . 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." *Id.*, at 440.

Thus, for example, California law provides:

> "In the case of a corporation . . . owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation . . . owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary." Cal. Rev. & Tax. Code Ann. § 25104 (West 1979).[5]

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[4] We note that the Uniform Act does not speak to this question one way or the other.

[5] See also Cal. Rev. & Tax. Code Ann. § 25105 (West 1979) (defining "ownership or control"). A necessary corollary of the California approach, of course, is that intercorporate dividends in a unitary business *not* be included in gross income, since such inclusion would result in double-counting of a portion of the subsidiary's income (first as income attributed to the unitary business, and second as dividend income to the parent). See § 25106.

Some States, it should be noted, have adopted a hybrid approach. In *Mobil* itself, for example, a nondomiciliary State invoked a unitary business justification to include an apportioned share of certain corporate dividends in the gross income of the taxpayer, but did not require a combined return and combined apportionment. The Court in *Mobil* held that the taxpayer's objection to this approach had not been properly raised in the state proceedings. 445 U. S., at 441, n. 15. JUSTICE STEVENS, however, reached the merits, stating in part: "Either Mobil's worldwide 'petroleum enterprise' is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner." *Id.*, at 461 (citation omitted). See *id.*, at 462 (STEVENS, J., dissenting) (outlining al-

Even among States that take this approach, however, only some apply it in taxing American corporations with subsidiaries located in foreign countries.[6] The difficult question we address in Part V of this opinion is whether, for reasons not implicated in *Mobil*,[7] that particular variation on the theme is constitutionally barred.

(2)

Having determined that a certain set of activities constitute a "unitary business," a State must then apply a formula apportioning the income of that business within and without the State. Such an apportionment formula must, under both the Due Process and Commerce Clauses, be fair. See *Exxon Corp.*, *supra*, at 219, 227–228; *Moorman Mfg. Co.*, 437 U. S., at 272–273; *Hans Rees' Sons, Inc.*, 283 U. S., at 134. The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not "invalidat[e] an apportionment formula whenever it *may* result in taxation

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ternative approaches available to State); cf. The Supreme Court, 1981 Term, 96 Harv. L. Rev. 62, 93–96 (1982).

[6] See generally General Accounting Office Report to the Chairman, House Committee on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving 31 (1982).

[7] *Mobil* did, in fact, involve income from foreign subsidiaries, but that fact was of little importance to the case for two reasons. First, as discussed in n. 5, *supra*, the State in that case included *dividends* from the subsidiaries to the parent in its calculation of the parent's apportionable taxable income, but did not include the underlying income of the subsidiaries themselves. Second, the taxpayer in that case conceded that the dividends could be taxed *somewhere* in the United States, so the actual issue before the Court was merely whether a particular State could be barred from imposing some portion of that tax. See 445 U. S., at 447.

of some income that did not have its source in the taxing State . . . ." *Moorman Mfg. Co., supra*, at 272 (emphasis added). See *Underwood Typewriter Co.*, 254 U. S., at 120–121. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' *[Hans Rees' Sons, Inc.,]* 283 U. S., at 135, or has 'led to a grossly distorted result,' [*Norfolk & Western R. Co.* v. *State Tax Comm'n*, 390 U. S. 317, 326 (1968)]." *Moorman Mfg. Co., supra*, at 274.

California and the other States that have adopted the Uniform Act use a formula—commonly called the "three-factor" formula—which is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales which are located in the taxing State. See Cal. Tax & Rev. Code Ann. §§25128–25136 (West 1979). We approved the three-factor formula in *Butler Bros.* v. *McColgan*, 315 U. S. 501 (1942). Indeed, not only has the three-factor formula met our approval, but it has become, for reasons we discuss in more detail *infra*, at 183, something of a benchmark against which other apportionment formulas are judged. See *Moorman Mfg. Co., supra*, at 282 (BLACKMUN, J., dissenting); cf. *General Motors Corp.* v. *District of Columbia*, 380 U. S. 553, 561 (1965).

Besides being fair, an apportionment formula must, under the Commerce Clause, also not result in discrimination against interstate or foreign commerce. See *Mobil Oil Corp., supra*, at 444; cf. *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434, 444–448 (1979) (property tax). Aside from forbidding the obvious types of discrimination against interstate or foreign commerce, this principle might have been construed to require that a state apportionment formula not differ so substantially from methods of allocation used by other jurisdictions in which the taxpayer is subject to taxation as to produce double taxation of the same income and a resultant tax burden higher than the taxpayer would incur if its business were limited to any one jurisdiction. At least in the interstate commerce context, however, the antidiscrimination principle has not in practice required much in addition to the requirement of fair apportionment. In *Moorman Mfg. Co.* v. *Bair, supra,* in particular, we explained that eliminating all overlapping taxation would require this Court to establish not only a single constitutionally mandated method of taxation, but also rules regarding the application of that method in particular cases. 437 U. S., at 278–280. Because that task was thought to be essentially legislative, we declined to undertake it, and held that a fairly apportioned tax would not be found invalid simply because it differed from the prevailing approach adopted by the States. As we discuss *infra,* at 185–187, however, a more searching inquiry is necessary when we are confronted with the possibility of international double taxation.

II

A

Appellant is in the business of manufacturing custom-ordered paperboard packaging. Its operation is vertically integrated, and includes the production of paperboard from raw timber and wastepaper as well as its composition into the finished products ordered by customers. The operation is also largely domestic. During the years at issue in this case—1963, 1964, and 1965—appellant controlled 20 foreign subsidiaries located in four Latin American and four European countries. Its percentage ownership of the subsidiaries (either directly or through other subsidiaries) ranged between 66.7% and 100%. In those instances (about half) in which appellant did not own a 100% interest in the subsidiary, the remainder was owned by local nationals. One of the subsidiaries was a holding company that had no payroll, sales, or property, but did have book income. Another was inactive. The rest were all engaged—in their respective local markets—in essentially the same business as appellant.

Most of appellant's subsidiaries were, like appellant itself, fully integrated, although a few bought paperboard and other intermediate products elsewhere. Sales of materials from appellant to its subsidiaries accounted for only about 1% of the subsidiaries' total purchases. The subsidiaries were also relatively autonomous with respect to matters of personnel and day-to-day management. For example, transfers of personnel from appellant to its subsidiaries were rare, and occurred only when a subsidiary could not fill a position locally. There was no formal United States training program for the subsidiaries' employees, although groups of foreign employees occasionally visited the United States for 2–6 week periods to familiarize themselves with appellant's methods of operation. Appellant charged one senior vice president and four other officers with the task of overseeing the operations of the subsidiaries. These officers established general standards of professionalism, profitability, and ethical practices and dealt with major problems and long-term decisions; day-to-day management of the subsidiaries, however, was left in the hands of local executives who were always citizens of the host country. Although local decisions regarding capital expenditures were subject to review by appellant, problems were generally worked out by consensus rather than outright domination. Appellant also had a number of its directors and officers on the boards of directors of the subsidiaries, but they did not generally play an active role in management decisions.[8]

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[8] There were a number of reasons for appellant's relatively hands-off attitude toward the management of its subsidiaries. First, it comported with the company's general management philosophy emphasizing local responsibility and accountability; in this respect, the treatment of the foreign subsidiaries was similar to the organization of appellant's domestic geographical divisions. Second, it reflected the fact that the packaging industry, like the advertising industry to which it is closely related, is highly

Nevertheless, in certain respects, the relationship between appellant and its subsidiaries was decidedly close. For example, approximately half of the subsidiaries' long-term debt was either held directly, or guaranteed, by appellant. Appellant also provided advice and consultation regarding manufacturing techniques, engineering, design, architecture, insurance, and cost accounting to a number of its subsidiaries, either by entering into technical service agreements with them or by informal arrangement. Finally, appellant occasionally assisted its subsidiaries in their procurement of equipment, either by selling them used equipment of its own or by employing its own purchasing department to act as an agent for the subsidiaries.[9]

B

During the tax years at issue in this case, appellant filed California franchise tax returns. In 1969, after conducting an audit of appellant's returns for the years in question, appellee issued notices of additional assessments for each of those years. The respective approaches and results reflected in appellant's initial returns and in appellee's notices of additional assessments capture the legal differences at issue in this case.[10]

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sensitive to differences in consumer habits and economic development among different nations, and therefore requires a good dose of local expertise to be successful. Third, appellant's policy was designed to appeal to the sensibilities of local customers and governments.

[9] There was also a certain spillover of goodwill between appellant and its subsidiaries; that is, appellant's customers who had overseas needs would on occasion ask appellant's sales representatives to recommend foreign firms, and, where possible, the representatives would refer the customers to appellant's subsidiaries. In at least one instance, appellant became involved in the actual negotiation of a contract between a customer and a foreign subsidiary.

[10] After the notices of additional tax, there followed a series of further adjustments, payments, claims for refunds, and assessments, whose combined effect was to render the figures outlined in text more illustrative

In calculating the total unapportioned taxable income of its unitary business, appellant included its own corporate net earnings as derived from its federal tax form (subject to certain adjustments not relevant here), but did not include any income of its subsidiaries. It also deducted—as it was authorized to do under state law, see *supra*, at 167, and n. 1—all dividend income, nonbusiness interest income, and gains on sales of assets not related to the unitary business. In calculating the share of its net income which was apportionable to California under the three-factor formula, appellant omitted all of its subsidiaries' payroll, property, and sales. The results of these calculations are summarized in the margin.[11]

The gravamen of the notices issued by appellee in 1969 was that appellant should have treated its overseas subsidiaries as part of its unitary business rather than as passive investments. Including the overseas subsidiaries in appellant's unitary business had two primary effects: it increased the income subject to apportionment by an amount equal to the total income of those subsidiaries (less intersubsidiary dividends, see n. 5, *supra*), and it decreased the percentage of that income which was apportionable to California. The net

than real as descriptions of the present claims of the parties with regard to appellant's total tax liability. These subsequent events, however, did not concern the legal issues raised in this case, nor did they remove either party's financial stake in the resolution of those issues. We therefore disregard them for the sake of simplicity.

[11]

	Total income of unitary business	*Percentage attributed to California*	*Amount attributed to California*	*Tax (5.5%)*
1963....	$26,870,427.00	11.041	$2,966,763.85	$163,172.01
1964....	28,774,320.48	10.6422	3,062,220.73	168,422.14
1965....	32,280,842.90	9.8336	3,174,368.97	174,590.29

See Exhibit A-7 to Stipulation; Record 36, 76, 77, 79, 104, 126.

effect, however, was to increase appellant's tax liability in each of the three years.[12]

Appellant paid the additional amounts under protest, and then sued in California Superior Court for a refund, raising the issues now before this Court. The case was tried on stipulated facts, and the Superior Court upheld appellee's assessments. On appeal, the California Court of Appeal affirmed, 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), and the California Supreme Court refused to exercise discretionary review. We noted probable jurisdiction. 456 U. S. 960 (1982).

III

A

We address the unitary business issue first. As previously noted, the taxpayer always has the "distinct burden of showing by 'clear and cogent evidence' that [the state tax] results in extraterritorial values being taxed." *Supra*, at 164. One necessary corollary of that principle is that this Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a "unitary business." As we said in a closely related context in *Norton Co.* v. *Department of Revenue*, 340 U. S. 534 (1951):

> "The general rule, applicable here, is that a taxpayer claiming immunity from a tax has the burden of establishing his exemption.

[12] According to the notices, appellant's actual tax obligations were as follows:

	Total income of unitary business	*Percentage attributed to California*	*Amount attributed to California*	*Tax (5.5%)*
1963....	$37,348,183.00	8.6886	$3,245,034.23	$178,476.88
1964....	44,245,879.00	8.3135	3,673,381.15	202,310.95
1965....	46,884,966.00	7.6528	3,588,012.68	197,340.70

See Exhibit A-7 to Stipulation; Record 76, 77, 79.

"*This burden is never met merely by showing a fair difference of opinion which as an original matter might be decided differently. . . .* Of course, in constitutional cases, we have power to examine the whole record to arrive at an independent judgment as to whether constitutional rights have been invaded, but that does not mean that we will re-examine, as a court of first instance, findings of fact supported by substantial evidence." *Id.*, at 537–538 (footnotes omitted; emphasis added).[13]

See *id.*, at 538 (concluding that, "in light of all the evidence, the [state] judgment [on a question of whether income should be attributed to the State] was within the realm of permissible judgment"). The legal principles defining the constitutional limits on the unitary business principle are now well established. The factual records in such cases, even when the parties enter into a stipulation, tend to be long and complex, and the line between "historical fact" and "constitutional fact" is often fuzzy at best. Cf. *ASARCO*, 458 U. S., at 326–328, nn. 22, 23. 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.[14] Rather, our task must be 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."[15]

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[13] This approach is, of course, quite different from the one we follow in certain other constitutional contexts. See, *e. g.*, *Brooks* v. *Florida*, 389 U. S. 413 (1967); *New York Times Co.* v. *Sullivan*, 376 U. S. 254, 285 (1964).

[14] It should also go without saying that not every claim that a state court erred in making a unitary business finding will pose a substantial federal question in the first place.

[15] *ASARCO* and *F. W. Woolworth* are consistent with this standard of review. *ASARCO* involved a claim that a parent and certain of its partial subsidiaries, in which it held either minority interests or bare majority interests, were part of the same unitary business. The State Supreme

B

In this case, we are singularly unconvinced by appellant's argument that the State Court of Appeal "in important part analyzed this case under a different legal standard," *F. W. Woolworth*, 458 U. S., at 363, from the one articulated by this Court. Appellant argues that the state court here, like the state court in *F. W. Woolworth*, improperly relied on appellant's mere *potential* to control the operations of its subsidiaries as a dispositive factor in reaching its unitary business finding. In fact, although the state court mentioned that "major policy decisions of the subsidiaries were subject to review by appellant," 117 Cal. App. 3d, at 998, 173 Cal. Rptr., at 127, it relied principally, in discussing the management relationship between appellant and its subsidiaries, on the more concrete observation that "[h]igh officials of appellant gave directions to subsidiaries for compliance with the parent's standard of professionalism, profitability, and ethical practices." *Id.*, at 998, 173 Cal. Rptr., at 127–128.[16]

Court upheld the claim. We concluded, *relying on factual findings made by the state courts*, that a unitary business finding was impermissible because the partial subsidiaries were not realistically subject to even minimal control by ASARCO, and were therefore passive investments in the most basic sense of the term. 458 U. S., at 320–324. We held specifically that to accept the State's theory of the case would not only constitute a misapplication of the unitary business concept, but would "destroy" the concept entirely. *Id.*, at 326.

F. W. Woolworth was a much closer case, involving one partially owned subsidiary and three wholly owned subsidiaries. We examined the evidence in some detail, and reversed the state court's unitary business finding, but only after concluding that the state court had made specific and crucial legal errors, not merely in the conclusions it drew, but in the legal standard it applied in analyzing the case. 458 U. S., at 363–364.

[16] In any event, although potential control is, as we said in *F. W. Woolworth*, not "*dispositive*" of the unitary business issue, *id.*, at 362 (emphasis added), it is *relevant*, both to whether or not the components of the purported unitary business share that degree of common ownership which is a prerequisite to a finding of unitariness, and also to whether there might exist a degree of implicit control sufficient to render the parent and the subsidiary an integrated enterprise.

Appellant also argues that the state court erred in endorsing an administrative presumption that corporations engaged in the same line of business are unitary. This presumption affected the state court's reasoning, but only as one element among many. Moreover, considering the limited use to which it was put, we find the "presumption" criticized by appellant to be reasonable. Investment in a business enterprise truly "distinct" from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle. 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.

Finally, appellant urges us to adopt a bright-line rule requiring as a prerequisite to a finding that a mercantile or manufacturing enterprise is unitary that it be characterized by "a substantial flow of goods." Brief for Appellant 47. We decline this invitation. The prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*, not a flow of goods.[17] As we reiterated in *F. W. Wool-*

[17] As we state *supra*, at 167–169, there is a wide range of constitutionally acceptable variations on the unitary business theme. Thus, a leading scholar has suggested that a "flow of goods" requirement would provide a reasonable and workable bright-line test for unitary business, see Hellerstein, Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business, 21 Nat. Tax J. 487, 501–502 (1968); Hellerstein, Allocation and Apportionment of Dividends and the Delineation of the Unitary Business, 14 Tax Notes 155 (Jan. 25, 1982), and some state courts have adopted such a test, see, *e. g.*, *Commonwealth* v. *ACF Industries, Inc.*, 441 Pa. 129, 271 A. 2d 273 (1970). But see, *e. g.*, McLure, Operational Interdependence Is Not the Appropriate "Bright Line Test" of a Unitary Business—At Least Not Now, 18 Tax Notes 107 (Jan. 10, 1983). However sensible such a test may be as a policy matter, however, we see no reason to impose it on all the States as a requirement of constitutional law. Cf. *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435, 445 (1940).

worth, a relevant question in the unitary business inquiry is whether "'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.'" 458 U. S., at 364, quoting *Mobil*, 445 U. S., at 438. "[S]ubstantial mutual interdependence," *F. W. Woolworth*, *supra*, at 371, can arise in any number of ways; a substantial flow of goods is clearly one but just as clearly not the only one.

C

The State Court of Appeal relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," 117 Cal. App. 3d, at 997, 173 Cal. Rptr., at 127, the "substantial" technical assistance provided by appellant to the subsidiaries, *id.*, at 998–999, 173 Cal. Rptr., at 128, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from *ASARCO* and *F. W. Woolworth*,[18] and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," *Mobil*, *supra*, at 440, which the State is entitled to tax as a single entity. We need not decide whether any one of these factors

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[18] See n. 15, *supra*. See also, *e. g.*, *F. W. Woolworth*, 458 U. S., at 365 ("*no* phase of any subsidiary's business was integrated with the parent's"); *ibid.* (undisputed testimony stated that each subsidiary made business decisions independently of parent); *id.*, at 366 ("each subsidiary was responsible for obtaining its own financing from sources other than the parent"); *ibid.* ("With one possible exception, none of the subsidiaries' officers during the year in question was a current or former employee of the parent") (footnote omitted).

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."[19]

IV

We turn now to the question of fair apportionment. Once again, appellant has the burden of proof; it must demonstrate that there is "'no rational relationship between the income attributed to the State and the intrastate values of the enterprise,'" *Exxon Corp.*, 447 U. S., at 220, quoting *Mobil, supra*, at 437, by proving that the income apportioned to

[19] Two of the factors relied on by the state court deserve particular mention. The first of these is the flow of capital resources from appellant to its subsidiaries through loans and loan guarantees. There is no indication that any of these capital transactions were conducted at arm's length, and the resulting flow of value is obvious. As we made clear in another context in *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 50–53 (1955), capital transactions can serve either an investment function or an operational function. In this case, appellant's loans and loan guarantees were clearly part of an effort to ensure that "[t]he overseas operations of [appellant] continue to grow and to become a more substantial part of the company's strength and profitability." Container Corporation of America, 1964 Annual Report 6, reproduced in Exhibit I to Stipulation of Facts. See generally *id.*, at 6–9, 11.

The second noteworthy factor is the managerial role played by appellant in its subsidiaries' affairs. We made clear in *F. W. Woolworth Co.* that a unitary business finding could not be based 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 . . . ." 458 U. S., at 369. As *Exxon* illustrates, however, mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. 447 U. S., at 224. 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. In this case, the business "guidelines" established by appellant for its subsidiaries, the "consensus" process by which appellant's management was involved in the subsidiaries' business decisions, and the sometimes uncompensated technical assistance provided by appellant, all point to precisely the sort of operational role we found lacking in *F. W. Woolworth.*

California under the statute is "out of all appropriate proportion to the business transacted by the appellant in that State," *Hans Rees' Sons, Inc.*, 283 U. S., at 135.

Appellant challenges the application of California's three-factor formula to its business on two related grounds, both arising as a practical (although not a theoretical) matter out of the international character of the enterprise. First, appellant argues that its foreign subsidiaries are significantly more profitable than it is, and that the three-factor formula, by ignoring that fact and relying instead on indirect measures of income such as payroll, property, and sales, systematically distorts the true allocation of income between appellant and the subsidiaries. The problem with this argument is obvious: the profit figures relied on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place. Indeed, we considered and rejected a very 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 identifiable 'source.' Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." 445 U. S., at 438 (citation omitted).

Appellant's second argument is related, and can be answered in the same way. Appellant contends:

> "The costs of production in foreign countries are generally significantly lower than in the United States, pri-

marily as a result of the lower wage rates of workers in countries other than the United States. Because wages are one of the three factors used in formulary apportionment, the use of the formula unfairly inflates the amount of income apportioned to United States operations, where wages are higher." Brief for Appellant 12.

Appellant supports this argument with various statistics that appear to demonstrate, not only that wage rates are generally lower in the foreign countries in which its subsidiaries operate, but also that those lower wages are not offset by lower levels of productivity. Indeed, it is able to show that at least one foreign plant had labor costs per thousand square feet of corrugated container that were approximately 40% of the same costs in appellant's California plants.

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. Appellant 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 other California factors, contributing—albeit more indirectly—to the same production. The mere fact that this possibility is not reflected in appellant's accounting does not disturb the underlying premises of the formula apportionment method.

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. Some methods of formula apportionment are particularly problematic because they focus on only a small part of the spectrum of activities by which value is generated. Although we have generally upheld the use of such formulas, see, *e. g.*, *Moorman Mfg. Co.* v. *Bair*, 437 U. S. 267 (1978); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113 (1920), we have on occasion found the distortive effect of focusing on only one factor so outrageous in a particular case as to require reversal. In *Hans Rees' Sons, Inc.* v. *North Carolina ex rel. Maxwell*, *supra*, for example, an apportionment method based entirely on ownership of tangible property resulted in an attribution to North Carolina of between 66% and 85% of the taxpayer's income over the course of a number of years, while a separate accounting analysis purposely skewed to resolve all doubts in favor of the State resulted in an attribution of no more than 21.7%. We struck down the application of the one-factor formula to that particular business, holding that the method, "albeit fair on its face operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." *Id.*, at 134.

The three-factor formula used by California has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated. It is therefore able to avoid the sorts of distortions that were present in *Hans Rees' Sons, Inc.*

Of course, even the three-factor formula is necessarily imperfect.[20] But we have seen no evidence demonstrating that

[20] First, the one-third-each weight given to the three factors is essentially arbitrary. Second, payroll, property, and sales still do not exhaust the entire set of factors arguably relevant to the production of income. Finally, the relationship between each of the factors and income is by no means exact. The three-factor formula, as applied to horizontally linked enterprises, is based in part on the very rough economic assumption that rates of return on property and payroll—as such rates of return would be measured by an ideal accounting method that took all transfers of value into account—are roughly the same in different taxing jurisdictions. This assumption has a powerful basis in economic theory: if true rates of return were radically different in different jurisdictions, one might expect a significant shift in investment resources to take advantage of that difference. On the other hand, the assumption has admitted weaknesses: an enterprise's willingness to invest simultaneously in two jurisdictions with very different true rates of return might be adequately explained by, for example, the difficulty of shifting resources, the decreasing marginal value of additional investment, and portfolio-balancing considerations.

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 appellant. Indeed, it would be difficult to come to such a conclusion on the basis of the figures in this case: for all of appellant's statistics showing allegedly enormous distortions caused by the three-factor formula, the tables we set out at nn. 11, 12, *supra*, reveal that the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business. See also *Moorman Mfg. Co.*, *supra*, at 272–273; *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331 (1939); *Underwood Typewriter Co.*, *supra*, at 120–121.

V

For the reasons we have just outlined, we conclude that California's application of the unitary business principle to appellant and its foreign subsidiaries was proper, and that its use of the standard three-factor formula to apportion the income of that unitary business was fair. This proper and fair method of taxation happens, however, to be quite different from the method employed both by the Federal Government in taxing appellant's business, and by each of the relevant foreign jurisdictions in taxing the business of appellant's subsidiaries. Each of these other taxing jurisdictions has adopted a qualified separate accounting approach—often referred to as the "arm's-length" approach—to the taxation of related corporations.[21] Under the "arm's-length" approach,

[21] The "arm's-length" approach is also often applied to geographically distinct divisions of a single corporation.

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.

If the unitary business consisting of appellant and its subsidiaries were entirely domestic, the fact that different jurisdictions applied different methods of taxation to it would probably make little constitutional difference, for the reasons we discuss *supra*, at 170–171. Given that it is international, however, we must subject this case to the additional scrutiny required by the Foreign Commerce Clause. See *Mobil Oil Corp.*, 445 U. S., at 446; *Japan Line, Ltd.*, 441 U. S., at 446; *Bowman* v. *Chicago & N. W. R. Co.*, 125 U. S. 465, 482 (1888). The case most relevant to our inquiry is *Japan Line*.

A

Japan Line involved an attempt by California to impose an apparently fairly apportioned, nondiscriminatory, ad valorem property tax on cargo containers which were instrumentalities of foreign commerce and which were temporarily located in various California ports. The same cargo containers, however, were subject to an unapportioned property tax in their home port of Japan. Moreover, a convention signed by the United States and Japan made clear, at least, that neither National Government could impose a tax on temporarily imported cargo containers whose home port was in the other nation. We held that "[w]hen a State seeks to tax the instrumentalities of foreign commerce, two additional considerations, beyond those articulated in [the doctrine governing the Interstate Commerce Clause], come into play." 441 U. S., at 446. The first is the enhanced risk of multiple taxation. Although consistent application of the fair apportionment standard can generally mitigate, if not eliminate, double taxation in the domestic context, "neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. . . . Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though 'fairly apportioned' to reflect an instrumentality's presence within the State, may subject foreign commerce '"to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids."'" *Id.*, at 447–448, quoting *Evco* v. *Jones*, 409 U. S. 91, 94 (1972), in turn quoting *J. D. Adams Mfg. Co.* v. *Storen*, 304 U. S. 307, 311 (1938) (footnote omitted).

The second additional consideration that arises in the foreign commerce context is the possibility that a state tax will "impair federal uniformity in an area where federal uniformity is essential." 441 U. S., at 448.

"A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. . . . If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign commerce." *Id.*, at 450–451 (footnote omitted).

On the basis of the facts in *Japan Line*, we concluded that the California tax at issue was constitutionally improper because it failed to meet either of the additional tests mandated by the Foreign Commerce Clause. *Id.*, at 451–454.

This case is similar to *Japan Line* in a number of important respects. First, the tax imposed here, like the tax imposed in *Japan Line*, has resulted in actual double taxation, in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the State's share of the total income of the unitary business of which those subsidiaries are a part.[22] Second, that double taxation stems from a serious divergence in the taxing schemes adopted by California and the foreign taxing authorities. Third, the taxing method adopted by those foreign taxing authorities is consistent with accepted international practice. Finally, our own Federal Government, to the degree it has spoken, seems to prefer the taxing method adopted by the international community to the taxing method adopted by California.[23]

Nevertheless, there are also a number of ways in which this case is clearly distinguishable from *Japan Line*.[24] First,

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[22] The stipulation of facts indicates that the tax returns filed by appellant's subsidiaries in their foreign domiciles took into account "only the applicable income and deductions incurred by the subsidiary or subsidiaries in that country and not . . . the income and deductions of [appellant] or the subsidiaries operating in other countries." App. 72. This does not conclusively demonstrate the existence of double taxation because appellant has not produced its foreign tax returns, and it is entirely possible that deductions, exemptions, or adjustments in those returns eliminated whatever overlap in taxable income resulted from the application of the California apportionment method. Nevertheless, appellee does not seriously dispute the existence of actual double taxation as we have defined it, Brief for Appellee 114–121, but cf. Tr. of Oral Arg. 28–29, and we assume its existence for the purposes of our analysis. Cf. *Japan Line*, 441 U. S., at 452, n. 17.

[23] But see *infra*, at 196–197 (discussing whether state scheme is preempted by federal law).

[24] Note that we deliberately emphasized in *Japan Line* the narrowness of the question presented: "whether instrumentalities of commerce that are

it involves a tax on income rather than a tax on property. We distinguished property from income taxation in *Mobil Oil Corp.*, 445 U. S., at 444–446, and *Exxon Corp.*, 447 U. S., at 228–229, suggesting that "[t]he 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. 445 U. S., at 445. Second, the double taxation in this case, although real, is not the "inevitabl[e]" result of the California taxing scheme. Cf. *Japan Line*, 441 U. S., at 447. In *Japan Line*, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part—a combination resulting necessarily in double taxation. *Id.*, at 447, 452, 455. Here, by contrast, we are faced with two distinct methods of allocating the income of a multinational 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 income not being taxed at all is dependent solely on the facts of the individual case.[25] The third difference between this case and *Japan Line* is that 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. We specifically left open in *Japan Line* the application of that case to "domesti-

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." 441 U. S., at 444.

[25] Indeed, in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81-349, which was argued last Term and carried over to this Term, 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 factors.

cally owned instrumentalities engaged in foreign commerce," *id.*, at 444, n. 7, and—to the extent that corporations can be analogized to cargo containers in the first place—this case falls clearly within that reservation.[26]

In light of these considerations, our task in this case must be to determine whether the distinctions between the present tax and the tax at issue in *Japan Line* add up to a constitutionally significant difference. For the reasons we are about to explain, we conclude that they do.

B

In *Japan Line*, we said 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." *Id.*, at 456 (footnote omitted). If we were to take that statement as an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end. But, in fact, such an absolute rule is no more appropriate here than it was in *Japan Line* itself, where we relied on much more than the mere fact of double taxation to strike down the state tax at issue. Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State.

In *Japan Line*, the taxing State could entirely eliminate one important source of double taxation simply by adhering to one bright-line rule: do not tax, to any extent whatsoever, cargo containers "that are owned, based, and registered abroad and that are used exclusively in international com-

[26] 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. See also n. 32, *infra*.

merce . . . ." *Id.*, at 444. To require that the State adhere to this rule was by no means unfair, because the rule did no more than reflect consistent international practice and express federal policy. In this case, California could try to avoid double taxation simply by not taxing appellant's income at all, even though a good deal of it is plainly domestic. But no party has suggested such a rule, and its obvious unfairness requires no elaboration. Or California could try to avoid double taxation by adopting some version of the "arm's-length" approach. That course, however, would not by any means guarantee an end to double taxation.

As we have already noted, the "arm's-length" approach is generally based, in the first instance, on a multicorporate enterprise's own formal accounting. But, despite that initial reliance, the "arm's-length" approach recognizes, as much as the formula apportionment approach, that closely related corporations can engage in a transfer of values that is not fully reflected in their formal ledgers. Thus, for example, 26 U. S. C. § 482 provides:

> "In any case of two or more . . . businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary [of the Treasury] may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such . . . businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such . . . businesses."[27]

[27] Cf. Treasury Department's Model Income Tax Treaty of June 16, 1981, Art. 9, reprinted in CCH Tax Treaties ¶ 158 (1981) (hereinafter Model Treaty) ("Where . . . an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State . . . and . . . conditions are made or imposed between the two enterprises in their commercial or financial relations

And, as one might expect, the United States Internal Revenue Service has developed elaborate regulations in order to give content to this general provision. Many other countries have similar provisions.[28] A serious problem, however, is that even though most nations have adopted the "arm's-length" approach in its general outlines, the precise rules under which they reallocate income among affiliated corporations often differ substantially, and whenever that difference exists, the possibility of double taxation also exists.[29] Thus, even if California were to adopt some version of the "arm's-length" approach, it could not eliminate the risk of double taxation of corporations subject to its franchise tax, and might in some cases end up subjecting those corporations to more serious double taxation than would occur under formula apportionment.[30]

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which differ from those which would be made between independent enterprises, then any profits which, but for those conditions would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly"); J. Bischel, Income Tax Treaties 219 (1978) (hereinafter Bischel).

[28] See generally G. Harley, International Division of the Income Tax Base of Multinational Enterprise 143–160 (1981) (hereinafter Harley); Madere, International Pricing: Allocation Guidelines and Relief from Double Taxation, 10 Tex. Int'l L. J. 108, 111–120 (1975).

[29] See Surrey, Reflections on the Allocation of Income and Expenses Among National Tax Jurisdictions, 10 L. & Policy Int'l Bus. 409 (1978); Bischel 459–461, 464–466; B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 15.06 (4th ed. 1979); Harley 143–160.

[30] Another problem arises out of the treatment of intercorporate dividends. Under formula apportionment as practiced by California, intercorporate dividends attributable to the unitary business are, like many other intercorporate transactions, considered essentially irrelevant and are not included in taxable income. See n. 5, *supra*. If the "arm's-length" method were entirely consistent, it would tax intercorporate dividends when they occur, just as all other investment income is taxed. (In which State that dividend could be taxed is not particularly important, since the issue here is international rather than interstate double taxation. See *Mobil*, 445 U. S., at 447–448.) It could also be argued that this would not,

That California would have trouble avoiding double taxation even if it adopted the "arm's-length" approach is, we think, a product of the difference between a tax on income and a tax on tangible property. See *supra*, at 187–188. Allocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow. In the absence of a central coordinating authority, absolute consistency, even among taxing authorities whose basic approach to the task is quite similar, may just be too much to ask.[31] If California's

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strictly speaking, result in double taxation, since the income taxed would be income "of" the parent rather than income "of" the subsidiary. The effect, however, would often be to penalize an enterprise simply because it has adopted a particular corporate structure. In practice, therefore, most jurisdictions allow for tax credits or outright exemptions for intercorporate dividends among closely tied corporations, and provision for such credits or exemptions is often included in tax treaties. See generally Model Treaty, Art. 23; Bischel 2. No suggestion has been made here that appellant's dividends from its subsidiaries would have to be exempt entirely from domestic state taxation. And the grant of a credit, which is the approach taken by federal law, see 26 U. S. C. § 901 *et seq.*, does not in fact entirely eliminate effective double taxation: the same income is still taxed twice, although the credit insures that the total tax is no greater than that which would be paid under the higher of the two tax rates involved. Moreover, once the Federal Government has allowed a credit for foreign taxes on a particular intercorporate dividend, we are not persuaded why, as a logical matter, a State would have to grant another credit of its own, since the federal credit would have already vindicated the goal of not subjecting the taxpayer to a higher tax burden that it would have to bear if its subsidiary's income were not taxed abroad.

[31] At the federal level, double taxation is sometimes mitigated by provisions in tax treaties providing for intergovernmental negotiations to resolve differences in the approaches of the respective taxing authorities. See generally Model Treaty, Art. 25; 2 New York University, Proceedings of the Fortieth Annual Institute on Federal Taxation § 31.03[2] (1982) (hereinafter N. Y. U. Institute). But cf. Owens, United States Income Tax Treaties: Their Role in Relieving Double Taxation, 17 Rutgers L. Rev. 428, 443–444 (1963) (role of such provisions procedural rather than substantive). California, however, is in no position to negotiate with foreign gov-

method of formula apportionment "inevitably" led to double taxation, see *supra*, at 188, that might be reason enough to render it suspect. But since it does not, 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. Cf. *Moorman Mfg. Co.*, 437 U. S., at 278–280.

It could be argued that even if the Foreign Commerce Clause does not require California to adopt the "arm's-length" approach to foreign subsidiaries of domestic corporations, it does require that whatever system of taxation California adopts must not result in double taxation in any particular case. The implication of such a rule, however, would be that even if California adopted the "arm's-length" method, it would be required to defer, not merely to a single internationally accepted bright-line standard, as was the case in *Japan Line*, but to a variety of § 482-type reallocation decisions made by individual foreign countries in individual cases. Although double taxation is a constitutionally disfavored state of affairs, particularly in the international context, *Japan Line* does not require forbearance so extreme or so one-sided.

C

We come finally to the second inquiry suggested by *Japan Line*—whether California's decision to adopt formula apportionment in the international context was impermissible because it "may impair federal uniformity in an area where federal uniformity is essential," 441 U. S., at 448, and "prevents the Federal Government from 'speaking with one voice' in international trade," *id.*, at 453, quoting *Michelin Tire Corp.*

ernments, and neither the tax treaties nor federal law provides a mechanism by which the Federal Government could negotiate double taxation arising out of state tax systems. In any event, such negotiations do not always occur, and when they do occur they do not always succeed.

v. *Wages*, 423 U. S. 276, 285 (1976). In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, "[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States." *Mobil*, 445 U. S., at 448. See also *Japan Line*, 441 U. S., at 456, n. 20; *Michelin Tire Corp.*, *supra*, at 286. Thus, a state tax at variance with federal policy will violate the "one voice" standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of pre-emption analysis.

(1)

The most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole. 441 U. S., at 450. In considering this issue, however, we are faced with a distinct problem. This Court has little competence in determining precisely when foreign nations will be offended by particular acts, 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. The best that we can do, in the absence of explicit action by Congress, is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations.

This case is not like *Mobil*, in which the real issue came down to a question of interstate rather than foreign commerce. 445 U. S., at 446–449. Nevertheless, three distinct factors, which we have already discussed in one way or another, seem to us to weigh strongly against the conclusion that the tax imposed by California might justifiably lead to significant foreign retaliation. First, the tax here does not create an *automatic* "asymmetry," *Japan Line*, *supra*, at 453, in international taxation. See *supra*, at 188, 192–193. Second, the tax here was imposed, not on a foreign entity as was the case in *Japan Line*, but on a domestic corporation. Although, California "counts" income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation.[32] Third, even if foreign nations have a legitimate interest in reducing the tax burden of domestic corporations, the fact remains that appellant is without a doubt amenable to be taxed in California in one way or another, and that the amount of tax it pays is much more the function of California's tax rate than of its allocation method. Although a foreign nation might be more offended by what it considers unorthodox treatment of appellant than it would be if California simply raised its general tax rate to achieve the same economic result, we can only assume that the offense involved in either event would be attenuated at best.

A state tax may, of course, have foreign policy implications other than the threat of retaliation. We note, however, that in this case, unlike *Japan Line*, the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax.[33] The lack of such a submission is by no means

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[32] We recognize that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests. We need not decide here whether such a case would require us to alter our analysis.

[33] The Solicitor General did submit a memorandum opposing worldwide formula apportionment by a State in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81–349, a case that was argued last Term, and carried over to this Term. Although there is no need for us to speculate as to the reasons for the Solicitor General's decision not to submit a similar memorandum or brief in this case, cf. Brief for National Governors' Association et al. as *Amici Curiae* 6–7, there has been no indication that the position taken by the Government in *Chicago Bridge & Iron Co.* still represents its views, or that we should regard the brief in that case as applying to this case.

dispositive. Nevertheless, when combined with all the other considerations we have discussed, it does suggest that the foreign policy of the United States—whose nuances, we must emphasize again, are much more the province of the Executive Branch and Congress than of this Court—is not seriously threatened by California's decision to apply the unitary business concept and formula apportionment in calculating appellant's taxable income.

(2)

When we turn to specific indications of congressional intent, appellant's position fares no better. First, there is no claim here that the federal tax statutes themselves provide the necessary pre-emptive force. Second, although the United States is a party to a great number of tax treaties that require the Federal Government to adopt some form of "arm's-length" analysis in taxing the domestic income of multinational enterprises,[34] that requirement is generally waived with respect to the taxes imposed by each of the contracting nations on its own domestic corporations.[35] This fact, if nothing else, confirms our view that such taxation is in reality of local rather than international concern. Third, the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as States,[36] and in none of the treaties does the restriction on "non-arm's-length" methods of taxation apply to the States. Moreover, the Senate has on at least one occasion, in considering a proposed treaty, attached a reservation declining to give its consent to a provision in the treaty that would have extended that restriction to the States.[37] Finally, it remains true, as we said in *Mobil*, that "Congress

[34] See generally Model Treaty, Art. 7(2); Bischel 33–38, 459–461.

[35] See Model Treaty, Art. 1(3); Bischel 718; N. Y. U. Institute § 31.04[3].

[36] See Bischel 7.

[37] See 124 Cong. Rec. 18400, 19076 (1978).

has long debated, but has not enacted, legislation designed to regulate state taxation of income." 445 U. S., at 448.[38] Thus, whether we apply the "explicit directive" standard articulated in *Mobil*, or some more relaxed standard which takes into account our residual concern about the foreign policy implications of California's tax, we cannot conclude that the California tax at issue here is pre-empted by federal law or fatally inconsistent with federal policy.

VI

The judgment of the California Court of Appeal is

Affirmed.

JUSTICE STEVENS took no part in the consideration or decision of this case.

JUSTICE POWELL, with whom THE CHIEF JUSTICE and JUSTICE O'CONNOR join, dissenting.

The Court's opinion addresses the several questions presented in this case with commendable thoroughness. In my view, however, the California tax clearly violates the Foreign Commerce Clause—just as did the tax in *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U. S. 434 (1979). I therefore do not consider whether appellant and its foreign subsidiaries constitute a "unitary business" or whether the State's apportionment formula is fair.

With respect to the Foreign Commerce Clause issue the Court candidly concedes: (i) "double taxation is a constitutionally disfavored state of affairs, particularly in the international context," *ante*, at 193; (ii) "like the tax imposed in *Japan Line*, [California's tax] has resulted in actual double taxation," *ante*, at 187; and therefore (iii) this tax "deserves

[38] There is now pending one such bill of which we are aware. See H. R. 2918, 98th Cong., 1st Sess. (1983).

to receive close scrutiny," *ante*, at 189. The Court also concedes that "[t]his case is similar to *Japan Line* in a number of important respects," *ante*, at 187, and that the Federal Government "seems to prefer the ['arm's-length'] taxing method adopted by the international community," *ibid.* The Court identifies several distinctions between this case and *Japan Line*, however, and sustains the validity of the California tax despite the inevitable double taxation and the incompatibility with the method of taxation accepted by the international community.

In reaching its result, the Court fails to apply "close scrutiny" in a manner that meets the requirements of that exacting standard of review. Although the facts of *Japan Line* differ in some respects, they are identical on the critical questions of double taxation and federal uniformity. The principles enunciated in that case should be controlling here: a state tax is unconstitutional if it either "creates a substantial risk of international multiple taxation" or "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" 441 U. S., at 451.

I

It is undisputed that the California tax not only "creates a substantial risk of international multiple taxation," but also "has resulted in actual double taxation" in this case. See *ante*, at 187. As the Court explains, this double taxation occurs because California has adopted a taxing system that "serious[ly] diverge[s]" from the internationally accepted taxing methods adopted by foreign taxing authorities. *Ibid.* The Court nevertheless upholds the tax on the ground that California would not necessarily reduce double taxation by conforming to the accepted international practice.[1] *Ante*, at

[1] The Court also appears to attach some weight to its view that California is unable "simply [to] adher[e] to one bright-line rule" to eliminate double taxation. See *ante*, at 189. From California's perspective, however, a

190–193. This argument fails to recognize the fundamental difference between the current double taxation and the risk that would remain under an "arm's-length" system. I conclude that the California tax violates the first principle enunciated in *Japan Line.*

At present, double taxation exists because California uses an allocation method that is different in its basic assumptions from the method used by all of the countries in which appellant's subsidiaries operate. The State's formula has no necessary relationship to the amount of income earned in a given jurisdiction as calculated under the "arm's-length" method. On the contrary, the formula allocates a higher proportion of income to jurisdictions where wage rates, property values, and sales prices are higher. See J. Hellerstein & W. Hellerstein, State and Local Taxation 538–539 (4th ed. 1978). To the extent that California is such a jurisdiction, the formula inherently leads to double taxation.

Appellant's case is a good illustration of the problem. The overwhelming majority of its overseas income is earned by its Latin American subsidiaries. See App. 112. Since wage rates, property values, and sales prices are much lower in Latin America than they are in California, the State's apportionment formula systematically allocates a much lower proportion of this income to Latin America than does the internationally accepted "arm's-length" method.[2] Correspond-

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bright-line rule that avoids Foreign Commerce Clause problems clearly exists. The State simply could base its apportionment calculations on appellant's United States income as reported on its federal return. This sum is calculated by the "arm's-length" method, and is thus consistent with international practice and federal policy. Double taxation is avoided to the extent possible by international negotiation conducted by the Federal Government. California need not concern itself with the details of the international allocation, but could apportion the American income using its three-factor formula.

[2] Although there are a few foreign countries where wage rates, property values, and sales prices are higher than they are in California, appellant's principal subsidiaries did not operate in such countries.

ingly, the formula allocates a higher proportion of the income to California, where it is subject to state tax. As long as the three factors remain higher in California, it is inevitable that the State will tax income under its formula that already has been taxed by another country under accepted international practice.

In the tax years in question, for example, over 27% of appellant's worldwide income was earned in Latin America and taxed by Latin American countries under the "arm's-length" method. See *ibid.* Latin American wages, however, represented under 6% of the worldwide total; Latin American property was about 20% of the worldwide total; and Latin American sales were less than 14% of the worldwide total. See *id.*, at 109–111. As a result, roughly 13% of appellant's worldwide income—less than half of the "arm's-length" total—was allocated to Latin America under California's formula. In other words, over half of the income of appellant's largest group of subsidiaries was allocated elsewhere under the State's formula. In accordance with international practice, all of this income had been taxed in Latin America, but the California system would allow the income to be taxed a second time in California and other jurisdictions. This problem of double taxation cannot be eliminated without either California or the international community changing its basic tax practices.

If California adopted the "arm's-length" method, double taxation could still exist through differences in application.[3] California and Colombia, for example, might apply different accounting principles to a given intracorporate transfer. But these types of differences, although presently tolerated under international practice, are not inherent in the "arm's-

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[3] Similarly, there could be double taxation if the entire international community adopted California's method of formula apportionment. Different jurisdictions might apply different accounting principles to determine wages, property values, and sales. Indeed, any system that calls for the exercise of any judgment leaves the possibility for some double taxation.

length" system. Moreover, there is no reason to suppose that they will consistently favor one jurisdiction over another. And as international practice becomes more refined, such differences are more likely to be resolved and double taxation eliminated.

In sum, the risk of double taxation can arise in two ways. Under the present system, it arises because California has rejected accepted international practice in favor of a tax structure that is fundamentally different in its basic assumptions. Under a uniform system, double taxation also could arise because different jurisdictions—despite their agreement on basic principles—may differ in their application of the system. But these two risks are fundamentally different. Under the former, double taxation is inevitable. It cannot be avoided without changing the system itself. Under the latter, any double taxation that exists is the result of disagreements in application. Such disagreements may be unavoidable in view of the need to make individual judgments, but problems of this kind are more likely to be resolved by international negotiation.

On its face, the present double taxation violates the Foreign Commerce Clause. I would not reject, as the Court does, the solution to this constitutional violation simply because an international system based on the principle of uniformity would not necessarily be uniform in all of the details of its operation.

II

The Court acknowledges that its decision is contrary to the Federal Government's "prefer[ence for] the taxing method adopted by the international community." *Ante*, at 187. It also states the appropriate standard for assessing the State's rejection of this preference: "a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Ante*, at 194 (emphasis in original). The Court concludes, however, that the California tax does not prevent the Federal

Government from speaking with one voice because it perceives relevant factual distinctions between this case and *Japan Line*. I conclude that the California taxing plan violates the second principle enunciated in *Japan Line*, despite these factual distinctions, because it seriously "implicates foreign policy issues which must be left to the Federal Government."

The Court first contends that "the tax here does not create an *automatic* 'asymmetry.'" *Ante*, at 194–195 (emphasis in original) (quoting *Japan Line*, 441 U. S., at 453). This seems to mean only that the California tax does not result in double taxation in every case. But the fundamental inconsistency between the two methods of apportionment means that double taxation is inevitable. Since California is a jurisdiction where wage rates, property values, and sales prices are relatively high, double taxation is the logical expectation in a large proportion of the cases. Moreover, we recognized 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." *Id.*, at 456.

The Court also relies on the fact that the taxpayer here technically is a domestic corporation. See *ante*, at 195. I have several problems with this argument. Although appellant may be the taxpayer in a technical sense, it is unquestioned that California is taxing the income of the foreign subsidiaries. Even if foreign governments are indifferent about the overall tax burden of an American corporation, they have legitimate grounds to complain when a heavier tax is calculated on the basis of the income of corporations domiciled in their countries. If nothing else, such a tax has the effect of discouraging American investment in their countries.

The Court's argument is even more difficult to accept when one considers the dilemma it creates for cases involving foreign corporations. If California attempts to tax the American subsidiary of an overseas company on the basis of the parent's worldwide income, with the result that double taxation occurs, I see no acceptable solution to the problem created. Most of the Court's analysis is inapplicable to such a case. There can be little doubt that the parent's government would be offended by the State's action and that international disputes, or even retaliation against American corporations, might be expected.[4] It thus seems inevitable that the tax would have to be found unconstitutional—at least to the extent it is applied to foreign companies. But in my view, invalidating the tax only to this limited extent also would be unacceptable. It would leave California free to discriminate against a Delaware corporation in favor of an overseas corporation. I would not permit such discrimination[5] without explicit congressional authorization.

The Court further suggests that California could impose the same tax burden on appellant under the "arm's-length" system simply by raising the general tax rate. See *ante*, at 195. Although this may be true in theory, the argument ignores the political restraints that make such a course infeasible. If appellant's tax rate were increased, the State

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[4] This is well illustrated by the protests that the Federal Government already has received from our principal trading partners. Several of these are reprinted or discussed in the papers now before the Court. See, *e. g.*, App. to Brief for Committee on Unitary Tax as *Amicus Curiae* 7 (Canada); *id.*, at 9 (France); *id.*, at 13-16 (United Kingdom); *id.*, at 17–19 (European Economic Community); App. to Brief for International Bankers Association in California et al. as *Amici Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, pp. 4–5 (Japan); Memorandum for United States as *Amicus Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, p. 3 ("[A] number of foreign governments have complained—both officially and unofficially—that the apportioned combined method . . . creates an irritant in their commercial relations with the United States. Retaliatory taxation may ensue . . ."); App. to *id.*, at 2a–3a (United Kingdom); *id.*, at 8a–9a (Canada).

[5] California is, of course, free to tax its own corporations more heavily than it taxes out-of-state corporations.

would be forced to raise the rate for all corporations.[6] If California wishes to follow this course, I see no constitutional objection. But it must be accomplished through the political process in which corporations doing business in California are free to voice their objections.

Finally, the Court attaches some weight to the fact that "the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax." *Ibid.* The Court, in a footnote, dismisses the Solicitor General's memorandum in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81–349, despite the fact that it is directly on point and the case is currently pending before the Court. See *ante*, at 195, n. 33. In this memorandum, the Solicitor General makes it clear beyond question what the Executive Branch believes: "imposition of [a state tax] on the apportioned combined worldwide business income of a unitary group of related corporations, including foreign corporations, impairs federal uniformity in an area where such uniformity is essential."[7] Memorandum for United States as *Amicus Curiae* in *Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, O. T. 1982, No. 81–349, p. 2. I recognize that the Government may change its position from time to time, but I see no reason to ignore its view in one case currently pending before the Court when considering another case that raises exactly the same issue. The Solicitor General has not withdrawn his memorandum, nor has he supplemented it with anything taking a contrary position. As long as *Chicago Bridge & Iron* remains before us, we must conclude that the Government's views are accurately reflected in the Solicitor General's memorandum in that pending case.

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[6] The State could not raise the tax rate for appellant alone, or even for corporations engaged in foreign commerce, without facing constitutional challenges under the Equal Protection or the Commerce Clause.

[7] *Chicago Bridge & Iron*, it might be noted, is a case in which the state tax is imposed on an American parent corporation.

In sum, none of the distinctions on which the Court relies is convincing. California imposes a tax that is flatly inconsistent with federal policy. It prevents the Federal Government from speaking with one voice in a field that should be left to the Federal Government.[8] This is an intrusion on national policy in foreign affairs that is not permitted by the Constitution.

III

In *Japan Line* we identified two constraints that a state tax on an international business must satisfy to comply with the Foreign Commerce Clause. We explicitly declared that "[i]f a state tax contravenes either of these precepts, it is unconstitutional." 441 U. S., at 451. In my view, the California tax before us today violates *both* requirements. I would declare it unconstitutional.

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[8] The Court relies on the absence of a "clear federal directive." See *ante*, at 194, 196–197. In light of the Government's position, as stated in the Solicitor General's memorandum, see *supra*, at 204, the absence of a more formal statement of its view is entitled to little weight.