

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672
1521 SCOMM 55: JNT. SPEC. COMM. ON STATE TAX POLICY, 1986-1987 / 321

this preference as being a constitutional ruling that formula apportionment *must* be employed in lieu of separate accounting.

While separate accounting is not constitutionally required,³⁷ and while it may have some weaknesses when applied to some unitary businesses,³⁸ this methodology has not been rejected as unconstitutional. The United States Supreme Court in *Container Corp.* concluded that:

Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but difficult to describe in theory....

....
But we see no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in ... separate accounting....

463 U.S. at 182, 183-84, 103 S.Ct. at 2949, 2949-2950, 77 L.Ed.2d at 564, 565.

B. Due Process

The oil companies claim that the Oil Tax is unconstitutional because it taxes extraterritorial values. They claim that the state impermissibly taxes all of their production income from Alaska oil, despite the contributions that other states have made to those earnings in terms of research, management and sales.

[5] "As a general principle, a state may not tax value earned outside its borders." *Earth Resources v. State, Department of Revenue*, 665 P.2d 960, 966 (Alaska 1983) (quoting *ASARCO v. Idaho State Tax Commission*, 458 U.S. 307, 315, 102 S.Ct. 3103, 3108, 73 L.Ed.2d 787, 794 (1982)); *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 164, 103 S.Ct. at

2940, 77 L.Ed.2d at 552. Any attempt to tax extraterritorial values would be an unconstitutional taking of property under the due process clause.³⁹

[6] Due process imposes two requirements before a state may tax income generated in interstate commerce. First, a "minimal connection" must exist between the interstate activities and the taxing state. Second, the income attributed to the taxing state must bear a rational relationship to intrastate values of the enterprise. *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 219-220, 100 S.Ct. 2109, 2118-2119, 65 L.Ed.2d 66, 79 (1980); *Mobil Oil v. Commissioner of Taxes*, 445 U.S. at 436-37, 100 S.Ct. at 1231-1232, 63 L.Ed.2d at 520; *Moorman Manufacturing v. Bair*, 437 U.S. at 272-73, 98 S.Ct. at 2343-2345, 57 L.Ed.2d at 204.

[7] The first requirement—a minimal connection—is established if the corporation "avails itself of the 'substantial privilege of carrying on business' within the State." *Exxon v. Wisconsin Department of Revenue*, 447 U.S. at 220, 100 S.Ct. at 2118, 65 L.Ed.2d at 79 (quoting *Mobil*, 445 U.S. at 437, 100 S.Ct. at 1231, 63 L.Ed.2d at 520, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45, 61 S.Ct. 246, 249-250, 85 L.Ed. 267, 271 (1940)). Clearly, a nexus exists between the oil production and transportation activities of ARCO, Exxon, and Sohio, and the State of Alaska.

As to the second requirement, the United States Supreme Court has not required absolute precision in determining a state's share of interstate income. In *Moorman Manufacturing v. Bair*, 437 U.S. 267, 98 S.Ct. at 2340, 57 L.Ed.2d 197, an animal feed company which manufactured its product in Illinois and sold it in Iowa challenged the constitutionality of Iowa's statu-

37. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81.

38. See *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521; *Earth Resources v. State, Dep't of Revenue*, 665 P.2d 960, 966 (Alaska 1983).

39. The due process clause of the fourteenth amendment provides in part:

[N]or 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.

Cite as 705 P.2d 418 (Alaska 1985)

tory apportionment formula. Instead of the typical three-factor (payroll, property and sales) formula, Iowa used a single-factor formula based exclusively on sales. The corporation argued that this formula resulted in extraterritorial taxation and violated the due process and commerce clauses of the federal Constitution. In addressing the rational relationship requirement, the Supreme Court stated:

States have wide latitude in the selection of apportionment formulas and . . . a formula-produced assessment will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State," or has "led to a grossly distorted result." 437 U.S. at 274, 98 S.Ct. at 2345, 57 L.Ed.2d at 205 (citations omitted). The Court found the taxpayer had failed to demonstrate any arbitrary result in its case, and thus the tax survived the due process challenge.

More recently the United States Supreme Court has expressly refused to constitutionally require a particular income attribution method to the exclusion of all others. In *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545, the Supreme Court upheld California's inclusion of the income of Container Corporation's foreign subsidiaries in the state's apportionment formula. The corporation argued that inclusion of this income violated both the due process and commerce clauses, because the same income California was subjecting to apportionment was taxed by foreign jurisdictions under a separate accounting methodology. In rejecting this argument, the Court noted:

In the case of a more-or-less integrated business enterprise operating in more than one State, . . . arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in

practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, 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. . . ."

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting [separate accounting].

463 U.S. at 164, 103 S.Ct. at 2939, 77 L.Ed.2d at 552-53 (citations omitted, emphasis added).

[8] We hold that the Oil Tax satisfies the second requirement of the due process clause. It makes a reasonable attempt to attribute only that income to Alaska that was generated in Alaska, while excluding expenses and profits generated beyond Alaska's borders. Under a separate accounting approach, income is viewed as earned when and where the principal operating activity occurs. Support activities are universally accounted for only as expenses, whether they occur in or outside the income-producing state. As with other states' separate accounting methods, the Oil Tax allows for the deduction of costs and profits from marketing, refining and transportation, and expenses related to other support activities.⁴⁰ Moreover, Alaska's tax is unique in allowing a deduction for out-of-state profits as well as costs of general overhead and administrative activities incident to Alaskan oil production and transportation, if the companies report them as such. See 15 AAC 21.290(b) (Eff. 2/22/79, am. 3/26/82). By allowing all of these deductions, the Oil Tax is intended to tax only those profits associated with the companies' activities within the state. Thus, the Oil Tax taxes only a portion of the companies' income, although by a technique quite different from formula apportionment.⁴¹ Because the Oil Tax operates

40. See La. Income Tax Reg. art. 47:244.A (1985); Miss.Code Ann. § 27-7-23(b)(3) (1983); Okla. Stat. Ann. tit. 68, § 2358, A.4.a, b, c (1985); see

also *Webb Resources v. McCoy*, 194 Kan. 758, 401 P.2d 879, 890 (1965).

41. See *Container Corp.*, 463 U.S. at 188, 103 S.Ct. at 2952, 77 L.Ed.2d at 568 (Formula apportion-

to tax only a portion of the companies' income, we hold that it satisfies the dual requirements of due process.

C. Commerce Clause

[9] We have previously recognized that the commerce clause⁴² "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." *Sjong v. State, Department of Revenue*, 622 P.2d at 973. Generally, if a state tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce and is fairly related to the services provided by the State," there is no impermissible burden on interstate commerce. *Complete Auto Transit v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977). The nexus and fair apportionment factors have been discussed in the previous due process section. We now turn to a consideration of the other two factors of the *Complete Auto Transit* test.

The oil companies contend that the Oil Tax violates the commerce clause because it inevitably results in overlapping or duplicative taxation, thus discriminating against businesses engaged in interstate commerce. They claim that recent United States Supreme Court decisions on the subject of multiple taxation render the Oil Tax unconstitutional, citing *Japan Line v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979), *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. at 1223, 63 L.Ed.2d 510, and *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66. We disagree.

In *Japan Line*, six Japanese companies challenged a California property tax on shipping containers. The Japanese-owned containers were subject to a property tax

on 100% of their value in their home port of Japan. Under California's tax, all containers in the state on a specified tax day were subject to an apportioned *ad valorem* property tax. The companies contended that California's tax, as applied to their containers, created multiple taxation and violated the commerce clause.

The Court in *Japan Line* assumed that the *Complete Auto Transit* test was met. However, because taxation of instrumentalities of foreign commerce was at issue, the Court found it necessary to inquire whether California's tax, notwithstanding its fair apportionment, created a substantial risk of international multiple taxation. 441 U.S. at 451, 99 S.Ct. at 1823, 60 L.Ed.2d at 349. In this regard, the Court contrasted taxation of interstate instrumentalities with that of international instrumentalities:

In order to prevent multiple taxation of interstate commerce, this Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value. The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile.... Otherwise there would be multiple taxation of interstate operations." The basis for this Court's approval of apportioned property taxation, in other words, has been its ability to enforce full apportionment by all potential taxing bodies.

441 U.S. at 446-47, 99 S.Ct. at 1820-1821, 60 L.Ed.2d at 347 (citations omitted). While the Court could require apportionment among the states for property taxation purposes, it obviously could not prevent Japan from taxing 100% of the value

ment and separate accounting are "two distinct methods of allocating the income of a multinational enterprise.").

42. The commerce clause is set forth in article I, § 8 of the United States Constitution:

The Congress shall have Power To ... regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes; ...

of the containers. The Court held California's nondiscriminatory tax unconstitutional because it resulted in actual multiple taxation of instrumentalities of international commerce.⁴³

[10] The oil companies in the present litigation argue that if Alaska had been the home port instead of Japan in *Japan Line*, the Supreme Court would have invalidated Alaska's 100% *ad valorem* tax. We agree that Alaska would not be entitled to apply a property tax to the full value of instrumentalities of foreign commerce. But the oil companies' attempt to equate a property tax on the full value of goods used in foreign commerce with the Oil Tax is inappropriate. While the single situs property tax may be analogous to the specific allocation by situs method of income taxation, it is a totally different species from separate accounting.⁴⁴ The Oil Tax, as a separate accounting division-of-income method, does not automatically conflict with an apportionment method and result in double taxation.⁴⁵ Because separate accounting and formula apportionment can coexist without overlapping tax bases, *Japan Line* does not require invalidation of the Oil Tax.⁴⁶

In *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510, the Court upheld the constitutionality of the inclusion of foreign source dividend income in the total income subject to taxation by Vermont. Mobil argued that Vermont could not tax its dividend income because New York, the state of commercial domicile, had the power under the commerce clause to allocate all of the dividend

income to itself. Allowing Vermont to tax a share of the income by apportionment would, therefore, result in double taxation if New York implemented such a tax. In this situation, the Court considered the risk of multiple taxation to be sufficient since the specific allocation by situs method was "theoretically incommensurate" with apportionment.⁴⁷ The Court found that if one method were constitutionally preferable, a tax based on the other method could not be sustained. 445 U.S. at 444-45, 100 S.Ct. at 1235-1236, 63 L.Ed.2d at 525.

Instead of accepting Mobil's argument that specific allocation by situs was preferable, the Court found apportionment to be the better approach. While the Court chose not to rule on the constitutionality of a hypothetical New York tax, the Court stated that in theory New York could not exclusively tax Mobil's dividend income since

the dividends reflect income from a unitary business, part of which is conducted in other states. In that situation, the income bears relation to benefits and privileges conferred by several states. These are the circumstances in which apportionment is *ordinarily* the accepted method.

Id. at 446, 100 S.Ct. at 1236, 63 L.Ed.2d at 526 (emphasis added).

Several months after the *Mobil* case, the Court decided *Exxon v. Wisconsin Department of Revenue*, 447 U.S. 207, 100 S.Ct. 2109, 65 L.Ed.2d 66. *Exxon*, like this litigation, involved state taxation of oil pro-

43. The Court indicated that it need not decide "under what circumstances the mere risk of multiple taxation would invalidate a state tax, or whether this risk would be evaluated differently in foreign, as opposed to interstate, commerce." 441 U.S. at 452 n. 17, 99 S.Ct. at 1823 n. 17, 60 L.Ed.2d at 350 n. 17 (emphasis in original).

44. See discussion *supra* section II.A.2.

45. *Container Corp.*, 463 U.S. at 194-95, 103 S.Ct. at 2955-2956, 77 L.Ed.2d at 572.

46. There is language in *Japan Line* to the effect that an "unapportioned" tax will not be sus-

tained. 441 U.S. at 447, 99 S.Ct. at 1820, 60 L.Ed.2d at 347. However, this statement must be read in context. In the property tax area, separate accounting is not even a viable theory for dividing income. Allocation of the full property to one state or apportionment among several states are the only two options. Since allocation of the full property value to one of several proper taxing jurisdictions is unconstitutional, apportionment is the only permissible means of dividing the value of property used in interstate commerce for property taxation purposes.

47. Cf. *Moorman*, 437 U.S. at 277, 98 S.Ct. at 2346, 57 L.Ed.2d at 207.

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47. *Cf. Moorman*, 437 U.S. at 277, 98 S.Ct. at 2346, 57 L.Ed.2d at 207.

duction income. Exxon's activities in Wisconsin were limited to the marketing of petroleum products. Exxon challenged Wisconsin's inclusion of oil production income in the income subject to apportionment by Wisconsin. Exxon argued that production of oil and marketing of oil were two distinct operations. In Exxon's view, since it could illustrate by separate accounting that these two activities were distinct, Wisconsin could not constitutionally include production income in the tax base for apportionment.

Exxon contended that the commerce clause required the allocation of all income derived from exploration and production functions to the situs state, rather than inclusion in the apportionment formula. Exxon asserted that since the producing state was constitutionally entitled to allocate all production income to itself, non-producing states could not tax an apportioned share of this same income.

To this, the Supreme Court replied:

We do not agree. As was the case with income from intangibles, there is nothing "talismanic" about the concept of situs for income from exploration and production of crude oil and gas. Presumably, the States in which appellant's crude oil and gas production is located are permitted to tax in some manner the income derived from that production, there being an obvious nexus between the taxpayer and those States. However, "there is no reason in theory why that power should be exclusive when the [exploration and production income as distinguished through separate functional accounting] reflect[s] income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which

apportionment is ordinarily the accepted method."

In short, the Commerce Clause does not require that any income which a taxpayer is able to separate through accounting methods and attribute to exploration and production of crude oil and gas be allocated to the States in which those production centers are located. *The geographic location of such raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business.*

447 U.S. at 229-30, 100 S.Ct. at 2123-2124, 65 L.Ed.2d at 85 (emphasis added; citations omitted).

Basically, both the oil companies and the state view *Japan Line*, *Mobil* and *Exxon* as prohibiting allocation of oil production income entirely to the situs state. The debate focuses on whether the Oil Tax allocates all oil production income to Alaska, as the oil companies contend, or is instead a distinct method of dividing the production income, as the state contends. Because we hold that the Oil Tax is a distinct method of dividing oil production income by use of separate accounting, its constitutional validity is not directly determined by these three cases.⁴⁸

While *Mobil* and *Exxon* indicate the Court's strong endorsement of the use of apportionment formulas, the Court clearly implied that the use of separate accounting is constitutionally permissible under the commerce clause.⁴⁹ The constitutional preference for apportionment of "unitary" dividend income in *Mobil* stemmed from the fact that the two competing methods at issue—specific allocation and formula apportionment—were "theoretically incom-

48. See W. Hellerstein, Memorandum to Mr. Milton Barker (April 20, 1981) (discussing proposed Oil Tax). [Record 17,091]

49. In both *Exxon* and *Mobil*, the Court stated that separate accounting "is not constitutionally required." *Exxon*, 447 U.S. at 223, 100 S.Ct. at 2120, 65 L.Ed.2d at 81; *Mobil*, 445 U.S. at 438, 100 S.Ct. at 1232, 63 L.Ed.2d at 521.

mensurate." *Mobil*, 445 U.S. at 444, 100 S.Ct. at 1235, 63 L.Ed.2d at 525.⁵⁰

The type of duplicative taxation found unacceptable in *Japan Line*, *Exxon* and *Mobil* all involved one taxing jurisdiction using the specific allocation by situs method, while another used apportionment. In other words, one taxing jurisdiction taxed the whole pie, while another taxed a slice. In such a situation, double taxation is inevitable, and one method has to be chosen over another. By contrast, in *Moorman Manufacturing v. Bair*, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197, two jurisdictions used different apportionment formulas. Each took only a slice of the pie, but since they used different formulas to divide the pie, the Court recognized that there was high probability of some overlap. While the potential for overlap existed, it certainly was not inevitable, and the Court upheld Iowa's apportionment method. The Court held that prevention of duplicative taxation should be effected by a national uniform rule for the division of income, but that the "Constitution . . . is neutral with respect to the content of any uniform rule." *Id.* at 279, 98 S.Ct. at 2347, 57 L.Ed.2d at 208. Given the absence of federal legislation, the Court was unwilling to specify that a particular methodology was constitutionally preferable. While acknowledging a clear risk of multiple taxation in a variety of situations due to the divergence in division-of-income techniques employed by the various states, the Court found such risk preferable to choosing one technique as constitutionally superior to another. *Id.* at 278-80, 98 S.Ct. at 2347-2348, 57 L.Ed.2d at 207-09.

The oil companies in the present litigation acknowledge that *Moorman* evidenced the Supreme Court's high degree of tolerance for apportionment formulas. But in their view, this tolerance does not extend beyond the apportionment method. They claim that *Moorman* does not sanction the use of Alaska's Oil Tax because the tax is not apportioned. We disagree. First, as we have previously explained, the Oil Tax

utilizes a division-of-income method. Second, while *Moorman* pertained to the conflict presented when two jurisdictions employ different types of formula apportionment, the principle of the opinion was that non-uniform state taxes are inevitable and constitutionally permissible. Since *Moorman*, the Court has continued to maintain that states enjoy broad leeway in their choice of division-of-income methods. See *Container Co. v. Franchise Tax Board*, 463 U.S. at 164, 103 S.Ct. at 2939, 77 L.Ed.2d at 552.

Container Corp. closely resembles the situation in this case. In *Container Corp.*, California sought to determine its share of total income by use of formulary apportionment, while foreign jurisdictions employed separate accounting.⁵¹ Discussing discrimination against interstate commerce, the Court reiterated its view that the Constitution does not require the elimination of all overlapping taxation on the interstate level. 463 U.S. at 171, 103 S.Ct. at 2943, 77 L.Ed.2d at 557. Thus, if the problem were limited to the interstate level, "the fact that different jurisdictions applied different methods of taxation . . . would probably make little constitutional difference." 463 U.S. at 185, 103 S.Ct. at 2950, 77 L.Ed.2d at 566.

In *Container Corp.*, the Court faced the additional complication of international commerce. Even so, the Court upheld the tax, distinguishing *Japan Line* on the ground that Japan's specific allocation by situs method necessarily resulted in double taxation.

Here, by contrast, we are faced with two distinct methods of allocating the income of a multi-national enterprise. The "arm's-length" approach [i.e., separate accounting] 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

50. See W. Hellerstein, *supra* note 48, at 2. [Record 17,093]

51. See discussion *supra* section IV.B.

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.

463 U.S. at 188, 103 S.Ct. at 2952, 77 L.Ed.2d at 568 (footnote omitted). The Court held that the two taxing methods do "not create an automatic 'asymmetry'." *Id.* at 194-95, 103 S.Ct. at 2955-2956, 77 L.Ed.2d at 572. "[I]t would be perverse, [therefore,] 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." *Id.* at 193, 103 S.Ct. at 2955, 77 L.Ed.2d at 571. The fact that the Court found the two methods could coexist on the international level, where duplicative taxation is viewed more strictly, makes separate accounting a quite permissible alternative when only interstate commerce is involved, as is the case in the present litigation.

The Supreme Court has repeatedly recognized that neither separate accounting nor formula apportionment will result in the attribution of the exact amount of income earned in the state to that particular state. Some multiple taxation may result when one jurisdiction employs one method and another uses a different approach. This threat is inherent in any system where state attribution methods are nonuniform. But a state does not offend the commerce clause merely because its method of dividing income is different from that of its neighbors. *Moorman Manufacturing v. Bair*, 437 U.S. at 278-80, 98 S.Ct. at 2347-2348, 57 L.Ed.2d at 208-09.

We have already explained that the separate accounting method employed by the State of Alaska does not tax all profits generated from Alaskan oil production and does not impermissibly attribute extraterritorial values to Alaska. Using the leeway it retains absent a federal uniform approach, the Alaska legislature chose a con-

stitutionally permissible method of income division, albeit not the one "ordinarily" employed for most other types of unitary businesses.

[11] We hold that the Oil Tax comports with the requirements of the *Complete Auto Transit* test and creates no impermissible burden on interstate commerce. The location of the oil fields in Prudhoe Bay creates a substantial "nexus" between the oil companies' activities and the State of Alaska.⁵² As discussed above, the Oil Tax is fairly apportioned to represent only that part of the companies' income generated from its Alaskan activities—oil and gas production and transportation. As in *Container Corp.*, the Oil Tax does not inevitably result in multiple taxation. Moreover, any possible overlap created by Alaska's use of separate accounting and other jurisdictions' use of different income division methods is not the fault, in the constitutional sense, of Alaska. Thus, the Oil Tax does not discriminate against interstate commerce. Finally, because the oil companies all benefit from the "substantial privilege" ⁵³ of extracting oil in Alaska, the Oil Tax is fairly related to services provided in the state.

D. Federal and State Equal Protection

The oil companies assert that the Oil Tax violates both state and federal equal protection since it "arbitrarily [and] irrationally subject[s] a special group of taxpayers to treatment not accorded taxpayers at large." They argue, in effect, that using a distinct method of taxation for multistate oil companies, but not for any other unitary businesses, violates equal protection. We reject the oil companies' equal protection challenge.

The analysis under Alaska's equal protection clause involves a three-step process. *Alaska Pacific Assurance v. Brown*, 687 P.2d 264, 269-70 (Alaska 1984) [hereinafter

52. See *Exxon v. Wisconsin Dep't of Revenue*, 447 U.S. at 229, 100 S.Ct. at 2123, 65 L.Ed.2d at 85.

53. See *Commonwealth Edison v. Montana*, 453 U.S. at 628-29, 101 S.Ct. at 2959-2960, 69 L.Ed.2d at 901.

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Cite as 705 P.2d 418 (Alaska 1985)

cited as ALPAC]; *State v. Ostrosky*, 667 P.2d 1184, 1192-94 (Alaska 1983), *appeal dismissed*, — U.S. —, 104 S.Ct. 2379, 81 L.Ed.2d 339 (1984); *State v. Erickson*, 574 P.2d 1, 11-12 (Alaska 1978).⁵⁴ First, in order to ascertain the appropriate level of review, the nature of the constitutional interest affected must be identified. *ALPAC*, 687 P.2d at 269. Next, the validity of the statutes' purpose must be analyzed in light of the interest impinged. *Id.* Lastly, the means chosen must be examined, also in light of the interest, to insure that they are sufficiently related to the goals of the statute. *Id.* at 269-70.

The interest involved here, freedom from disparate taxation, lies at the low end of the continuum of interests protected by the equal protection clause.⁵⁵ Regarding the statute's purpose, the oil companies claim that greed and other improper motives led the Alaska legislature to enact the Oil Tax. The state, however, has adequately established that a primary purpose of the Oil Tax was to rectify a perceived underestimation of oil production and pipeline transportation income that occurred with the application of an apportionment formula. The goal was to insure that the tax rate assessed to the oil companies on this income was commensurate with the rate applicable to the income of other corporations in the state. Ch. 110, § 1, SLA 1978. Taxing the oil companies differently to rectify a perceived inequity was the legislature's attempt to prevent disparate treatment; thus, the validity of this purpose in light of the companies' interest is established. Finally, the means chosen were sufficiently related to the goals of the legislation. The use of separate accounting, rather than formula apportionment, increased the

amount of production and transportation income subject to Alaska taxation and more fairly represented the extent of the business activities of the oil companies in Alaska.

The Oil Tax did not adversely affect any fundamental interest, nor did it contain a suspect classification. Thus, to be upheld under the federal analysis, it need only to have been rationally related to a legitimate state interest. *Exxon v. Eagerton*, 462 U.S. 176, 195-96, 103 S.Ct. 2296, 2307-2309, 76 L.Ed.2d 497, 513 (1983). The rational basis standard is particularly easy to meet in the area of taxation. The United States Supreme Court has stated that "[l]egislatures have especially broad latitude in creating classifications and distinctions in tax statutes." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547, 103 S.Ct. 1997, 2002, 76 L.Ed.2d 129, 138 (1983). The Oil Tax clearly bore a rational relationship to the state's goal of correcting a perceived inequity in the tax structure.

[12] While the oil companies dispute the underlying premise that the Oil Tax rectifies inequities, the legislature could have reasonably concluded that the Oil Tax would more accurately compute the companies' income generated in Alaska. Thus, the Oil Tax survives the equal protection challenge, under both the United States and the Alaska Constitutions.

E. Contract Clause

[13] The oil companies argue that the Oil Tax is invalid because it impairs the obligation of the state's lease contracts with them.⁵⁶ They contend that the tax increases the state's share under the lease

54. In determining questions of equal protection under the Alaska Constitution, we employ a single test. As we stated in *State v. Erickson*, 574 P.2d 1, 12 (Alaska 1978):

Such a test will be flexible and dependent upon the importance of the rights involved. Based on the nature of the right, a greater or lesser burden will be placed on the state to show that the classification has a fair and substantial relation to a legitimate governmental objective.

55. See *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547, 103 S.Ct. 1997,

705 P.2d—11

2002, 76 L.Ed.2d 129, 138 (1983). See generally P. Hartman, *supra* note 8, § 3.1, at 131-38.

56. The State of Alaska began issuing oil and gas leases a few months after passage of the Alaska Land Act, as 38.05, in 1959. The first oil and gas leases at Prudhoe Bay were issued in 1964 the state entered into lease contracts with the oil companies, whereby the state sold the companies whatever gas and oil might be found on the leaseholds in exchange for "bonus" payments and royalties of 12½%.

contracts, and that such modification of the terms of the leases violates the contract clause of the United States Constitution.⁵⁷

This argument is without merit. No lease provision has been impaired. In entering into the leases the state could not,⁵⁸ and did not, contract away its power as a sovereign to tax income earned in the state. *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 102 S.Ct. 894, 71 L.Ed.2d 21 (1982) disposes of this issue:

Contractual arrangements remain subject to subsequent legislation by the presiding sovereign. Even where the contract at issue requires payment of a royalty for a license or franchise issued by the governmental entity, the government's power to tax remains unless it "has been specifically surrendered in terms which admit of no other reasonable interpretation." *St. Louis v. United R. Co.*, 210 U.S. 266, 280, 28 S.Ct. 630, 634, 52 L.Ed. 1054, 28 S.Ct. 630 (1908). 455 U.S. at 148, 102 S.Ct. at 907, 71 L.Ed.2d at 36 (citations omitted); see also *Exxon v. Eagerton*, 462 U.S. at 187-94, 103 S.Ct. at 2304-2307, 76 L.Ed.2d at 508-12.

VIII. RETROACTIVITY OF THE OIL TAX

The Oil Tax Act was signed into law on July 8, 1978.⁵⁹ Section 4 of the Act provided that it would apply retroactively to January 1, 1978. Section 5 provided the Act would be "effective" immediately. While the Senate voted 16 to 4 to approve section 5, the entire Oil Tax Act only passed by a vote of 11 to 9. Thus, at no time did more than 11 senators vote to approve section 4.

The companies argue that the Act may not constitutionally be made applicable to income earned prior to July 8, 1978. They

interpret article II, § 18 of the Alaska Constitution⁶⁰ and AS 01.10.070(a)⁶¹ as requiring the approval of two-thirds majority of each house of the legislature to give retroactive effect to a new law. The companies argue that even though a two-thirds vote was attained for an immediate effective date, a two-thirds vote was also required to enact section 4, applying the Act retroactively to January 1, 1978. We disagree.

AS 01.10.090 states that "[n]o statute is retrospective unless expressly declared therein." A two-thirds vote requirement does not appear in that section, nor elsewhere in Alaska law. The legislature, however, has recognized that where retroactive application of a portion or all of a bill is desired, an immediate effective date, which does require a two-thirds vote under article II, § 18 and AS 01.10.070(a), should be used in conjunction with the retroactivity section. Legislative Affairs Agency, *Manual of Legislative Drafting* 11 (1977); Uniform Rules of the Alaska State Legislature, Rule 10 (May 3, 1977). Accordingly, because two-thirds of the legislature voted to make the Oil Tax Act immediately effective, a separate two-thirds vote for the Act to be retroactive was not constitutionally required. The Oil Tax was properly retroactive to January 1, 1978.

The superior court's action in granting the state's motion for summary judgment is AFFIRMED.

COMPTON, J., not participating.

APPENDIX 1

AS 43.21, Oil and Gas Corporate Income Tax provided:

Sec. 43.21.010. Application [Repealed effective January 1, 1982]. AS 43.21.010—

57. "No State shall ... pass any ... Law impairing the Obligation of Contracts..." U.S. Const., art. I, § 10, cl. 1.

58. The Alaska Constitution provides: "The power of taxation ... shall not be ... contracted away, except as provided in this article." Alaska Const. art. IX, § 1.

59. Ch. 110, SLA 1978.

60. Alaska Const. art. II, § 18 provides:

Laws passed by the legislature become effective ninety days after enactment. The legislature may, by concurrence of two-thirds of the membership of each house, provide for another effective date.

61. AS 01.10.070(a) contains language paralleling Alaska Const. art. II, § 18.

APPENDIX 1—Continued

43.21.120 applies to every corporation doing business in the state which derives income from the production of oil or gas from a lease or property in the state or from the pipeline transportation of oil or gas in the state. The tax calculated under AS 43.21.010—43.21.120 is measured by the total taxable income of the corporation during the tax period as determined under AS 43.21.020—43.21.040 and is calculated at the rates established under AS 43.20.011(e).

Sec. 43.21.020. Determination of taxable income from oil and gas production [Repealed effective January 1, 1982]. (a) The taxable income of a corporation from the production of oil and gas from a lease or property in the state shall be the corporation's net income as calculated by the department in accordance with this section.

(b) Gross income of a corporation from oil and gas production shall be the gross value at the point of production of oil or gas produced from a lease or property in the state. The department shall by regulation determine a uniform method of establishing the gross value at the point of production. In making its determination the department may use the actual prices or values received for the oil or gas, the posted prices for the oil or gas in the same field, or the prevailing prices or values of oil or gas in the same field. In addition, in its determination of gross value at the point of production of oil or gas produced from a lease or property, the department shall determine the reasonable costs of transportation from the point of sale to the point of production of the oil or gas. Transportation costs set by a tariff properly on file with the Alaska Pipeline Commission or other regulatory agency shall be considered prima facie reasonable, but if a tariff properly on file with a regulatory agency is subsequently amended, changed, or overturned retroactively, the reasonable costs of transportation shall be recomputed for that period using the newly determined tariff.

(c) Net income from oil and gas production shall be determined by the department

by deducting from gross income the following:

(1) royalties paid in kind or in value;

(2) taxes imposed under AS 43.55.011—43.55.150 and AS 43.57.010 which are actually paid or incurred by the corporation on the production from a lease or property in the state;

(3) taxes imposed under AS 43.56.010—43.56.210 and AS 29.53.010—29.53.460 which are actually paid or incurred by the corporation on property used directly in the production of oil or gas from a lease or property in the state, including property used in production, gathering, treatment, or preparation of the oil or gas for pipeline transportation, but only if those property tax payments were due and payable only after the date of commercial production from the lease or property with which the property was associated;

(4) the direct costs incurred by or for the corporation in operating the lease or property, including the direct costs of producing, gathering, treating, or preparing the oil or gas for pipeline transportation, but not of any payments received for those activities and not including any indirect cost or overhead expense;

(5) depreciation (using the unit of production method or such other reasonable methods as the department may by regulation establish) on property used directly in the production, gathering, treatment, or preparation of the oil or gas for pipeline transportation including amortization of capitalized interest for investments in this property at a rate not to exceed the average cost of borrowed capital to the taxpayer during the year in which it is capitalized;

(6) the amortization of lease acquisition payments and taxes paid or incurred under AS 43.56.010—43.56.210 and AS 29.53.010—29.53.460 (including capitalized interest on both) for or on producing properties before the commencement of commercial production from the lease or property for which the property is being used;

APPENDIX 1—Continued

(7) interest expense of the corporation not capitalized during construction, that was paid or incurred in connection with property in Alaska; however, unless (f) of this section applies, the interest expense may not exceed that portion of the total interest paid by the consolidated business of which the corporation is a part, determined by multiplying the total interest by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business; in this subsection, "total interest paid by the consolidated business" does not include interest expense arising from intercompany obligations within the consolidated business except to the extent that the interest expense reflects a pass-through of interest on a third-party borrowing by the parent or other member of the consolidated business with the purpose, expressed at the time of the third-party borrowing, of financing Alaska business activity of the taxpayer corporation;

(8) expenses incurred by the corporation after December 31, 1977, of unsuccessful exploration of oil or gas in the state including the acquisition costs of abandoned properties, dry hole costs, and the costs of geologic and geophysical exploration related to those abandoned properties;

(9) general overhead or administrative expense incurred by the corporation attributable to deriving income from the production of oil or gas from a lease or property in the state to the extent, except as provided in (f) of this section, that it does not exceed that portion of the total general overhead or administrative expense incurred by the consolidated business of which the corporation is a part, determined by multiplying the total general overhead or administrative expense by a fraction, the numerator of which is the value of the corporation's real and tangible personal property used

directly in the production of oil or gas from a lease or property in the state and the denominator of which is the value of all real and tangible personal property of the consolidated business;

(10) the amount of income from the production of oil and gas from a lease or property that is divided among the regional Native corporations under sec. 7(i) of the Alaska Native Claims Settlement Act. (P.L. 92-203);

(11) the tax imposed by sec. 4986 of the Internal Revenue Code that is paid or incurred by the taxpayer for oil production from leases or properties in the state.

(d) Deductions from gross income under this section shall not include expenses previously deducted on a return filed under AS 43.20.011-43.20.350.

(e) Where a corporation subject to AS 43.21.010-43.21.120 shares the production or proceeds of the production from a lease or property through a working interest, royalty interest, overriding royalty interest, production payment, net profit interest, joint venture or other agreement, the department shall allocate the deductions from gross income between the corporation and the persons with whom it has such an agreement in accordance with the terms of the agreement.

(f) If a corporation demonstrates to the satisfaction of the department that it paid or incurred actual expenses for interest or for general overhead or administration attributable to deriving income from the production of oil or gas from a lease or property in the state in an amount greater than the amount determined under (c)(7) or (c)(9) of this section, the department may allow the corporation to deduct the greater amount.

Sec. 43.21.030. Determination of income from oil and gas pipeline transportation [Repealed effective January 1, 1982].

(a) Except as provided in (c) of this section, taxable income attributable to the transportation of oil in a pipeline engaged in interstate commerce in Alaska shall be deter-

APPENDIX 1—Continued

ruined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission or its successors as net operating income, less those portions of interest and general administrative expense attributable to the pipeline transportation of oil in the state, except that taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of oil in the state.

(b) Except as provided in (c) of this section, taxable income attributable to the transportation of natural gas in a pipeline engaged in interstate commerce in Alaska shall be determined by the department and shall be the amount reported or that would be required to be reported to the Federal Energy Regulatory Commission as net operating income less that portion of interest and general administrative expense attributable to pipeline transportation in the state, except that the taxable income shall also include taxes on or measured by income. The department shall establish regulations governing the determination of interest and general administrative expense attributable to pipeline transportation of natural gas in the state.

(c) Taxable income attributable to the transportation of oil or natural gas in Alaska of any corporation not under the Federal Energy Regulatory Commission jurisdiction, or of a corporation under the jurisdiction of the Federal Energy Regulatory Commission but not reporting the operation of pipelines in Alaska separately from the operation of pipelines elsewhere, shall be determined by the department and shall be based upon an amount equal to that which would have been reported to the Federal Energy Regulatory Commission under (a) of this section in the case of oil pipelines, or (b) of this section in the case of natural gas pipelines, had the corporation been, in fact, under Federal Energy Regulatory Commission jurisdiction for the taxable year and required to report on the operation of Alas-

ka pipelines separately from the operation of pipelines elsewhere.

Sec. 43.21.040. Determination of income from activities other than oil and gas production or pipeline transportation [Repealed effective January 1, 1982]. (a) Taxable income of a corporation subject to AS 43.21.010–43.21.120 from activities in this state other than the production of oil or gas from a lease or property in the state or the pipeline transportation of oil or gas in the state shall be determined in accordance with the method established in art. IV of AS 43.19.010 and in AS 43.20.071, as modified by (b)–(f) of this section.

(b) The total taxable income of the consolidated business is its entire income less the portion of that entire income attributable to worldwide production and pipeline transportation of oil and gas. In this section,

(1) for a member of a consolidated business who is required to file under the Internal Revenue Code, "entire income" means taxable income under Subtitle F and chapter 1 of Subtitle A of the Internal Revenue Code of 1954, as amended, except that those provisions adopted after December 31, 1975, which change or modify exemptions from tax are not adopted by reference as a part of this section until the second January 1 following the effective date of the federal law;

(2) for a member of a consolidated business who is not required to file under the Internal Revenue Code, "entire income" means book income, except that a taxpayer may elect to report his income as the income would be determined under (1) of this subsection.

(c) The numerator and denominator of the property factor, of the payroll factor and of the sales factor shall be calculated without reference to that portion of property, payroll or sales directly related to the production of oil or gas from a lease of property in the state or the pipeline transportation of oil or gas in the state.

(d) Repealed by § 17 ch. 116, SLA 1981.

(e) Repealed by § 17 ch. 116, SLA 1981.

APPENDIX 1—Continued

(f) The value attributed to vessels transporting Alaskan oil or gas of the consolidated business which are not owned or effectively owned by the consolidated business shall be excluded from the property factor.

Sec. 43.21.050. Assessment of income and tax [Repealed effective January 1, 1982]. (a) The department shall assess taxable income and the amount of tax payable on that taxable income.

(b) On or before August 15 of each year the department shall send to every corporation taxable under AS 43.21.010-43.21.120 a notice of assessment showing the amount of income taxable under AS 43.21.010-43.21.120 for the previous year and the amount of tax payable on that taxable income.

(c) For purposes of AS 43.21.010-43.21.120 the department may combine taxable incomes of corporations subject to tax under AS 43.21.010-43.21.120 who are part of the same consolidated business.

(d) If the methods of allocation and apportionment provided in AS 43.21.010-43.21.120 do not fairly represent the extent of a corporation's business activity in the state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable, the employment of any method authorized under art. IV, sec. 18, of the Multistate Tax Compact (AS 43.19.010) to effectuate an equitable allocation and apportionment of the corporation's income. The commissioner shall include in his annual report required in AS 43.21.110 a report on all relief granted under this subsection, including for each case a statement of the changes in tax liability resulting from the granting of relief, the tax years involved, and a description of the method of determining taxable income that was substituted for those provided in AS 43.21.010-43.21.120.

Sec. 43.21.060. Returns [Repealed effective January 1, 1982]. On or before April 15 of each year, a corporation subject to tax under AS 43.21.010-43.21.120 shall submit a return in a form prescribed by the

department setting out information required by the department to determine taxable income. For purposes of AS 43.21.010-43.21.120, the department may require corporations subject to tax under AS 43.21.010-43.21.120 who are part of the same consolidated business to file a single return.

Sec. 43.21.070. Payment of tax [Repealed effective January 1, 1982]. The tax levied under AS 43.21.010-43.21.120 is payable to the department on or before September 30 of each year or in installments, including prepayments of estimated tax, at the times and under the conditions the department may by regulation require. This tax is payable on the due date set out in this section even though the assessment is under appeal or the validity, enforceability or application of AS 43.21.010-43.21.120 or any provision of AS 43.21.010-43.21.120 is challenged before the department or in the courts.

Sec. 43.21.080. Transitional rules [Repealed effective January 1, 1982]. The department shall provide by regulation transition rules for corporations subject to tax under AS 43.20.011-43.20.350 before July 9, 1978 to avoid double taxation of the same income or double deduction of the same expense of those corporations as a result of becoming subject to tax under AS 43.21.010-43.21.120.

Sec. 43.21.090. Regulations [Repealed effective January 1, 1982]. The department may adopt regulations in accordance with the Administrative Procedure Act (AS 44.62.010-44.62.650) as appropriate to administer and enforce AS 43.21.010-43.21.120.

Sec. 43.21.100. Penalties [Repealed effective January 1, 1982]. The penalties established in AS 43.20.011-43.20.350 apply to AS 43.21.010-43.21.120.

Sec. 43.21.110. Public reporting [Repealed effective January 1, 1982]. (a) The commissioner of revenue shall compile and transmit to the legislature an annual consolidated report of state revenues and taxation policies under AS 43.21.010-43.21.120.

APPENDIX 1—Continued

This report shall include total aggregate income tax paid by corporations covered under AS 43.21.010-43.21.120 and aggregate income and deductions by category, so classified as to prevent the identification of particular returns or reports.

(b) The legislative auditor shall transmit to the legislature an annual report reviewing the actions of the department in administering AS 43.21.010-43.21.120.

Sec. 43.21.120. Definitions [Repealed effective January 1, 1982]. Unless the context requires otherwise the definitions contained in AS 43.55.140 are applicable to AS 43.21.010-43.21.120. In addition, in AS 43.21.010-43.21.120.

(1) "base of operations" means the closest point on land to the offshore oil or gas production operations from which goods, services and supplies flow to those offshore oil or gas production operations;

(2) "consolidated business" means a corporation or group of corporations having more than 50 per cent common ownership direct or indirect, or a group of corporations in which there is common control either direct or indirect as evidenced by any arrangement, contract or agreement.



Ralph R. STEFANO, C. Harold Gillam,
and Estate of Robert L. Crow,
Appellants,

v.

Patricia M. COPPOCK, Appellee.

No. S-453.

Supreme Court of Alaska.

Aug. 23, 1985.

Minority shareholder brought action against controlling shareholder-directors of closely held corporation. Following re-

mand, 621 P.2d 270, the Superior Court, Third Judicial District, Anchorage, Seaborn, J. Buckalew, Jr., J., ordered defendants to buy out minority shareholder, and they appealed. The Supreme Court, Moore, J., held that: (1) evidence warranted forced buy out; (2) prior Supreme Court opinion did not preclude Superior Court from ordering buy out at equitable price; (3) ordering buy out as remedy for fraudulent or oppressive acts, rather than liquidation, was not abuse of discretion; and (4) prejudgment interest award was not abuse of discretion.

Affirmed in part; reversed in part; remanded.

1. Corporations ⇐182.4(5)

Evidence that majority shareholder-directors did not provide minority shareholder with notice of several meetings and did not respond to her attorney's second letter demanding inspection of corporate records on her behalf supported findings of oppressive or fraudulent conduct sufficient to warrant remedy of forced buy out of her shares.

2. Appeal and Error ⇐1194(1)

Prior Supreme Court opinion, which stated that in order for minority shareholder to warrant forced buy out of her shares, she must establish on remand that actions of controlling shareholders were illegal, oppressive, or fraudulent, or, alternatively, constituted waste or misapplication of corporate assets, did not preclude superior court from ordering on remand that controlling shareholders buy out minority shareholder's shares at equitable price, where trial court had not reached that issue at time of that Supreme Court opinion. AS 10.05.540(2).

3. Corporations ⇐614(2)

AS 10.05.540, permitting liquidation of assets and business of corporation as remedy in shareholder's action based on illegal, oppressive, or fraudulent acts of directors or those in control of corporation, is remedial statute and does not deprive superior

Oil & Gas Conservation Tax

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

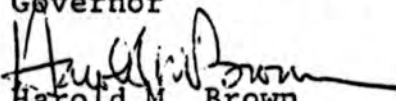
BILL SHEFFIELD, GOVERNOR

P.O. BOX K—STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

November 14, 1986

M E M O R A N D U M

TO: Honorable Bill Sheffield
Governor

FROM: 
Harold M. Brown
Attorney General

RE: Attached bill relating to the oil
and gas conservation tax
Our file: 773-87-0074

The attached bill, requested by the Oil and Gas Conservation Commission in the Department of Commerce and Economic Development, deals with the oil and gas conservation tax. The request was approved by Jim Ayers on October 29, 1986.

A very similar bill was drafted but not introduced during the last legislative session. (Department of Law file no. 773-86-0078). It is our understanding that the bill was not introduced because it might have become a vehicle for separate-accounting legislation.

Also attached is a draft transmittal letter to the legislature.

HMB:AEP:md

cc w/enc.: Hon. Loren Lounsbury, Commissioner
Dept. of Commerce & Economic Development

C.V. Chatterton, Commissioner
Oil & Gas Conservation Commission
Anchorage

D R A F T

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the oil and gas conservation tax.

The primary purpose of the bill is to adjust the existing oil and gas conservation tax in AS 43.57.010 to provide enough additional revenue to the state to cover the amount of the operating costs of the Alaska Oil and Gas Conservation Commission ("commission"). An oil and gas conservation tax is included in most of the conservation Acts of the 30 oil and gas producing states. The tax would be in the amount of four mills per barrel of crude oil and 50,000 cubic feet of natural gas. Proceeds from the tax would be placed in the general fund. The commission has calculated that approximately \$2,680,000 would be collected annually if this bill were enacted.

The concept of a tax related to oil and gas conservation activities is not new to the state. Section 15, ch. 40, SLA 1955, which created the commission, provided funding by levying a tax on the gross amount of oil and gas produced. The tax rate was then five mills per barrel of oil and per 50,000 cubic feet of natural gas. After statehood, sec. 15 became AS 31.05.130 and 31.05.140.

The original tax was repealed effective July 1, 1970, by ch. 247, SLA 1970.

Effective July 1, 1974, AS 43.57.010, the Oil and Gas Regulation and Conservation Tax, was enacted. Sec. 1, ch. 5, FSSLA 1973. This tax is still in effect. It assesses a tax of 1.25 mills (one-eighth of one cent) per barrel of oil, a 75 percent reduction from the amount of the conservation tax levied up to July 1, 1970. The amount of revenue generated by this tax is not even equal to the operating costs of the commission, and may be perceived by the oil and gas industry as little more than a "nuisance tax." As described earlier, the tax in AS 43.57.010 would be adjusted to include a tax on production of natural gas, and to increase the amount of the tax.

Sincerely,

Steve Cowper
Governor

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE BILL NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FIFTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the oil and gas conservation tax;
7 and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 43.57.010 is amended to read:

10 Sec. 43.57.010. OIL AND GAS [REGULATION AND] CONSERVATION TAX.

11 (a) Every [THERE IS LEVIED UPON THE] producer of oil and gas shall
12 pay a tax of four mills per [ONE-EIGHTH OF ONE CENT ON EACH] barrel of
13 oil and per 50,000 cubic feet of natural gas removed from or sold on
14 [FROM] each lease or property in the state, less any part the owner-
15 ship or right to which is exempt from taxation.

16 (b) The tax is in addition to and must [SHALL] be [ADMINISTERED
17 AND] paid in the same manner as the taxes imposed by AS 43.55.. Pro-
18 ducers of oil and gas shall [ARE REQUIRED TO] make reports of produc-
19 tion in the same manner and under the same penalties as required by AS
20 43.55.

21 (c) Proceeds from the tax must [SHALL] be paid into the general
22 fund. The commissioner of administration shall separately account for
23 all proceeds of the tax deposited in the general fund.

24 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
25 10.070(c).

STATE OF ALASKA 1987 LEGISLATIVE SESSION

FISCAL NOTE

Revision Date : _____

REQUEST

Bill/Resolution No. : 773-87-0074
 Title : An Act relating to the Oil
and Gas Conservation Tax

 Sponsor : Rules
 Requestor : Governor
 Date of Request : _____

FISCAL DETAIL

Agency Affected : Oil & Gas Conservation Com.
 BRU : _____

 Components : _____

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 87	FY 88	FY 89	FY 90	FY 91	FY 92
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0					

CAPITAL	0					
---------	---	--	--	--	--	--

REVENUE		2402.8	2212.9	1927.5	1684.9	1373.6
---------	--	--------	--------	--------	--------	--------

Los. by AS 43.57 repeal 745.2 685.9 596.7 520.9 462.8

FUNDING : (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS :

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Based on November '86 production record, Prudhoe Oil Pool and Kuparuk Oil Pool initiating a production decline rate of 15% starting July 1, 1987; Lisbourne Oil Pool on stream July 1, 1987 at 100,000 b/d; and Endicott Oil Pool on stream July 1, 1986 at 100,000 b/d.

Prepared by : Chat Chatterton *Chat Chatterton/bdb* Phone : 279-1433
 Division : _____ Date : _____
 Approved by Commissioner : *[Signature]* Date : 11/24/86
 Agency : _____

Distribution (by Agency preparing fiscal note) :

Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

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.

SJONG v. STATE, DEPT. OF REVENUE

Alaska 967

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 in-

come 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 non-resident 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 allocation 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.

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.

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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Joseph K. Donohue, Teo C. Spengler, Asst. Attys. Gen., Avrum M. Gross, Atty. Gen., Juneau, for appellee.

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 Alaska² and sells

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

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.

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

due process clause⁴ 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 minimis*; . . . 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.

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

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

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

payer 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).

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, 1033 (1940). Furthermore, a tax-

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.

Cite as, Alaska, 622 P.2d 967

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 Constitution¹⁰ 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).

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."

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 considered¹¹ and whether the commerce clause will be violated by imposition of the state net income tax

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 Inter-

state 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

any State . . . for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S.Const. amend. XXI.

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

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-

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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 Mfg. 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).

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:

In the original assessment of the tax, the Department of Revenue relied on Revenue Ruling 74-2¹⁸ 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.

(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%.

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

[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-

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

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.

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:

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**.



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

24. Sjog 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

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.

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

<u>Year</u>	<u>Individuals</u>	<u>Corporations</u>
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) (retroactively repealed)	5.4% & 3.96% surtax of income (surtax on income over \$25,000)
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

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

3

$$\frac{1/4 \text{ \& } 1/4 \text{ \& } 1/4}{3} = \frac{3/4}{3} = \frac{1}{4} \times \$4,000 = \$1,000$$

STATE C TAX LIABILITY

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

3

$$\frac{2/4 \text{ \& } 2/4 \text{ \& } 2/4}{3} = \frac{6/4}{3} = \frac{1}{2} \times \$4,000 = \$2,000$$

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
<u>Costs</u>				
Payroll	\$1,000	\$1,000	\$2,000	\$4,000
Other	\$2,000	\$2,000	\$4,000	\$8,000
Net income:	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$2,000</u>	<u>\$4,000</u>

Example 2

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

Example 3

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

APPORTIONMENT FOR HYPOTHETICAL
VERTICALLY INTEGRATED TAXPAYER
(Example 1)

This taxpayer manufactures a product in State A. The product is then transferred to State B for marketing and sale. There are no sales of the product in State A; all of the product is transferred 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:	<u>\$1,000</u>		<u>\$ 1,000</u>		<u>\$ 2,000</u>

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

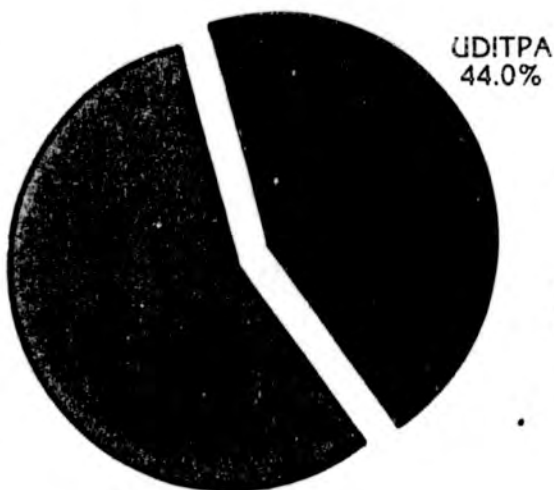
Since the bookkeeping change of the transfer value did not change the formula factors, the formula calculation remains unchanged:

	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:	$1/2 \times \$2,000 = \$1,000$	$1/2 \times \$2,000 = \$1,000$

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

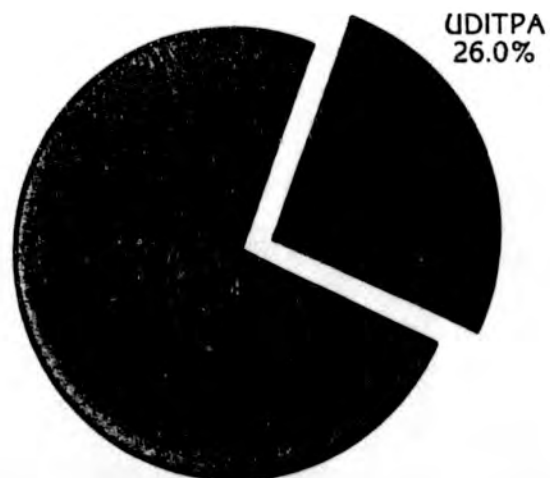


As Estimated By Arthur Anderson (Life of Field)

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

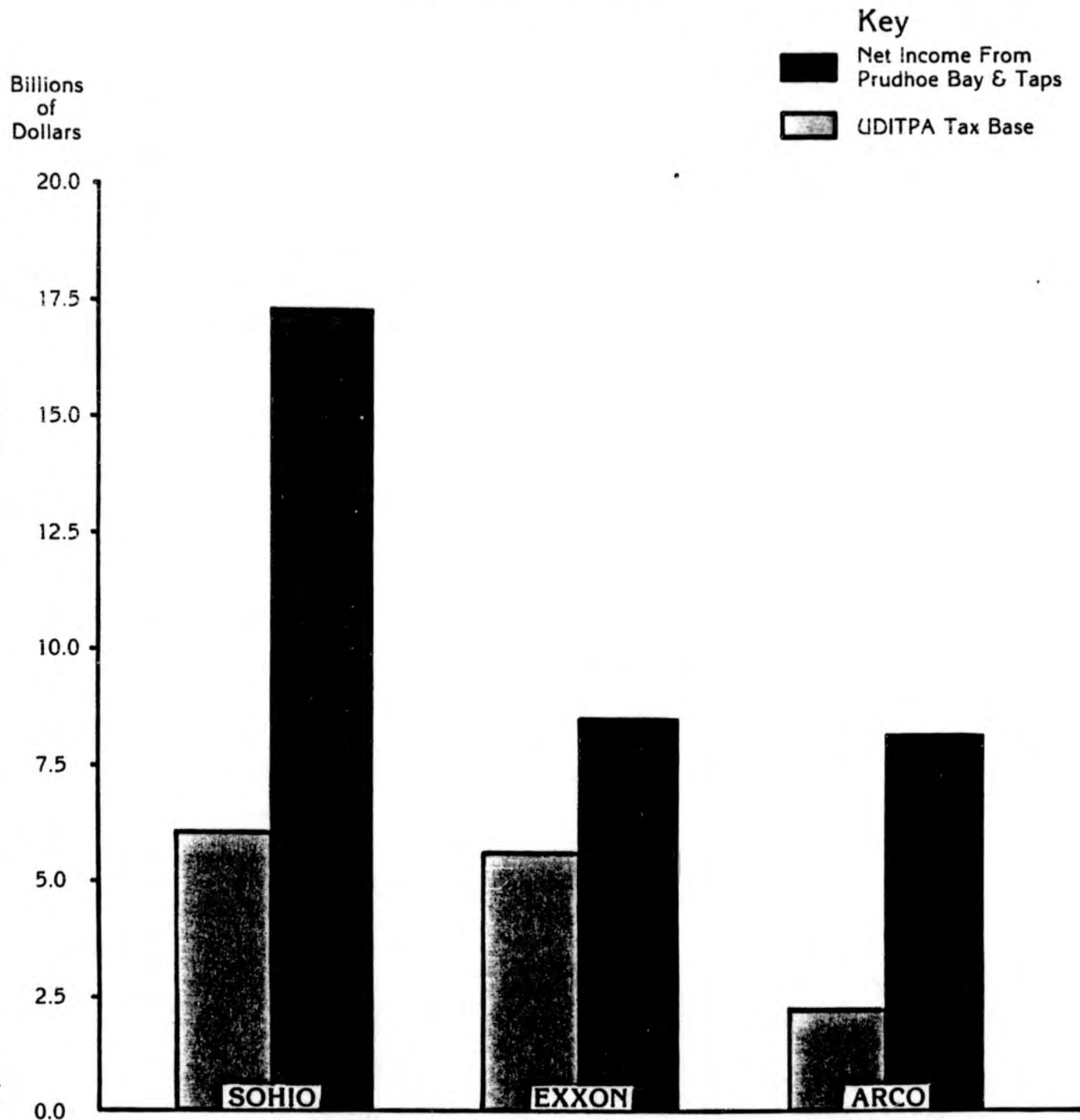
As Estimated By W.J. Levy & Assoc. From Sohio Submission One (1978)

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



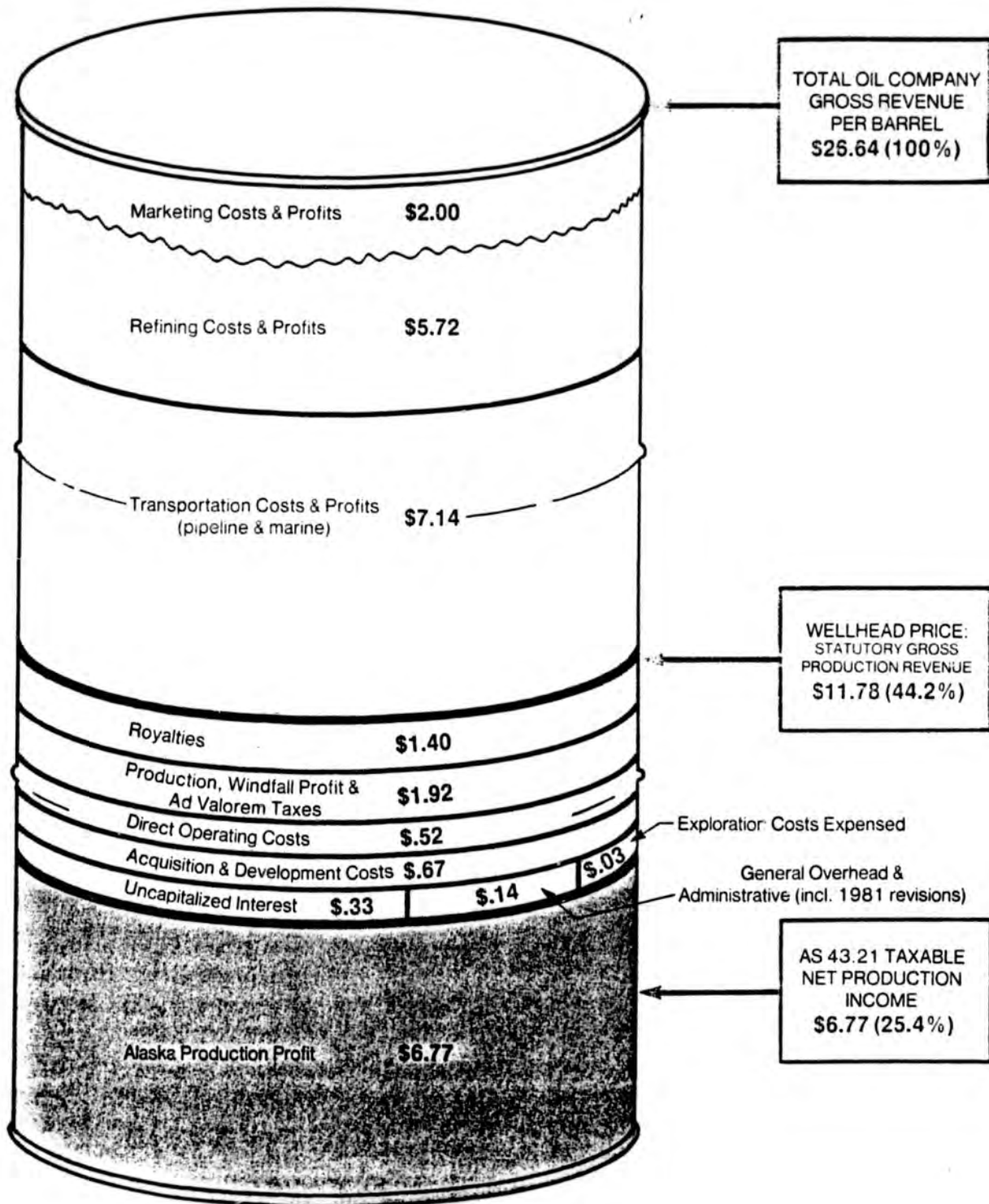
Net Income From Prudhoe Bay and Taps

Compared With
UDITPA Tax Base
(Life of Field)



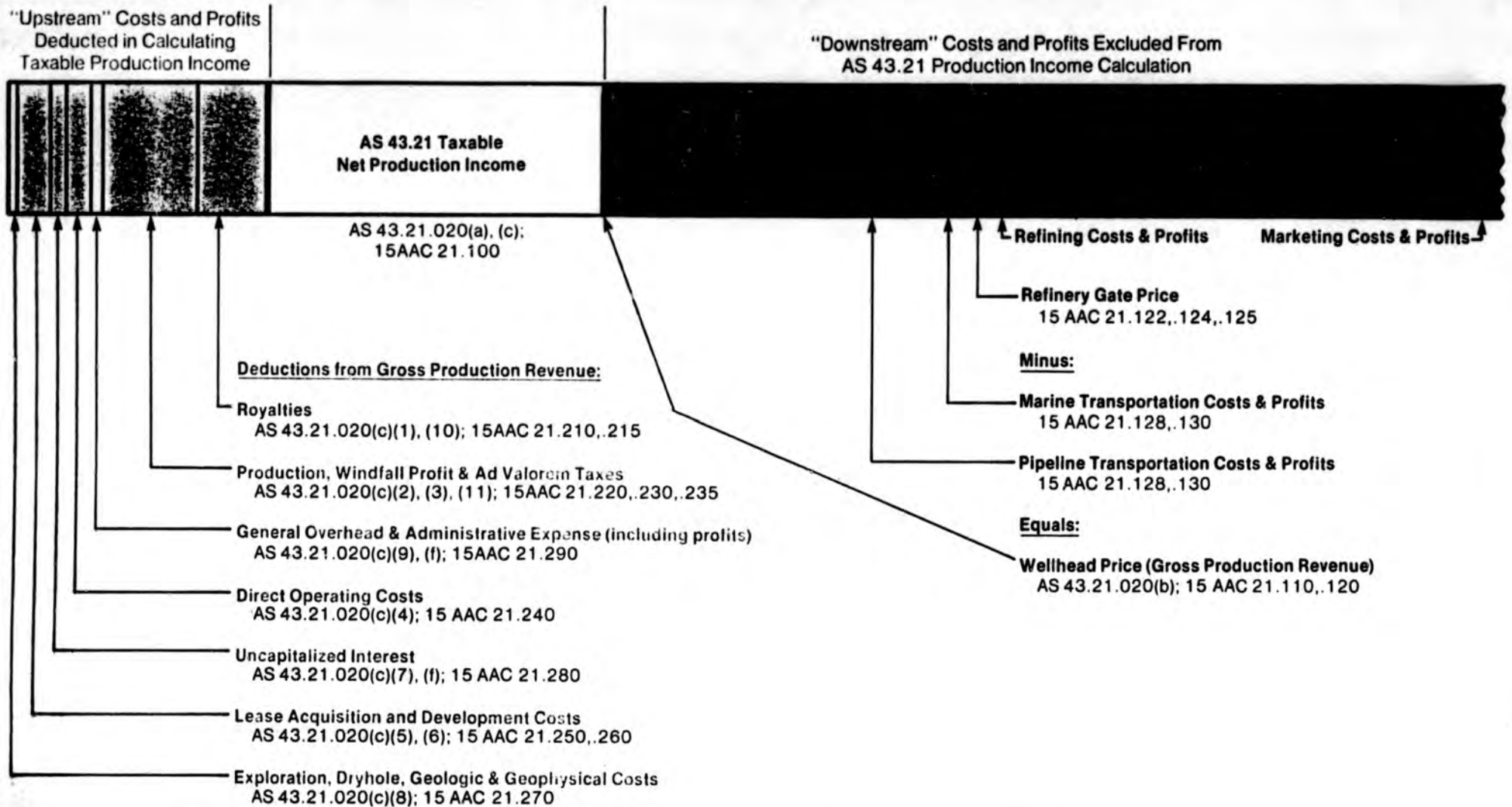
Source: Arthur Anderson Study, Exhibit VIII(a)(R. 2899)

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



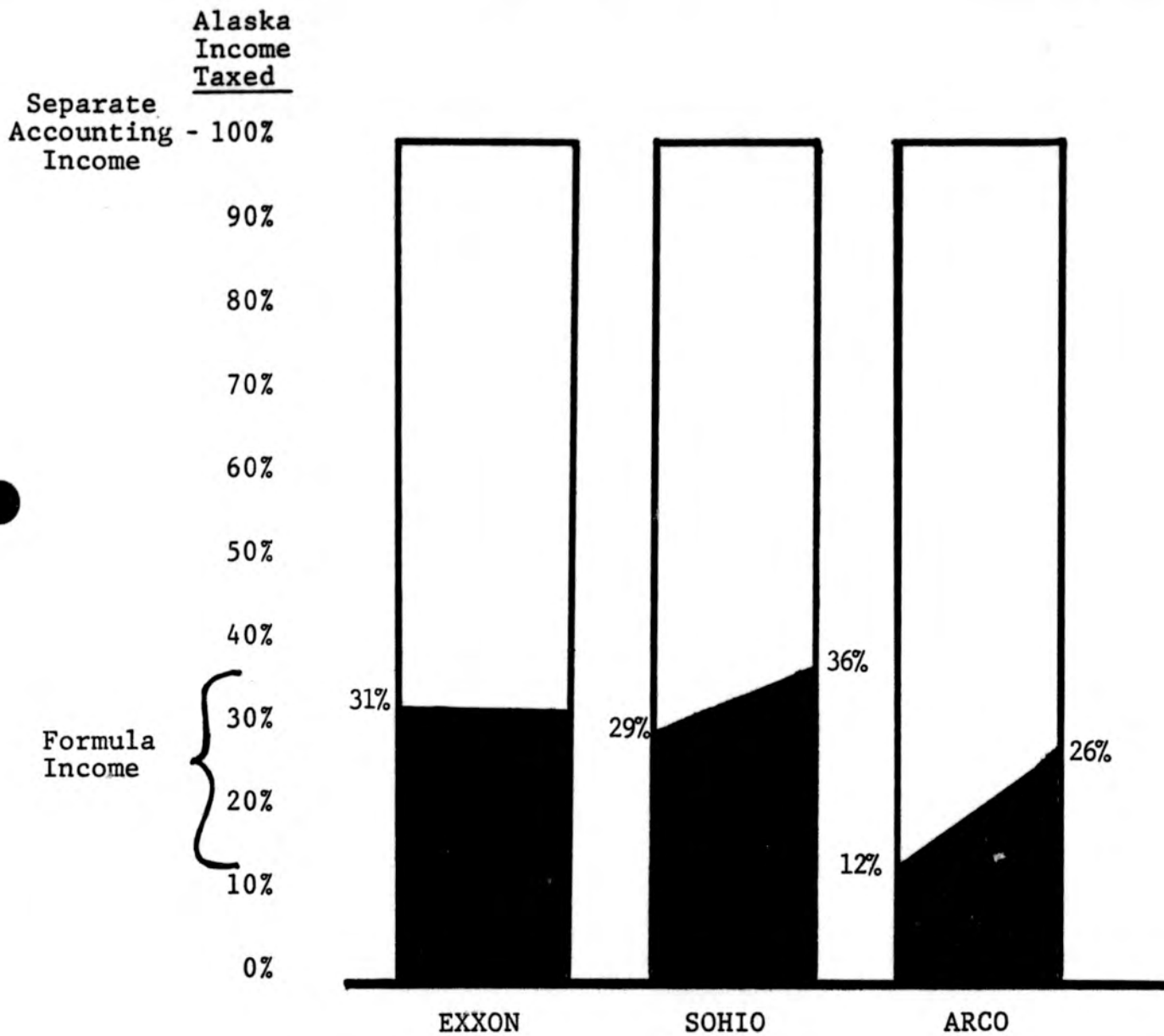
SOURCE: Deakin 2d Supplemental Affidavit * 15, R. 16917, 16929.

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.

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



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.

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Department of Law

NOV 14 1985

AM 7 8 9 10 11 12 1 2 3 4 5 6 PM

Deborah Vogt
November 13, 1985
Page 2

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

^{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.

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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

^{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.

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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.

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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

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.

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

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

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

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

6 “(2) any other corporation which is a member of
7 such group and which is a foreign corporation,
8 unless such amount is includable in the gross income of the
9 corporation described in paragraph (1) for purposes of chapter
10 1 (including any amount includable in gross income under
11 subpart F of part III of subchapter N of chapter 1) for the
12 taxable year in which or with which the taxable period (for
13 purposes of State or local law) ends.

14 “(b) INCOME TAX DEFINED.—For purposes of this sec-
15 tion, the term ‘income tax’ means any tax which is imposed
16 on, according to, or measured by net income.

17 “(c) AFFILIATED GROUP DEFINED.—For purposes of
18 subsection (a), the term ‘affiliated group’ means a common
19 parent corporation and one or more chains of corporations
20 connected through stock ownership with such common parent
21 corporation.

22 “(d) CERTAIN CORPORATIONS TREATED AS FOREIGN
23 CORPORATIONS.—For the purpose of this section, a domes-
24 tic corporation shall be treated as a foreign corporation if
25 under section 861(a)(2)(A) a dividend received from such cor-

1 poration in the taxable year referred to in subsection (a)
2 would not be treated as income from sources within the
3 United States.

4 “(e) CERTAIN DIVIDENDS PAID OR DEEMED PAID.—

5 “(1) DIVIDENDS EXCLUDED FROM TAX.—If a
6 corporation receives in any taxable year a dividend
7 from a foreign corporation (or is by application of sec-
8 tion 951 treated as having received such a dividend), in
9 imposing an income tax on such corporation no State,
10 or political subdivision thereof, may tax, or otherwise
11 take into account—

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

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

21 “(i) the amount of the dividend exclu-
22 sive of any amount of dividend determined
23 under paragraph (3), or

24 “(ii) the amount by which the dividend
25 plus any amount of dividend determined

1 under paragraph (3) exceeds the excluded
2 portion of the dividend determined in accord-
3 ance with paragraph (2).

4 “(C) in the case of a dividend received from
5 any other foreign corporation more than the lesser
6 of—

7 “(i) the amount of the dividend (exclu-
8 sive of any amount determined under section
9 78), or

10 “(ii) the amount by which the dividend
11 plus any amount determined under section
12 78 exceeds the excluded portion of the divi-
13 dend determined in accordance with para-
14 graph (2).

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

20 “(A) the numerator of the fraction shall be
21 the sum of—

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

24 “(ii) the total amount of tax which by
25 application of section 902 or section 960 to

1 all such dividends, the domestic corporation
2 is deemed to have paid, and

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

5 "(B) The denominator of the fraction shall be
6 46 percent of all such dividends.

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

12 "(A) treat as a dividend for purposes of sub-
13 paragraph (B) of paragraph (1), and

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

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

1 901 (determined without regard to the limitations in
2 section 904 and 907) shall be taken into account.”.

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

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

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

“Sec. 7518. Income of corporations attributable to foreign corporations.”

○

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

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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 com- panies)	One-factor gross receipts formula	PA. STAT. ANN. §7401.3
	Wisconsin	-----	WIS. STAT. ANN. §71.07(2)(e)

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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).

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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)

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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)

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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)

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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)

<u>Industry</u>	<u>State</u>	<u>Apportionment</u>	<u>Authority</u>
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

10-22-85

132-A

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 dr-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 Comm.
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	Col. B	Col. C	Col. D
RATES and MINIMUM TAX	RETURN & PAY DATES (1, 8)	INSTALLMENTS DUE (2)	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 Compt.
MASS. Excise: \$2.60 per \$M on tan- gible 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 7.02% 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.

10-22-85

Charts—Corporation Rates, Returns, Payments

112-C

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 Comm.
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 1/2 with return and 1/2 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: 0.3125% 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, 1/4% (1/2%, '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.—2 3/4% 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 3 1/100 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. 2/5%; Mont. 1/2%; N.M. 3/4%; N.Dak. 9/10% to \$20,000, 9/10% over \$20,000-\$55,000, 1% on \$55,000-\$100,000; Oreg. 1/4% (1/4% 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 \$25M; 8.25% over \$250,000.

Syllabus

CONTAINER CORPORATION OF AMERICA v.
FRANCHISE TAX BOARDAPPEAL 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 paper-board 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. Latham 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.*

*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-

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-

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 unquantifi-

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Opinion of the Court

able 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 ac-

tivities 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. McCollgan*, *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-*

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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

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-

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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

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

⁶See 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.