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# State Power to Tax Enterprises as Unitary Businesses: U.S. Supreme Court Narrows the Reach

By James K. Hedges, Jr.\*

In two recent companion cases, *ASARCO Incorporated v. Idaho State Tax Commission*<sup>1</sup> and *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*,<sup>2</sup> the U.S. Supreme Court curbed the ability of states to combine multistate and multinational enterprises into "unitary businesses" for tax purposes. The Court relied on the principle that due process considerations prevent states from taxing values not rationally related to the taxing state. By setting down more stringent requirements for state compliance with the Due Process Clause<sup>3</sup> in this area of taxation, these decisions not only have important implications for the structuring of multinational enterprises, but also will have marked effect on many pending and future cases.

## I

### BACKGROUND OF THE *ASARCO* AND *WOOLWORTH* DECISIONS

The federal government determines the taxable income of multinational enterprises essentially on an item by item basis. Because U.S. corporations are fully taxable by the United States on their worldwide income while their foreign affiliates (whether upstream or downstream) are generally taxable only on their U.S. source income, there is an incentive inherent in the system to divert income to foreign affiliates through various pricing schemes. The Internal Revenue Code<sup>4</sup> and accompanying regulations set forth what has come to be known as the "arm's-length" standard for affiliated intercompany transactions. The rules generally require that prices assigned to them are comparable to those between unrelated business entities dealing at arm's-length. The federal system is compatible with those of the various OECD member

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1. 458 U.S. —, 50 U.S.L.W. 4962 (1982), *rev'g.* 99 Idaho 924, 592 P.2d 39 (Idaho 1979).

2. 458 U.S. —, 50 U.S.L.W. 4957 (1982), *rev'g.* 624 P.2d 28 (N.M. 1981).

3. U.S. CONST. amend. XIV, § 1.

4. I.R.C. § 482 (1982).

states,<sup>5</sup> and virtually all U.S. tax treaties adopt this method.<sup>6</sup>

The states, however, are not bound by the tax policy of the federal government when taxing multistate and multinational enterprises. In contrast to the federal system, the states which extract corporate income taxes generally aggregate all the income of a unitary business and then apportion it using various formulas. The most common method is that of the Uniform Division of Income for Tax Purposes Act (UDITPA),<sup>7</sup> which has been adopted in twenty-nine states.<sup>8</sup> The UDITPA system is a "three-factor" formulary apportionment method,<sup>9</sup> in contrast with formulas using a single factor such as total sales within the state. Both systems have been approved by the Supreme Court.<sup>10</sup>

As it is often to a state's financial advantage to be able to apply formulary apportionment to very large enterprises regardless of how large a share of the operations may be located intrastate, many states have been challenging the separate accounting used by parent and subsidiary corporations and have been requiring worldwide combined reporting for tax purposes. Nineteen states and the District of Columbia have joined the Multistate Tax Compact<sup>11</sup> as full members and eleven others have joined as associate members.<sup>12</sup> Even so, the relative independence of the states in the field of taxation has left businesses faced with a "parochial hodge-podge of overlapping and conflicting tax policies."<sup>13</sup>

The legal background of the unitary issue began as early as the late 19th century, when the U.S. Supreme Court first allowed formu-

5. See Letter forwarded to the U.S. Department of State by the Italian Embassy on behalf of nine EEC Governments (Mar. 19, 1980), *reprinted in* 19 I.L.M. 749-750 (1980).

6. An exception is the Convention on Taxation, June 20, 1973, United States-Soviet Union, 27 U.S.T. 1, T.I.A.S. No. 8225. That treaty sets forth categories of income and distinguishes between income derived by a "representation" and other forms.

7. Uniform Division of Income for Tax Purposes Act, 7 U.L.A. 91 (1978) (hereinafter cited as UDITPA).

8. See Brief of Amicus Curiae Multistate Tax Commission in Support of Appellee's Motion to Dismiss or Affirm at 4, *ASARCO, Inc. v. Idaho State Tax Comm'n.*, 50 U.S.L.W. at 4962.

9. UDITPA distinguishes between "business" income and "nonbusiness income." "Non-business" income is allocated for tax purposes to the commercial domicile of the taxpayer or to the situs of the property or activity which produces the income. "Business" income is apportioned using the "three-factor" formula: The ratio of the taxpayer's in-state property, payroll and sales to its total property, payroll and sales (the three factors being averaged).

10. See, e.g., *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980) and *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

11. The Multistate Tax Compact has the ostensible purposes of facilitating the proper determination of the tax liabilities of multistate taxpayers, promoting tax system compatibility and uniformity, increasing taxpayer convenience and avoiding duplicative taxation. The Compact is similar to a uniform state tax code and establishes a commission with the capacity to make interstate audits of multistate taxpayers.

12. *ASARCO*, 50 U.S.L.W. at 4963 n.7.

13. *Id.* at 4968 (O'Connor, J., dissenting). See also Letter, *supra* note 5, at 749.

lary apportionment to be applied in capital stock and property cases where the taxed entity was involved in interstate commerce. These cases largely involved the taxation of railroads.<sup>14</sup> The next step in the evolution of the doctrine was its application to the income taxation of multistate corporations. The cases generally allowed the use of formula apportionment where there was an interstate flow of products and a close economic relationship between operations in the various states.<sup>15</sup> It was inevitable that the states would eventually apply the unitary method to multinational enterprises and thereby encounter the maze of additional legal issues that international taxation involves.

Worldwide unitary combinations not only elicit stronger arguments under the Due Process Clause, but have additional Foreign Commerce Clause<sup>16</sup> implications as well. The Supreme Court recognized in *Japan Lines v. Los Angeles County*<sup>17</sup> that due process considerations will come into play, as "neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign."<sup>18</sup> The Court also emphasized that a "state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential."<sup>19</sup> The *Japan Lines* Court held the California ad valorem property tax unconstitutional under the Commerce Clause,<sup>20</sup> because it resulted in multiple taxation of the instrumentalities of foreign commerce. The Court took care to distinguish this result from that in *Moorman Manufacturing Co. v. Bair*,<sup>21</sup> which held that the Commerce Clause did not render Iowa's state income tax (single factor formula) unconstitutional. The Supreme Court found that the Constitution does not prohibit overlap in the computation of taxable income by individual states, but noted that the force of the unitary business' claim might be stronger in a foreign commerce setting.

Prior to the recent decisions in *ASARCO* and *Woolworth*, the Supreme Court's most definitive attempts to delineate the constitutional bounds of the unitary business principle were its decisions in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*<sup>22</sup> and *Exxon*

14. See, e.g., *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18 (1891); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897); *Union Tank Line v. Wright*, 249 U.S. 275 (1919).

15. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980).

16. U.S. CONST. art. I, § 8, cl. 3.

17. 441 U.S. 434 (1979).

18. *Id.* at 447.

19. *Id.* at 448.

20. U.S. CONST. art. I, § 8, cl. 3.

21. 437 U.S. 267 (1978).

22. 445 U.S. 425 (1980).

*Corp. v. Department of Revenue of Wisconsin.*<sup>23</sup> These two cases fueled the controversy that became the subject of *ASARCO* and *Woolworth*.

In *Mobil*, the Court upheld Vermont's imposition of a corporate income tax on "foreign source" dividend income. The Vermont tax utilized an apportionment formula and presumed that the businesses so taxed were unitary. The Court found no violation of either the Due Process Clause or the Interstate or Foreign Commerce Clauses.<sup>24</sup> Significantly, however, the Court added the caveat that "the linchpin of apportionability in the field of state income taxation is the unitary business principle."<sup>25</sup> As a result, "[w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state, due process considerations might well preclude apportionability, because there would be no underlying unitary business."<sup>26</sup>

In *Exxon*, the Court again upheld the state of Wisconsin's tax formula in the face of Due Process and Commerce Clause challenges. The *Exxon* Court held that the taxpayer's use of separate accounting for its various functional departments (in that case, Exploration and Production, Refining, and Marketing) did not create a binding presumption that the business was not unitary. While noting that there was a unitary stream of income, the Court felt that Wisconsin had fulfilled both of the requirements of due process: A minimal connection or "nexus" between the interstate activities and the taxing state, and a "rational relationship between the income attributed to the state and the interstate values of the enterprise."<sup>27</sup> It is perhaps the failure to heed the warnings of *Mobil* and *Exxon* which necessitated the *ASARCO* and *Woolworth* litigation.<sup>28</sup>

## II

### THE DECISIONS IN *ASARCO* AND *WOOLWORTH*

The decisions in *ASARCO* and *Woolworth*, in contrast with those in *Mobil* and *Exxon*, favored the taxpayer rather than the state. Essentially, the Supreme Court delimited the expanded powers recognized in its earlier decisions. This should not be viewed as a reversal of direction so much as an effort on the Court's part to flesh out the warning

23. 447 U.S. 207 (1980).

24. U.S. CONST. art. I, § 8, cl. 3.

25. *Mobil*, 445 U.S. at 439.

26. *Id.* at 442.

27. *Mobil*, 445 U.S. at 436-437; *Moorman*, 437 U.S. at 272-273.

28. Some time before the *ASARCO* and *Woolworth* decisions, Eugene F. Corrigan, the Executive Director of the Multistate Tax Commission, cautioned that the *Mobil* decision should not be read as a blanket endorsement of formulary apportionment. The unitary business concept was still a restraining factor. Corrigan, *Mobilizing Interstate Taxation*, 15 TAX NOTES 803, Oct. 12, 1981.

given in *Mobil*. State tax statutes must now be construed in the light of more stringent due process standards and a newly clarified definition of "unitary business." It must now be recognized that the "dispute between the states and the business community is not over the unitary concept, but rather the extension of that concept to activities and income outside the United States."<sup>29</sup>

#### A. *The ASARCO Case*

ASARCO is a New Jersey corporation domiciled in New York, and engaged in the business of mining, processing, and selling metals. ASARCO's major connection with Idaho is the operation of a silver mine, although it also maintains some administrative capacity there. During the tax years in question, ASARCO collected dividends from five corporations in which it owned major interests; it also received interest income from three of them and realized capital gains from the sale of stock in two. The basic question confronting the Court was "whether the State of Idaho constitutionally may include within the taxable income of a non-domiciliary parent corporation doing some business in Idaho a portion of intangible income (the dividends, interest payments and capital gains) that the parent receives from subsidiary corporations having no other connection with the state."<sup>30</sup>

ASARCO treated the income in question as "nonbusiness" income not subject to apportionment in Idaho. An auditor for the Multistate Tax Commission audited ASARCO's returns on behalf of Idaho and six other states. In addition to recommending the unitary treatment of ASARCO and six wholly-owned subsidiaries (the property of which was not in question before the Supreme Court), the auditor also recommended that the intangible income from the other five subsidiaries be treated as "business income." The auditor made this recommendation despite his further finding that the five subsidiaries were not unitary with ASARCO.

The procedural history of this case was highly unusual. The Idaho State Tax Commission adopted the auditor's views and assessed tax deficiencies against ASARCO for the years in question (1968, 1969, and 1970) totalling \$325,515.08 plus interest.<sup>31</sup> On ASARCO's petition for review, the State District Court upheld the unitary treatment of the six wholly-owned subsidiaries but overruled the determination that the disputed income from the other five subsidiaries constituted "business" income. The Court reasoned that a finding that the five subsidiaries were unitary with ASARCO had not been made and that such a find-

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29. Persky, Letter to the Editor, 8 TAX NOTES 501, Feb. 22, 1982.

30. ASARCO, 50 U.S.L.W. at 4962.

31. *Id.* at 4964.

ing was prerequisite to taxing the income as apportionable "business income."<sup>32</sup> The Tax Commission appealed to the Idaho Supreme Court, which held that the interest, dividends, and capital gains should not have been excluded as "nonbusiness" income.<sup>33</sup> The U.S. Supreme Court vacated and remanded the case for reconsideration in the light of its decision in *Mobil*.<sup>34</sup> The Idaho Supreme Court reinstated its previous opinion per curiam. On appeal, the U.S. Supreme Court reversed in the decision discussed here.

The nature of the relationship between ASARCO and its subsidiaries is the key to the Supreme Court decision. The five subsidiaries involved are: M.I.M. Holdings, Ltd.; General Cable Corp.; Revere Copper and Brass, Inc.; ASARCO Mexicana, S.A.; and Southern Peru Copper Corp. M.I.M. Holdings engages in the mining, milling, smelting, and refining of metals in Australia and England. Very minor sales transactions between ASARCO and M.I.M. were conducted during the years in question at prevailing market rates. ASARCO held 52.7% of M.I.M.'s stock but had never elected a member of M.I.M.'s board nor taken part in the selection of M.I.M.'s officers. The two companies shared no common directors or officers.

ASARCO owned approximately thirty-four percent of the stock of both General Cable and Revere Copper, which are both publicly owned companies in the business of fabricating metal products. A 1967 Justice Department antitrust decree prohibited ASARCO from maintaining common officers in these companies, voting its stock in them, and selling them copper at below market prices. The companies had engaged in substantial arm's-length transactions.

ASARCO owned forty-nine percent of ASARCO Mexicana and is in fact prohibited by Mexican foreign investment law from owning any greater percentage. Both companies are in the same general line of business, but there were only insignificant transfers between them during the years in question. ASARCO acts as an agent for ASARCO Mexicana in the United States, but does so for a fee. The Idaho Supreme Court found that "Mexicana does not seek approval from ASARCO concerning major policy decisions . . . ."<sup>35</sup>

ASARCO held 51.5% of the stock in Southern Peru and purchases approximately thirty-five percent of its output at arm's-length prices. Despite ASARCO's majority interest, a stipulation in Southern Peru's

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32. *Id.* at 4964.

33. *American Smelting & Refining Co. v. Idaho State Tax Commission*, 99 Idaho 924, 935-937, 592 P.2d 39, 50-52 (1979).

34. *ASARCO Inc. v. Idaho Tax Commission*, 445 U.S. 939 (1980).

35. *American Smelting*, 99 Idaho at 929, 592 P.2d at 44.

bylaws that ASARCO may appoint only six of the thirteen directors precluded its exercise of control.

The Court's conclusion from all these findings was to hold for ASARCO on the unitary business issue. The Court relied largely on due process considerations, referring to its caution in *Mobil* that the Court:

[Did] not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each state where that corporation does business. Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state, due process considerations might well preclude apportionability, because there would be no underlying unitary business.<sup>36</sup>

Also the court again restated its belief that the key to a state's ability to apply formulary apportionment is the use of the unitary business principle.<sup>37</sup>

The Court distinguished *Mobil* and *Exxon*, saying that "[i]n both of these cases, that we follow today, the states prevailed because it was clear that the corporations operated unitary businesses with a continuous flow and interchange of common products. ASARCO has proved that these essential factors are wholly absent in this case."<sup>38</sup>

The factors the Court used in separating unitary businesses from non-unitary businesses are perhaps the most important part of the decision. First, it is apparent that the superficial form of the enterprise is irrelevant and that the Court will look to the "underlying economic realities of a unitary business."<sup>39</sup> Second, such factors as functional integration, centralized management, and controlled interaction will tend to show a unitary business, and the Court distinguished *Exxon* on these grounds.<sup>40</sup> Further, in order to escape a finding of unity, the income in question "must derive from unrelated business activity which constitutes a discrete business enterprise."<sup>41</sup>

Finally, the Court explicitly but summarily refused to accept Idaho's contention that "corporate purpose" should define the scope of the unitary business rule. The Court reasoned that this would destroy the unitary concept altogether, as virtually all operations of any enterprise can in some sense be considered as having the purpose of enhancing the business.<sup>42</sup> Idaho's contention presented a due process

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36. ASARCO, 50 U.S.L.W. at 4965.

37. *Id.* at 4965.

38. *Id.* at 4968 n. 24.

39. *Id.* at 4965.

40. *Id.* at 4965.

41. *Id.* at 4965.

42. *Id.* at 4967.

problem, since it would allow states to violate the requirement that there be a "rational relationship between the income attributed to the state and the intrastate values of the enterprise."<sup>43</sup>

### B. *The Woolworth Case*

F.W. Woolworth is a corporation domiciled in New York which engages in chain store retailing throughout the United States. Woolworth's connection with the State of New Mexico derived solely from the fact that 0.5% of its gross sales for the year in question were conducted there.<sup>44</sup> As in the *ASARCO* case, the dispute in *Woolworth* revolved around the taxability of dividends paid to the parent by its subsidiaries. Woolworth owns four foreign subsidiaries of relevance to the suit. Of these, three are wholly-owned: F.W. Woolworth GmbH, in Germany; F.W. Woolworth, Ltd., in Canada; and F.W. Woolworth, S.A. de C.V. Mexico. The fourth subsidiary, F.W. Woolworth Co., Ltd., is an English corporation of which Woolworth owns 52.7%.<sup>45</sup>

Woolworth treated \$39.9 million of dividend income from these subsidiaries, as well as a \$1.6 million gain from a hedging transaction in British pounds, as "nonbusiness" income, none of which was to be allocated to New Mexico. Woolworth treated similarly \$25.5 million of "gross-up"<sup>46</sup> it was deemed to have received under the federal tax laws.

The New Mexico Taxation and Revenue Department determined that Woolworth should have included these sums in its apportionable New Mexico income, thus increasing the assessment from \$84,622 to \$401,518.<sup>47</sup> The Department denied Woolworth's protest, but was reversed on appeal by the New Mexico Court of Appeals<sup>48</sup> which declined to find a unitary business. The New Mexico Supreme Court reversed.<sup>49</sup> In finding a unitary business, that court stated that:

The [dividend] income [from Woolworth's subsidiaries] is obviously related to the mutual activities of the parent and its affiliates. The control over the subsidiaries, the interdependence, the history of the relationships, the placing of the [dividend] money in [Woolworth's] general operating account, all point to functional integration and reveal an underlying unitary business for our purposes.<sup>50</sup>

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43. *Id.* at 4968; *Mobil*, 445 U.S. at 437; *Moorman*, 437 U.S. at 272-273.

44. *Woolworth*, 50 U.S.L.W. at 4957.

45. *Id.* at 4957.

46. "Gross-up" treats as dividend income under section 78 of the Internal Revenue Code of 1954 the taxpayer's indirect foreign tax credit under section 902 of the Internal Revenue Code of 1954. For federal income tax purposes, the amount is included in the tax base.

47. *Woolworth*, 50 U.S.L.W. at 4958.

48. *F. W. Woolworth Co. v. Bureau of Revenue*, 95 N.M. 542, 624 P.2d 51 (Ct. App. 1979).

49. *Taxation and Revenue Dep't v. F. W. Woolworth Co.*, 95 N.M. 519, 624 P.2d 28 (1981).

50. *Id.*, 95 N.M. at 529, 624 P.2d at 38.

In reversing the New Mexico Supreme Court and finding for Woolworth, the U.S. Supreme Court relied on the reasoning and authorities in *ASARCO*. The Court especially emphasized that the potential to operate as part of a unitary business, which existed here, was not dispositive, for the actual conduct of the business must be examined.<sup>51</sup>

The Court found little functional integration, no centralization of management, no interdependent relations of the parent and subsidiaries, and hence, no unitary business. The Court reached these conclusions despite a finding of some minor managerial links, such as several common directors and frequent management-level communications. Based on these conclusions, the Court stated further that:

[T]he four subsidiaries in question are not part of a unitary business under the principles articulated in *Mobil* and *Exxon*, and today reiterated in *ASARCO*. Except for the type of occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of management of these five corporations.<sup>52</sup>

### III

#### PENDING CASES, ISSUES FOR THE FUTURE AND CONCLUSIONS

A California District Court<sup>53</sup> has already taken note of the results in *ASARCO* and *Woolworth* by construing the California Bank and Corporation Tax Law in light of the "unitary business" discussions in the two cases. The U.S. Supreme Court itself remanded a case for consideration in the aftermath of *ASARCO* and *Woolworth*.<sup>54</sup> Several other cases are pending, a notable number of them in the California<sup>55</sup> state or federal courts.<sup>56</sup> The results in these cases should be watched closely, as they will probably involve new challenges to worldwide

51. *Woolworth*, 50 U.S.L.W. at 4959.

52. *Id.* at 4961.

53. *Shell Petroleum N.V. v. Graves, Corey, Dronenburg, Individually and as Members of, and Gerald H. Goldberg, Individually and as Executive Officer of, The Franchise Tax Board*, No. C81 4302 (N.D. Cal. Aug. 4, 1982).

54. *Russell Stover Candies, Inc. v. Dep't of Revenue of Montana*, 51 U.S.L.W. 3251 (1982).

55. That many of these challenges should be arising in the California courts is hardly surprising. California has built a reputation as the most aggressive "unitary" state and has been singled out by foreign nations for criticism. See Letter, *supra* note 5, at 749-750; O'Dell, *Japanese-Owned Firms Find State Is Losing Its Appeal*, Los Angeles Times, Apr. 3, 1983, Part V at 1, col. 5.

56. *Anaconda Co. v. Franchise Tax Board*, 130 Cal. App. 3d 15, 181 Cal. Rptr. 640 (1982), appeal docketed, (U.S. Aug. 20, 1982); *Shell Petroleum N. V.*, No. C81 4302 (N.D. Cal. Aug. 4, 1982); *Container Corporation of America v. Franchise Tax Board*, 117 Cal. App. 3d 988, 173 Cal. Rptr. 121, *prob. juris. noted*, No. 81-523 (U.S. May 3, 1982), *oral arg. heard* (U.S. Jan. 10, 1983); *Chicago Bridge & Iron v. Caterpillar Tractor Co. & Illinois Dep't of Revenue*, 84 Ill.2d 102, 417

combination. Beyond the basic issue of whether enterprises are unitary, the issues of double taxation and the ability of the federal government to speak with one voice in the area of foreign affairs are being raised under the Foreign Commerce Clause.<sup>57</sup> In addition, due process arguments based on the unitary doctrine's unfairness to particular taxpayers are being heard.<sup>58</sup>

In the *Moorman* case, the Supreme Court dealt with the multiple taxation issue in a merely interstate setting. The Court's tolerance for minor potential incidents of double taxation was evident. Subsequently, in the *Japan Lines* case, the Court held that in an international setting, state tax laws subjecting foreign business to the risk of multiple taxation would be given close judicial scrutiny. That case, however, pertained to a property tax, and the principles enunciated remain to be fully applied to an income tax case.

The argument that state unitary taxation results in unfair distortion also has merit. Formulary apportionment, to be fair, must be applied only in a system where equivalent investments in different areas would magically produce precisely equivalent returns.<sup>59</sup> But there is often drastic inequality in the profitability of foreign subsidiaries and domestic parents. In addition, other factors such as exchange rate fluctuations can also contribute to potential distortions.

The notion that state unitary taxation impairs the ability of the federal government to speak with one voice may also become a significant issue. Clearly, the actions of the state governments in this area do affect foreign commerce and its instrumentalities directly. The recent disillusionment of Japanese firms with the State of California<sup>60</sup> is a good example. A state which utilizes a unitary method of taxation places itself at a competitive disadvantage in the interstate battle to attract foreign investment and foreign-owned businesses. In California, "[i]t is the state's unitary tax, which taxes multinational companies doing business in California on a percentage of their worldwide earnings, that is the most visible cause of Japanese disillusionment with the state."<sup>61</sup> Several large firms have halted all further development in California to protest the system and others have instituted cutbacks in

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N.E. 2d 1343 (1981), *prob. juris. noted*, No. 81-349 (U.S. Nov. 9, 1981), *oral arg. heard*, (U.S. April 19, 1982), *reh'g granted* (U.S. May 3, 1982).

57. See *Container Corp. of America*, *supra* note 56.

58. *Id.*

59. As a general rule, foreign subsidiaries of U.S. parent corporations tend to be more profitable than domestic operations, while foreign parents tend to be more profitable than their U.S. subsidiaries. See *Letter*, *supra* note 5, at 749, where the concerns of EEC Member States about this problem were communicated to the U.S. State Department.

60. O'Dell, *supra* note 55.

61. *Id.* at 6, col. 1.

order to reduce their California tax liability.<sup>62</sup> The dilemma faced by states that have adopted unitary taxation is that reform would cause a short term loss in tax revenue (up to \$40 million a year in California),<sup>63</sup> but that in the long run fewer businesses will remain to be taxed in this manner. In the meantime, California maintains its unitary tax system, and foreign firms are considering investment in states with more liberal tax policies.

The governments of European Community (EC) countries are concerned as well.<sup>64</sup> They have complained that the "unitary basis makes no attempt to examine the profits generated by the (U.S.) subsidiary (of a foreign parent),"<sup>65</sup> that the method is "incompatible with the principles accepted by all OECD member states",<sup>66</sup> and that the unitary system gives rise to "double taxation"<sup>67</sup> and "very heavy compliance costs."<sup>68</sup> In light of these concerns, EC countries would undoubtedly support federal proposals to prohibit the states from using the worldwide combination method and restrict the state taxation of foreign-source dividend income of multinational enterprises.<sup>69</sup>

The attack against unitary taxation may thus proceed on two fronts: There is the potential for federal legislation to ensure uniformity of state tax policy regarding multinationals, and there is ongoing litigation involving the questionable constitutionality of the application of the unitary method of taxation.<sup>70</sup> In the aftermath of the *ASARCO* and *Woolworth* decisions, the Justice Department has filed an amicus curiae brief in the *Chicago Bridge & Iron v. Caterpillar Tractor Co. & Illinois Dept. of Revenue* case, now pending before the Supreme Court, urging further limitations on the states' taxing powers in this area.<sup>71</sup>

Furthermore, at least one commentator has argued that no real constitutional barriers exist to the various state income apportionment schemes. Under this view, due process is not considered to be violated by apportioning all income regardless of source and regardless of the unitary business approach, so long as the amount of net income appor-

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62. *Id.* at 6, cols. 1-2.

63. *Id.* at 6, col. 2.

64. Letter, *supra* note 5, at 749-750.

65. *Id.* at 749.

66. *Id.*

67. *Id.* at 750.

68. *Id.*

69. *Id.*

70. In an analogous vein, see Ault and Kaplan, *International Developments—Another View*, 9 J. CORP. TAX'N 289, 291 (1982). Those authors characterize the judicial assault on the unitary method as two-pronged: Attacks using the U.S. Constitution and attacks based on U.S. treaties.

71. 14 TAX NOTES 352, Feb. 8, 1982.

tioned to the taxing state is proportionate to the business activities carried on there by the corporation.<sup>72</sup>

In holding that nondomiciliary states cannot tax as business income an apportioned share of dividends received by a domestic company from foreign subsidiaries where the payor subsidiary is not unitary with the parent, the Supreme Court has by the *ASARCO* and *Woolworth* decisions curbed the states' taxing power over multistate and multinational businesses. Whereas many states had rejoiced at the apparent expansiveness of their taxing powers implied in the 1980 *Mobil* and *Exxon* decisions, it appears that this elation may have been premature and due to a failure to heed the Court's warnings. The *ASARCO* and *Woolworth* decisions should cause some re-evaluation, both on the part of business enterprises and the states, as to which businesses are "unitary" and which income is "apportionable."

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72. Lathrop, *Due Process Considerations and the Apportionment of Dividend Income: A Dissent from the ASARCO and Woolworth Decisions*, 16 TAX NOTES 3, Jul. 5, 1982.