BYU Law Review

Volume 1982 | Issue 3 Article 1

9-1-1982

The "Unitary" Business in State Taxation: Confusion at the Supreme Court?

C. Douglas Floyd

Follow this and additional works at: https://digitalcommons.law.byu.edu/lawreview

Part of the Taxation-State and Local Commons

Recommended Citation

C. Douglas Floyd, *The "Unitary" Business in State Taxation: Confusion at the Supreme Court?*, 1982 BYU L. Rev. 465 (1982).
Available at: https://digitalcommons.law.byu.edu/lawreview/vol1982/iss3/1

This Article is brought to you for free and open access by the Brigham Young University Law Review at BYU Law Digital Commons. It has been accepted for inclusion in BYU Law Review by an authorized editor of BYU Law Digital Commons. For more information, please contact hunterlawlibrary@byu.edu.

The "Unitary" Business in State Taxation: Confusion at the Supreme Court?

by
*C. Douglas Floyd**

On June 29, 1982, the United States Supreme Court decided *ASARCO, Inc. v. Idaho State Tax Commission*[1] and *F.W. Woolworth Co. v. Taxation and Revenue Department of New Mexico*,[2] the two latest opinions in its recent spate of decisions in the field of state taxation of the income of multi-state and multi-national business. If these opinions are read in isolation from the record and arguments that were before the Court, they could sustain the unfortunate inference that the Court has wandered from the sensible course it charted only two Terms ago in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*[3] and *Exxon Corp. v. Department of Revenue of Wisconsin.*[4] In *Mobil* and *Exxon,* the Court had strongly reaffirmed the implications of earlier decisions that state power to tax consistent with the due process clause of the fourteenth amendment turns on economic realities rather than on the form of the investment, on the form in which income is received, or on the vagaries of separate accounting.[5]

In *ASARCO,* the Court reaffirmed the concept of functional business integration as a basis for sustaining the use of the apportionment method in state taxation of corporate income.[6] But,

---

* B.S., 1964, Massachusetts Institute of Technology; LL.B., 1967, Stanford University School of Law. Professor of Law, J. Reuben Clark Law School, Brigham Young University.

1. 50 U.S.L.W. 4962 (U.S. June 29, 1982).

2. 50 U.S.L.W. 4957 (U.S. June 29, 1982).

3. 445 U.S. 425 (1980). The author was one of the attorneys on the amicus brief submitted in *Mobil* on behalf of Standard Oil Company of California.

4. 447 U.S. 207 (1980).

5. *Exxon,* 447 U.S. at 223-24; *Mobil,* 445 U.S. at 438, 440-42.

6. Thus, the Court noted that in *Mobil* it had "explicated the limiting 'unitary business' principle by observing that geographic accounting, in purporting to isolate income received in various states, 'may fail to account for contributions to income resulting from *functional integration,* centralization of management, and economies of scale.'" 50 U.S.L.W. at 4965 (quoting 445 U.S. at 438) (emphasis added).

in contrast to *Mobil* and *Exxon,* it proceeded to reject the apportionment of dividend income from five partially owned subsidiaries and affiliates of ASARCO in the face of some evidence suggesting functional integration.[7] The opinions can be read to have done so on the ground that ASARCO, under peculiar management arrangements present in that case, did not have or had not exercised "management control" of those subsidiaries.[8]

If this reading of *ASARCO* were to prevail in the lower courts, then the Supreme Court would have succeeded in rejecting the formalisms of separate accounting and income classification in *Mobil* only to embrace the formalism of "management control" in *ASARCO.* An evaluation of the briefs, record, and oral argument in *ASARCO* suggests, however, that the opinions should not be read so expansively. Consistent with *Mobil,* "management control" is a relevant but not controlling element in determining whether the business of a dividend payor is sufficiently integrated with that of the payee to allow apportionment of dividends in a manner consistent with the due process clause of the fourteenth amendment.

A review of the record suggests that the primary reason for the imprecise language in the Court's opinion, which gives rise to possible misinterpretation, was that the briefs and arguments of the states and the supporting amicus curiae appeared to have adopted an extreme interpretation of *Mobil,* which disclaimed reliance on the concept of functional integration between the business activities of the taxpayer and the business activities of the dividend payor. Thus, the records were not well developed on the functional integration issue, and the Court's attention was directed elsewhere. A second important factor may have been the Court's failure to appreciate the various ways that the phrase "unitary business principle"—which it enshrined in *Mobil* as the "linchpin" of apportionability[9]—comes into play with respect to state taxation of corporate income. By focusing on management control rather than functional integration in *ASARCO,* the Supreme Court appears to have endorsed a test which may well be a prerequisite in deciding whether "combined reporting" of all the income of a parent and its subsidiary corporations is an appropriate way to determine the taxpayer's in-

7. *See infra* text accompanying notes 87-108.

8. ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962, 4966 (U.S. June 29, 1982).

9. 445 U.S. at 439.

state income, but which is of limited significance in deciding whether particular items of income are subject to apportionment. In the latter context, the proper due process inquiry is simply whether the particular property which gives rise to the income in question—whether it be intangible, such as stock, debentures, or patents, or tangible, such as rented equipment or a leased office building—is held as an integral part of, and thus contributes directly to, the taxpayer's unitary business, or is merely an unrelated investment.

The Court's opinion in *ASARCO* is troublesome in other respects. It purports to call into question the general "business purpose" test—developed by the Multistate Tax Commission in its regulations under the Uniform Division of Income for Tax Purposes Act[10]—for the classification of income from intangibles as apportionable business income. In so doing, the Court may have seriously impaired the prospects for the development of a uniform approach to the treatment of such income in the states. Moreover, the Court failed to resolve the important unanswered question of whether an adjustment in the apportionment formula to take account of the "factors" of the dividend payor is constitutionally required in order to apportion dividend income.

Petitions for rehearing in *ASARCO* and *Woolworth* have been filed. Because of the disruptive potential consequences in the field of state taxation if the opinions are not clarified, one may hope that the Court will abandon its customary reticence to grant rehearing, and will issue a revised opinion in *ASARCO* that recognizes the limited relevance of formal management control in determining the constitutional limits on apportionability of income, as opposed to the propriety of combined reporting. A rehearing would also permit the Court to address the central issue of whether an adjustment in the apportionment formula to take account of the factors of the dividend payor is constitutionally required. Absent rehearing, however, the Court will have another opportunity to prevent disruptive misinterpretation of *ASARCO* in state tax litigation. Early in the 1982 Term, it will determine the constitutional limitations on the use of combined reports in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*[11] and *Container Corp. of America v. Franchise Tax Board.*[12]

10. 7A U.L.A. 91 (1978).

11. 50 U.S.L.W. 3857 (U.S. set for reargument May 3, 1982) (No. 81-349).

12. 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), *prob. juris. noted,* 102 S. Ct. 2034 (1982) (No. 81-523).

The Court should at the very least avail itself of that opportunity to explain the different considerations relevant to combination and apportionment, and the different weight to be accorded to management control in these two related but distinct settings.

I. The Unitary Business Concept and UDITPA

The states have very broad powers in enacting corporate income tax laws. It is a fundamental precept of the due process clause, however, that a state can tax only corporate income that is reasonably attributable to activities within the taxing state.[13] Even so, a state is not required to determine the in-state income of a corporation by separate, i.e., geographic, accounting procedures. Rather, in appropriate cases a state may determine a corporation's in-state income by applying an apportionment formula to the corporation's aggregate income. The most prevalent approach is that of the Uniform Division of Income for Tax Purposes Act ("UDITPA")[14] which has been adopted in twenty-nine states.[15] UDITPA classifies all income as "business" or "nonbusiness" income.[16] "Business" income as defined by UDITPA is apportioned in accordance with a three-factor formula consisting of the ratio of the taxpayer's in-state property, payroll, and sales to its total property, payroll, and sales.[17] "Nonbusiness" income is allocated specifically to the situs of the property or activity which produces the income or to the commercial domicile of the taxpayer.[18] Although this "three-factor" apportionment formula is the method most widely utilized among the states, the Supreme Court has also upheld the use of an apportionment formula consisting of the single factor of in-state sales to total sales.[19]

The theoretical and practical justification for using an ap-

---

13. Miller Bros. Co. v. Maryland, 347 U.S. 340, 345 (1954).

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

15. *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.

16. UDITPA, *supra* note 14, at § 1(a), (e), 7A U.L.A. 93, 94 (1978). For an excellent general discussion of UDITPA and the general concepts of allocation, apportionment, and combined reporting, see *Hearings Before the Subcomm. on State Taxation of Interstate Commerce of Senate Comm. on Finance*, 93d Cong., 1st Sess. 222-27 (1973) (statement of Frank H. Roberts).

17. UDITPA, *supra* note 14, at §§ 9, 10, 13, 15, 7A U.L.A. 100-04 (1978).

18. UDITPA, *supra* note 14, at §§ 4-8, 7A U.L.A. 97-100 (1978).

19. Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978).

portionment formula in the corporate net income tax area stems from the fact that activities of a corporation carried on in two or more states (or foreign countries) frequently are operationally or functionally interrelated and interdependent. Accordingly, it can be said that the business activities carried on outside the taxing state make a contribution to the profitability of the business within the taxing state, thus supplying the necessary due process nexus to justify use of the apportionment procedure. Over sixty years ago, in *Underwood Typewriter Co. v. Chamberlain*[20] the Supreme Court held that the use of an apportionment formula provided a fair and consistent method for determining the portion of a single corporation's overall profits attributable to activities conducted within the borders of the taxing state. A few years later in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*[21] the Supreme Court characterized the interconnected business activities of a single corporate taxpayer which justified the use of an apportionment formula as a "unitary business." Some forty years ago, in the landmark case of *Butler Brothers v. McColgan*[22] the Supreme Court reaffirmed the use of an apportionment formula to determine the in-state income of the "unitary" business of a single corporation, and held that dramatically different results under the taxpayer's separate accounting system did not impeach the validity of the unitary business method of apportioning income.

The unitary business concept is the governing factor for measuring the validity of the apportionment procedure in three distinct but related types of cases. One type of case presents the question whether various business activities of a taxpayer corporation constitute a single, interrelated business—i.e., a unitary business—or two (or more) separate, discrete, unitary businesses. This type of case is illustrated by *Bass* (the brewing and distribution segments of an ale business), *Butler Brothers* (the separate distribution segments of a wholesale dry goods business) and, more recently, *Exxon* (the exploration and production, refining, and marketing segments of an oil business).[23] It is in this two-business case that the Supreme Court historically

20. 254 U.S. 113 (1920).

21. 266 U.S. 271 (1924).

22. 315 U.S. 501 (1942).

23. 447 U.S. 207 (1980). *See also* Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963) and Honolulu Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963).

has established the unitary business concept as the basis for apportionability.

A second type of case presents the question whether a group of affiliated corporations form part of a single, unitary business and thus can be "combined" or "consolidated" so that the net income is determined and the apportionment formula is applied as if the unitary business were conducted by a single corporation. Although similar to the "two-business" situation, the combined report presents a more complex setting for applying the unitary business concept to justify income apportionment. In a combined report case corporate distinctions are ignored and tax is computed as if all of the unitary business operations were conducted by the taxpayer alone, even though outsiders may own a portion of the outstanding stock of one or more of the affiliated corporations. Because the combined report situation pierces the corporate veil and treats the two legally separate entites as one, logic compels the court to consider both the degree of ownership and management control and the functional integration of the activities of the various affiliated corporations. The California Supreme Court upheld the use of the second, combined reports approach over thirty years ago in *Edison California Stores v. McColgan.*[24] The court stated that in the combined report setting "the unitary nature of the business was definitely established by" the existence of "unity of ownership," "unity of operation" (e.g., "central purchasing, advertising, accounting and management"), and "unity of use" (e.g., a "centralized executive force and general system of operation").[25] In identifying these now-familiar "three unities," the court relied on its earlier decision in *Butler Brothers v. McColgan,*[26] which had later been affirmed by the United States Supreme Court.[27]

The third type of case presents the question whether a particular item of income (or deduction) is unitary business income, or is income generated by an investment or activity which lies outside the unitary business. It is of course quite common for corporations to make investments that are separate and distinct from their unitary business activities; accordingly, the question frequently arises whether particular items of income—such as

24. 30 Cal. 2d 472, 183 P.2d 16 (1947). *See also* John Deere Plow Co. v. Franchise Tax Bd., 38 Cal. 2d 214, 238 P.2d 569 (1951), *appeal dismissed,* 343 U.S. 939 (1952).

25. *Edison California Stores,* 30 Cal. 2d at 478, 183 P.2d at 20.

26. 17 Cal. 2d 664, 111 P.2d 334 (1941).

27. Butler Bros. v. McColgan, 315 U.S. 501 (1942).

rents, gains on the sale of property, interest, dividends, or earnings from participation in joint ventures—constitute unitary business income subject to apportionment. Prior to *Mobil,* however, the Supreme Court had not considered the unitary business concept in this type of case. This is not altogether suprising because the question whether a particular item of income is or is not unitary business income ordinarily has not presented unusual difficulties. If the income is derived from an asset or an activity integrally related to the conduct of the unitary business, then the income should be considered to be unitary business income subject to apportionment. Conversely, if the income is derived from an asset or activity that is not directly or integrally related to the conduct of the unitary business, and thus is held or conducted "outside" that business, then the income should not qualify as apportionable unitary business income because of the absence of the necessary "nexus" with or "contribution to" the profitability of the in-state business.

It is noteworthy that neither *Butler Brothers* nor *Edison California Stores* involved any question of whether a particular item of income was or was not sufficiently connected with the unitary business of a taxpayer to justify apportionment consistent with the due process clause. The Supreme Court's opinion in *Butler Brothers,* although it noted that unity of ownership existed,[28] focused on the critical factors for apportionability of income under the due process clause when it observed that "this Court has recognized that unity of use and management of a business which is scattered through several states may be considered where a state attempts to impose a tax on an apportionment basis"; that "the operation of the central buying division alone demonstrates that functionally the various branches are closely integrated"; and that "no showing has been made that income *unconnected with* the unitary business has been used in the formula."[29]

In its recent *ASARCO* decision the Supreme Court noted that a combined report of ASARCO and six subsidiaries had been required by the state of Idaho, and stated that the propriety of such treatment was not an issue before the Court.[30] Thus, for the first time, the Supreme Court will directly consider the

---

28. *Id.* at 508.
29. *Id.* at 508-09.
30. 50 U.S.L.W. 4963-64 (U.S. June 29, 1982).

unitary business concept in the context of the combined report procedure when it takes up the *Caterpillar Tractor Co.*[31] and *Container Corp.*[32] cases.

II. *Mobil* AND *Exxon*

The Supreme Court's 1980 decision in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*[33] has been subject to extensive commentary which there is no need to repeat.[34] In brief, the Supreme Court rejected Mobil's contention that the due process clause and foreign commerce clause precluded Vermont from apportioning dividends received from either subsidiaries or affiliates merely because Mobil received the income in the form of dividends, or because the dividend payor companies were incorporated or operating abroad.[35] The Court pointed out that in ascertaining whether the "minimal connection" and "rational relationship" requirements of the due process clause had been met,[36] the "linchpin of apportionability in the field of state income taxation is the unitary-business principle."[37] "So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business;" to determine whether apportionment is proper, "[o]ne must look principally at the underlying activity, not at the form of investment. . . ."[38] Thus, in order to establish that its dividend income was not subject to an apportioned tax in Vermont, Mobil was required to show that "the income was earned *in the course of activities un-*

---

31. 50 U.S.L.W. 3857 (U.S. set for reargument May 3, 1982) (No. 81-349).

32. 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), *prob. juris. noted,* 102 S. Ct. 2034 (1982) (No. 81-523).

33. 445 U.S. 425 (1980).

34. *See* Corrigan, *Mobil-izing Interstate Taxation,* 13 TAX NOTES 803 (Oct. 12, 1981); Dexter, *Tax Apportionment of the Income of a Unitary Business: An Examination of* Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 1981 B.Y.U. L. REV. 107; Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076,* 79 MICH. L. REV. 113 (1980); Keesling, *The Impact of the Mobil Case on Apportionment of Income,* 1981 B.Y.U. L. REV. 87; McLure, *Toward Uniformity in Interstate Taxation: A Further Analysis,* 13 TAX NOTES 51 (July 13, 1981); Peters, *Supreme Court's Mobil Decision on Income Apportionment Raises New Questions,* 53 J. TAX'N 36 (1980).

35. 445 U.S. at 434-35.

36. *Id.* at 436-37.

37. *Id.* at 439.

38. *Id.* at 440.

related to the sale of petroleum products in that State."[39] Mobil's due process claim was unsuccessful because it had made no effort to "demonstrate that the foreign operations of its subsidiaries and affiliates are distinct in any business or economic sense from its petroleum sales activities in Vermont,"[40] and had failed to prove the existence of "any unrelated business activity on the part of its subsidiaries and affiliates."[41] Absent this proof of a "discrete business enterprise," the alleged foreign source of the income "did not destroy the requisite nexus" to its Vermont activities.[42] A different result might follow "[w]here the business activities of the dividend payor have *nothing to do with* the activities of the recipient in the taxing State" because then "there would be no underlying unitary business."[43] Thus the Court looked to the underlying activities of the dividend payor to assist in determining whether the stock on which dividends were paid was a unitary business asset or an asset separate and distinct from the unitary business.

Mobil is not reasonably interpreted to have required "management control" of a subsidiary or affiliate as an essential precondition to dividend apportionment. The opinion focused instead on functional or operational integration between the business of the dividend payee and its dividend paying subsidiaries and affiliates. It is quite clear from the *Mobil* opinion that the six-member majority[44] of the Court regarded the following phrases as synonymous in their due process analysis of dividend apportionment:

(a) "[U]nderlying unitary business."[45]
(b) "[F]unctionally integrated enterprise."[46]

These, in turn, were viewed as the converse of:

(c) "[U]nrelated business activity."[47]
(d) Business activity having "nothing to do" with activity in

39. *Id.* at 439 (emphasis added).

40. *Id.* at 439.

41. *Id.* at 442.

42. *Id.* at 439-40.

43. *Id.* at 442 (emphasis added).

44. Justice Blackmun authored the majority opinion. Justices Stewart and Marshall took no part in the consideration or decision of the case. Justice Stevens dissented.

45. 445 U.S. at 442.

46. *Id.* at 440.

47. *Id.* at 442.

the taxing state.[48]
(e) "[D]iscrete business enterprise."[49]

The Court could not have intended "underlying unitary business" to impose any requirement of "management control" of the dividend payor as the "linchpin" of apportionability. To the contrary, the Court specifically noted that the major portion of the dividend income in question was from three wholly owned foreign subsidiaries and "from one *affiliate* incorporated in Delaware (Arabian American Oil Co. (ARAMCO)) of which appellant owned 10% of the capital stock."[50] The Court recognized the proper due process inquiry in *Mobil* when it observed that Mobil "has offered no evidence that would undermine the conclusion that most, if not all, of its subsidiaries and affiliates contribute to appellant's worldwide petroleum enterprise."[51]

To be sure, the Court's opinion in *Mobil* later reasoned that the fact that Mobil had chosen to conduct its foreign operation through subsidiaries rather than divisions worked no change in the underlying economic reality, and that since apportionment of income derived from divisions would meet due process standards, so too did apportionment of dividend income from subsidiaries.[52] These remarks were made in response to Mobil's contention that the mere fact of intercorporate division was a sufficient basis for limiting apportionability, and should not be read as a limitation on the full reach of the Court's holding that a sufficient due process basis for fair dividend apportionment exists if the operations of the subsidiary or affiliate "contribute to" the profitability of the business of the dividend payee within the taxing state.

The central due process questions are "minimal connection" and "rational relationship."[53] Therefore, if one accepts the Court's premise that a functional integration between the business of the dividend payor and that of the payee is sufficient to justify a fair apportionment, it is apparent that the concept of "management control," while not irrelevant, does not logically control the resolution of the due process issue.[54]

---

48. *Id.*
49. *Id.* at 439.
50. *Id.* at 430, n.5 (emphasis added).
51. *Id.* at 435.
52. *Id.* at 440-41.
53. *Id.* at 436-37.
54. *See infra* text following note 86.

Exxon Corp. v. Department of Revenue of Wisconsin[55] involved only the multistate activities of a single business corporation; it addressed neither the apportionment of dividends from subsidiaries and affiliates, nor the significance of management control. Rather the question in *Exxon* was whether Exxon's Wisconsin marketing operations were a separate, discrete business from its producing and refining activities carried on outside Wisconsin—in other words, whether Exxon conducted a single unitary business or several separate businesses. Nonetheless, in striking down Exxon's contention that the due process and commerce clauses precluded Wisconsin from establishing the net income of Exxon's in-state marketing activities by apportioning the income of Exxon's unitary oil business, the Court's opinion reached several conclusions relevant to the issue of dividend apportionment from subsidiaries and affiliates.

First, the Court emphatically rejected Exxon's contention that attribution of income to Wisconsin from out-of-state exploration, production, and refining would violate due process because Exxon had, as a matter of management policy, established its exploration and production, refining, and marketing departments as separate "investment centers," each with its own management, with transfers of raw materials among them based on "competitive wholesale market prices."[56]

Second, in reaching its conclusion, the Court expressed a broad view of the concept of the unitary business as the basis of apportionability. It quoted with apparent approval the test utilized by the Wisconsin Supreme Court: if " 'the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state[then] the business is unitary.' "[57] And the Supreme Court

---

55. 447 U.S. 207 (1980).

56. *Id.* at 212. As this, the primary thrust of Exxon's argument, was so clearly contrary to prior decisions and the basic concept of apportionment itself (*see* Butler Bros. v. McColgan, 315 U.S. 501 (1947)), one may wonder, with the welcome benefit of hindsight, why the Supreme Court set the appeal for full briefing and argument, rather than summarily affirming the decision of the state supreme court. One possible explanation is that the Justices saw an occasion to nip in the bud an unfortunate interpretation of Justice Stevens' opinion in Moorman Mfg. Co. v. Blair, 437 U.S. 267 (1978). *See Exxon,* 447 U.S. at 220-21. It is equally likely, however, that *Exxon* represents a not atypical instance in which the pressure of rapid-fire consideration generated by the Court's voluminous docket has led the Court to err in the selection of cases and appeals for full hearing.

57. 447 U.S. at 217 (quoting Department of Revenue v. Exxon Corp., 90 Wis. 2d 700, 711, 281 N.W.2d 94, 100 (1979) (quoting G. ALTMAN & F. KESSLING, ALLOCATION OF INCOME IN STATE TAXATION 101 (2d ed. 1950))). So far as the due process clause is con-

reiterated its own broad language in *Mobil* that:

> "[S]eparate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale."[58]

In the case before it, the Supreme Court found that Exxon operated "a highly integrated business which benefits from an umbrella of centralized management and controlled interaction,"[59] including centralized coordination of operations at various levels, centralized purchasing, and a national brand name and credit card system.[60]

Finally, the Court noted the special considerations applicable to a vertically integrated business involving the flow of raw materials and finished products through a series of production, manufacturing, transportation and marketing operations to the consumer.[61] In that context,

> [t]he decision to assign wholesale market values to internal transfers of raw materials for corpooate accountability does not change the unitary nature of appellant's business. An effective marketing operation is important to assure full or nearly full use of the refining capacities. Obviously the quality of the refined product affects the marketing operation. And the success of the Exploration and Production Department helps to keep the refineries operating at a capacity which is cost-efficient. There is indeed a unitary stream of income, of which the income derived from internal transfers of raw materials from exploration and production to refining is part. There is a sufficient nexus to satisfy the Due Process Clause.[62]

In *Exxon,* of course, each stage was controlled by the same management and the supplies and markets were in that sense "assured."[63] But assured supplies or markets can arise equally from a joint venture or other similar enterprise which grants each non-controlling participant an entitlement to supply or

---

cerned, this terminology is imprecise. It is not sufficient that the in-state operation contributes to the out-of-state business. Rather, apportionment is based on the contribution of the out-of-state business to values within the taxing state.

58. *Id.* at 222 (quoting *Mobil,* 445 U.S. at 438).

59. *Id.* at 224.

60. *Id.*

61. *See id.* at 210, 224-26.

62. *Id.* at 226 (footnote omitted).

63. *Id.* at 224-25.

marketing opportunities. Even short of such contractual entitlements, the practical "assurance" that may accompany a significant but less than controlling interest in the supply or marketing company should be sufficient to meet minimum due process "nexus" and "rational relation" tests, if the method of apportionment is fair.

III. Confusion of Combined Reporting and Dividend Apportionment in *ASARCO* and *Woolworth*

Although it is the Supreme Court's *ASARCO* decision which, in its application of *Mobil* and *Exxon,* raises the most significant unresolved questions, the Court's companion decision in *F.W. Woolworth Co. v. Taxation and Revenue Department of New Mexico*[64] merits preliminary attention. In *Woolworth,* New Mexico attempted to include in the apportionable state income of F.W. Woolworth Co. the dividend income received by the national retailing chain from four foreign subsidiaries doing business under the Woolworth tradename. The Supreme Court held that such an apportionment violated due process. The Court rejected New Mexico's contention that the ownership of substantial stock investment in foreign subsidiaries engaged in a similar line of business as domestic Woolworth in and of itself justified the apportionment of dividends received from such subsidiaries. In reaching this result, the Supreme Court's *Woolworth* opinion is a logical and an entirely consistent particularization of *Mobil.*

The argument for apportionment adopted by the state supreme court in *Woolworth* was that the mere possession of large assets (such as Woolworth's stock holdings in foreign subsidiaries) *might* enhance its credit standing, its purchasing power, or otherwise provide it with a "business advantage."[65] The United States Supreme Court's rejection of this argument—that the

---

64. 50 U.S.L.W. at 4957. Justice Powell wrote for the majority in both *Woolworth* and *ASARCO.* Justice O'Connor dissented in both cases, in opinions joined by Justices Blackmun and Rehnquist. 50 U.S.L.W. at 4962, 4968. Justice Blackmun's position that the decisions were inconsistent under the *Mobil* opinion, which he authored, is of particular significance. In *ASARCO,* Justice O'Connor argued that the necessary due process connection for dividend apportionment was present because (1) ASARCO had utilized expertise developed in its non-ferrous metals business in deciding to "invest" in the subsidiaries; (2) ASARCO had not shown that its "investments" were not made to obtain a return on capital that would be needed in its business in the future; and (3) ASARCO's subsidiaries contributed to its profit "stability" and gave it supply and marketing assurance. 50 U.S.L.W. 4962-72. As suggested here, the third argument is the most persuasive.

65. *Id.* at 4959.

production of income by investments provides a basis for treating the holding of these investments as part of the unitary business of the taxpayer—should be regarded as the primary lesson of both *Woolworth* and *ASARCO*. As the Supreme Court said in *Woolworth:*

> The state court's reasoning would trivialize this due process limitation by holding it satisfied if the income in question "adds to the riches of the corporation. . . ." Income, from whatever source, always is a "business advantage" to a corporation. Our cases demand more. In particular, they specify that the proper inquiry looks to "the underlying unity or diversity of business enterprise," . . . not to whether the nondomiciliary parent derives some economic benefit—as it virtually always will—from its ownership of stock in another corporation.[66]

Nor was it enough that Woolworth's foreign subsidiaries were engaged in the same general line of retail merchandising as the parent. Instead, the Court resolved the issue of dividend apportionment with reference to actual record evidence regarding the existence or non-existence of "functional integration, centralization of management, and economies of scale."[67] On this score, the Supreme Court took special notice of the state supreme court's observation that "[r]egretably, it needs to be said that the State did a very poor job of inquiring into and developing the facts of this case."[68] Woolworth's evidence indicated that there was no centralized purchasing, manufacturing, warehousing, or financing, and the United States Supreme Court concluded that "the evidence in this case is that *no* phase of any subsidiary's business was integrated with the parent's."[69] Nor was there evidence of centralized management or economies of scale; there was only the "occasional oversight—with respect to the capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary . . . ."[70]

The Court in *Woolworth* distinguished the record before it from the obvious functional integration that occurs in a vertically integrated flow or process industry, such as the petroleum

---

66. *Id.* (quoting Wallace v. Hines, 253 U.S. 66, 70 (1920) and *Mobil,* 445 U.S. at 440, respectively).

67. *Id.* at 4959 (quoting *Mobil,* 445 U.S. at 438).

68. *Id.* at 4958 (quoting Taxation and Revenue Dep't v. F.W. Woolworth Co., 95 N.M. 519, 524, 624 P.2d 28, 33 (1981)).

69. *Id.* at 4959 (emphasis original).

70. *Id.* at 4961.

business involved in *Exxon* and *Mobil:*

> There is a critical distinction between a retail merchandising business as conducted by Woolworth and the type of multinational business—now so familiar—in which refined, processed, or manufactured products (or parts thereof) may be produced in one or more countries and marketed in various countries, often world wide. In operations of this character there is a flow of international trade, often an interchange of personnel, and substantial mutual interdependence.[71]

Woolworth had succeeded where the taxpayers in *Exxon* and *Mobil* had failed in establishing that " 'the business activities of the dividend payor [had] *nothing to do* with the activities of the recipient *in the taxing state.*' "[72]

Whether the state in *Woolworth* could have established a stronger case of functional integration, "mutual interdependence," or "controlled interaction"[73] between domestic Woolworth and its foreign subsidiaries, based, for example, on such factors as the world-wide use and value of the well-known Woolworth trade name, is of little importance.[74] The critical fact is that by emphasizing the functional integration in the underlying operations of parent and subsidiary, and by rejecting the sweeping claim that an investment which aids the parent by making money provides a due process basis for dividend apportionment, *Woolworth* represents a logical and expected application of *Mobil.* So too was the Court's refusal to presume functional integration, in the face of persuasive evidence to the contrary, from the bald fact that the parent and subsidiary were engaged in the same line of business.

While the Court's decision in *Woolworth,* if viewed in the above light, can be said to be noncontroversial, the companion decision in *ASARCO* cannot. It is only when the *ASARCO* decision is read narrowly and critically in light of the record and arguments presented in that case that it can be reconciled with *Mobil* and *Exxon.* In *ASARCO,* the Court was confronted with a

71. *Id.* (footnote omitted).

72. *Id.* (quoting *Mobil,* 445 U.S. at 441-42) (second emphasis original).

73. *Id.* at 4961.

74. The Court specifically noted that "[t]here is no record information on the significance of the use of this common name." 50 U.S.L.W. at 4961 n.22. Thus, *Woolworth* turns largely on how much the taxpayer must show in order to carry its burden of showing lack of relation between its out-of-state and in-state operations, thereby shifting the burden of production to the state.

decision of the Idaho Supreme Court sustaining the constitutionality of the apportionment as "business income" under that state's version of UDITPA, of dividend income received by ASARCO from five subsidiaries and affiliates. ASARCO was headquartered in New York and operated a world-wide, vertically integrated business of mining, smelting, refining and selling non-ferrous metals such as copper, gold, lead, silver and zinc. It also owned major interests in five subsidiaries: Southern Peru Copper Corp.; Revere Copper and Brass, Inc.; General Cable Corp.; M.I.M. Holdings, Ltd.; and ASARCO Mexicana, S.A.[75] ASARCO's primary operation in Idaho was a silver mine, although it conducted other mining, sales and administrative activities there.[76] In calculating ASARCO's Idaho taxable income, the State Tax Commission had required combined reporting among ASARCO and six of its wholly owned subsidiaries.[77] Such a combination was expressly permitted by Idaho statute "when necessary to accurately reflect income" among "two . . . or more corporations the voting stock of which is more than fifty percent . . . owned directly or indirectly by a common owner or owners. . . ."[78] After *combining* these six wholly owned subsidiaries (disregarding intercompany transactions and dividends and taking total combined income of the subsidiaries and the parent into account), the State Tax Commission then *apportioned* the dividends from the five noncombined partially owned subsidiaries and affiliates.[79]

In the United States Supreme Court, the propriety of the combination of ASARCO and its six wholly owned subsidiaries was not at issue.[80] Nonetheless, the language utilized by the Court in discussing this point is instructive, because it highlights the potential for confusion in interpreting the Court's opinion. Describing the combination, the Court said that the auditor "first '*unitized*'—or treated as a single corporation—ASARCO" and its six subsidiaries.[81] The Court observed that "as a conse-

75. 50 U.S.L.W. at 4963.

76. *Id.* at 4962.

77. To use the terminology of the Supreme Court, "the auditor first 'unitized'—or treated as one single corporation—ASARCO and six of its *wholly* owned subsidiaries." *Id* at 4963 (emphasis original) (footnote omitted).

78. *Id.* at 4963 n.8 (quoting Idaho Code § 63-3027(s) (Supp. 1981)).

79. *Id.* at 4963-64.

80. *Id.* at 4964.

81. *Id.* at 4963 (emphasis added).

quence of *unitization*,"[82] the auditor had required combined reports. Further "the auditor listed five factors thought to justify *unitizing* treatment,"[83] including majority stock ownership, vertical operating integration, management interlock and integration, numerous intercompany sales, and joint rendition of services.[84] The Court then pointed out that as to the subsidiaries and affiliates, the dividends of which had been apportioned, "the auditor determined that the links with ASARCO were *not sufficient to justify unitary treatment*. Nonetheless, he found that ASARCO's receipt of dividends from each of these did constitute 'business' income to ASARCO."[85]

Perhaps the Court was suggesting that there was some inconsistency in the auditor's treatment: If the business of the subsidiaries was not sufficiently "unitary" to justify "unitizing" for the purpose of combined reporting, how could they satisfy the linchpin "unitary business" test for dividend apportionability under *Mobil?* If this was the Court's suggestion—a matter by no means clear—then it was mistaken. Surely a dividend payor's business may be closely enough related to the business of the dividend payee that it makes a sufficient contribution to in-state values to support apportionment of dividends under the due process clause, without being so closely related that combined reporting would be appropriate or required in order correctly to reflect income. Yet the Court's language may be read erroneously to equate these two different uses of the concept of the "unitary business" in state taxation.

Under current practice followed by virtually all of the states, stock ownership of more than fifty percent of a subsidiary is required, at a minimum, in order to permit combination.[86] The practice of combination attributes to the parent all of the income from such subsidiaries (after disregarding intercompany transactions), with the total income of the combined enterprise then being apportioned according to a combined apportionment

82. *Id.* (emphasis added).

83. *Id.* (emphasis added).

84. *Id.* at 4963-64.

85. *Id.* at 4964 (emphasis added).

86. *See, e.g.*, California Franchise Tax Board Guide for Corporations Filing a Combined Report, [1 CAL.] ST. TAX REP. (CCH) ¶ 12-450A at 1129-14 (June 1981): "A corporation may be a part of a unitary group although the degree of common ownership or control is less than 100%; however, to be included in a unitary group, the degree of common ownership or control must be over 50%." *See generally* Corrigan, *Mobil-izing Interstate Taxation*, 13 TAX NOTES 803, 805 n.6 (Oct. 12, 1981).

formula. In this context, the concept that the parent should both have and exercise control over the operations of the subsidiary seems correct. To "pierce the corporate veil" and treat two legally separate entities as one is a substantial step which should obviously require at least a majority stock interest, and perhaps considerably more. Moreover, to the extent that combined reporting rests on the assumption that the distribution of income among affiliated corporations is within the taxpayer's control, control over the operations of the affiliate is necessarily also assumed.

The question for dividend apportionment purposes is different. In that context, there is no question of attributing all of the income of a legally separate entity, the subsidiary, to the parent for the purpose of apportionment. The only question is whether dividend income which the parent itself owns and has received from the subsidiary may be apportioned among the states where the parent does business, and if so on what basis. The relevant inquiry should be whether the stock is held as an integral part of the business of the parent conducted within the taxing jurisdiction. One—but not the exclusive—basis for concluding that it is part of that business is the existence of functional or operational interdependence between the operations of the dividend payor and those of the payee. As the *Mobil* Court recognized, if the dividend payor's business *contributes* to the business of the payee conducted in the taxing state, there is a suffficient "nexus" for a fair apportionment of dividends received by the payee. That is true whether or not the payee has or exercises "management control" over the business of the payor.

Assume that two domestic oil companies operating in state *A* own fifty percent each of a joint supply company operating in state *Z*. The joint supply company was incorporated solely for the purpose of obtaining crude oil supplies located in state *Z*, and supplies its owners with 100% of the crude oil utilized in their refineries and marketed in state *A*. The joint action of both companies is necessary for any management decision. Assume also that each of the oil companies owns fifty percent of a petroleum products pipeline company operating in state *Z*, which they established for the sole purpose of connecting their refineries in that state to a major publicly owned products pipeline running from state *Z* to state *A*. Neither the pipeline nor the crude supply companies do any business in the taxing state, but they pay all of their net profits as dividends to the taxpayers

which do.

Under normal combined reporting standards, combined reports would be impermissible in this example because of the absence of more than fifty percent ownership and management control. In that sense, the companies are not unitary in typical combined reporting terminology, because the unity of ownership is absent. Yet can there be any real question but that the dividend payors' businesses contribute so substantially and directly to the business of the dividend payees in the taxing state that the apportionment of the dividend income actually paid from the profits of the jointly-owned companies to the in-state taxpayers is justified?

The transfer of products at ostensible market prices should not lead to a different result; this is just a variation of the separate accounting theme rejected in *Mobil* and *Exxon.* The ultimate due process question is whether the ownership of stock on which the dividends are paid lends some special or enhanced contribution to the operations of the taxpayer in the taxing state beyond that which would exist in an open market setting between two entirely unrelated corporations. Where there is substantial stock ownership accompanied by a substantial supply relationship, there should be an almost conclusive presumption that such a special contribution exists, for even if transfer prices were in fact at the true market level, the normal business motive for such arrangements is the supply or marketing assurance that they provide.

The possible assumption that "unitariness" for combined reporting should be equated with that for dividend apportionment is also reflected in the *ASARCO* Court's analysis of the specific dividend-paying subsidiaries involved. The Court first addressed dividends received from Southern Peru Copper Corp., in which ASARCO held 51.5 percent of the stock.[87] Although the record with respect to the relationship between Southern Peru's operations and those of ASARCO was sketchy, it did reveal that Southern Peru produced smelted but unrefined "blister copper" and that it sold seventy to eighty percent of its output to its shareholders in proportion to their ownership interests under contracts.[88] Southern Peru sold approximately thirty-five percent of its total output to ASARCO under a long-term contract

87. 50 U.S.L.W. at 4966.

88. *Id.*

which fixed the price with reference to trade prices quoted in an independent trade publication.[89]

Since an arrangement which assures a supply of raw materials is a strong indication of operational integration,[90] one would have expected the mere fact of the supply relation in tandem with a substantial stock ownership to establish a relation between the business operations of Southern Peru and the business of ASARCO sufficient to support dividend apportionment. As pointed out, the *Mobil* Court applied the unitary test for dividend apportionment with reference to whether the affiliate could be viewed as a "functionally integrated enterprise," engaged in related as opposed to "unrelated business activity."[91] In *ASARCO*, however, the Court concluded that "ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business."[92] In reaching that conclusion the Court appears to have focused on combined reporting criteria and to have overlooked the obvious fact of functional intergration. Indeed, in one footnote it commented that *Exxon* and *Mobil* were distinguishable because they involved "unitary businesses with a continuous flow and interchange of common products. ASARCO has proved that these essential factors are wholly absent in this case."[93] In view of the admitted significant supply relationship established by the record, one is at best puzzled by the Court's analysis.

Instead of focusing on functional integration or interdependence between the operations of ASARCO and Southern Peru, the Supreme Court rested its conclusion almost wholly on evidence that despite its 51.5 percent stock ownership, ASARCO had entered into a management agreement with the other shareholders which required eight votes to pass any resolution and which limited ASARCO to appointing only six of thirteen directors.[94] Thus, although ASARCO had veto power, it could not exercise full management control over Southern Peru.[95] The Court also referred to conclusory testimony by an ASARCO official

89. *Id.*

90. *See* 447 U.S. at 224-25.

91. *See supra* text accompanying notes 45-49.

92. 50 U.S.L.W. at 4966.

93. *Id.* at 4968 n.24.

94. *Id.* at 4966.

95. *Id.*

that it did not "control Southern Peru in any sense of that term," nor did Southern Peru "seek direction or approval from ASARCO on major decisions,"[96] without apparent sensitivity to the fact that ASARCO's affirmative vote was necessary to pass any resolution.

The Court's analysis with respect to the other four subsidiaries followed much the same pattern. ASARCO held only minority (thirty-four percent) stock interests in General Cable and Revere Copper[97] and a consent decree precluded it from voting the subsidiaries' stock or selling them copper at other than market prices.[98] The corporations did not consult with ASARCO on operational or management decisions.[99] These facts led the Court to conclude that their businesses were not unitary with that of ASARCO. In a footnote the Court noted without analysis that in the years in question Revere had purchased three to four percent of ASARCO's output and General Cable had purchased approximately six percent.[100] The remaining subsidiaries, M.I.M. and Mexicana, were engaged in the same line of business as ASARCO in Australia and England, and Mexico, respectively.[101] ASARCO held 52.7 percent of M.I.M.'s stock, and the Court observed that it had "the control potential to manage M.I.M., [but] no claim is made that it has done so."[102] There was a de minimis one percent supply relationship between M.I.M. and ASARCO.[103] ASARCO held forty-nine percent of Mexicana, but the Court noted that the trial court had found that it "operates independently of [ASARCO]" and "does not seek approval from ASARCO concerning major policy decisions."[104] In a footnote, the Court noted that ASARCO acted as a contract sales agent for Mexicana in the United States, but cited testimony by an ASARCO vice president that the contract would continue even if ASARCO lost its stock ownership.[105]

---

96. *Id.* (quoting Joint App. at 121a, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982) [hereinafter cited as Joint App.]).

97. 50 U.S.L.W. at 4966.

98. *Id.*

99. *Id.*

100. *Id.* at 4966 n.19.

101. *See id.* at 4966-67.

102. *Id.* (footnote omitted).

103. *Id.*

104. *Id.* at 4967 (quoting Juris. Statement at 43a App., ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982) [hereinfter cited as Juris. Stmt.]).

105. 50 U.S.L.W. at 4967 n.21; Joint App. *supra* note 96, at 121a, 131a.

The Court's holding with respect to Mexicana and M.I.M. is arguably unexceptionable on the record before it. As there was little evidence of operational integration, the Court was justified in looking to the other criteria of *Mobil* and *Exxon* for determining whether the necessary due process connection existed, namely, "centralization of management" and "economies of scale."[106] Finding neither, it was probably justified in holding that the requisite due process connection did not exist.

General Cable and Revere Copper presented stronger cases for apportionment of dividends, because of enhanced evidence of functional integration through a supply arrangement.[107] However, apart from a general discomfort with the absence of articulated standards, these decisions standing alone would present little cause for concern since dividend apportionment can be appropriate only if the ownership relation between the companies provides some special assurance or contribution to the business of the dividend payee in the taxing state beyond that which would normally come from open-market trading between two unrelated companies. Where the taxpayer has established that any purchases or sales are at market price (as the consent decree applicable in the cases of General Cable and Revere Copper required[108]), and are quantitatively insignificant, with little or no management centralization or direction, a court is justified in inferring that no such special or enhanced contribution exists.

However, in the case of Southern Peru, there was evidence of a very substantial supply relationship with a company in which ASARCO had majority stock ownership, the right to designate six of thirteen directors, and negative management control. In this context, the absence of *complete* "management control" does not logically detract from the conclusion that the stock relationship between the companies is intended to and does in fact reflect a special contribution by the business of the dividend payor to that of the dividend payee, beyond that which could be expected in an entirely arm's length market setting. That is true whether or not transfer prices are purportedly at the market level, for not only is that fact difficult to ascertain under the best circumstances, but as pointed out in *Exxon,* an *assurance* of supplies and markets is frequently the business

106. *See supra* text accompanying notes 58-60.
107. *See* 50 U.S.L.W. at 4966 n.19 (U.S. June 29, 1982).
108. *See id.* at 4966.

motive for such investments.[109] Such assurance can flow from management control, but it can equally derive from contractual entitlements or even the practical assurance that derives from a significant, albeit not "controlling" ownership and management role. Indeed, not only did ASARCO possess a long term output contract with Southern Peru[110], but ASARCO's negative control no doubt gave it sufficient leverage over the other participants in Southern Peru to assure the continuance of copper sales in proportion to ownership interests beyond the expiration of any particular supply contract or arrangement. In light of the established principle that it is the *taxpayer's* burden to demonstrate that its out-of-state operations do not contribute to the profitability of its business within the taxing state[111], the result in the case of Southern Peru is clearly wrong.

To make the issue of dividend apportionment turn on management control in the face of such evidence of contribution by the out-of-state operations of the dividend payor to the in-state operations of the taxpayer would open the door to manipulation by taxpayers. This is illustrated by the facts of *ASARCO* itself. Despite a controlling stock interest in Southern Peru, ASARCO was found not to have management control of Southern Peru by virtue of a management agreement which gave it the right to appoint only six of thirteen directors when eight votes were required to pass any resolution. Indeed, if the Supreme Court's *ASARCO* opinion were read literally, even such a shareholder arrangement would be unnecessary to avoid apportionment of dividends received by a parent with a controlling stock interest. ASARCO held 52.7% of M.I.M.'s stock, and the Court thought it significant that "[a]lthough ASARCO has the control potential to manage M.I.M. no claim is made that it has done so."[112]

One possible explanation of the apparent incongruities in the *ASARCO* opinion is the fact that ASARCO's predominant business in Idaho was silver mining, whereas the dividends from Southern Peru flowed from a copper supply company. The Court's language at several points suggests that it attributed some significance to the intuitive lack of relation between a silver mining business and a copper smelting and sale business. For example, in concluding that Southern Peru's dividends were

109. *Exxon,* 447 U.S. at 225.
110. 50 U.S.L.W. at 4966.
111. *E.g., Mobil,* 445 U.S. at 442.
112. 50 U.S.L.W. at 4966.

not properly apportioned, it observed that "ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business."[113] Later it stated that the five dividend paying subsidiaries and affiliates, in "'any business or economic sense'—have 'nothing to do with the activities' of ASARCO *in Idaho*."[114]

It is true that there was no flow of products from Southern Peru to ASARCO's silver mining operation. But the Court's analysis seems to ignore the fact that for the purposes of the appeal, all of ASARCO's domestic metals operations were assumed to be unitary and themselves sufficiently interrelated and "interdependent" to justify, not simply dividend apportionment, but full combination.[115] That being true, it is difficult to see why a substantial interdependence of any portion of ASARCO's "unitary" domestic operations with the operations of Southern Peru should not be sufficient to attribute to Idaho a portion of the value contributed to the domestic business. Be that as it may, the Court's opinion does not attempt to deal with that line of argument, and it is apparent that the absence of any immediate flow or supply relationship between the Idaho silver operations of ASARCO and the copper operations of Southern Peru played an influential role in the Court's ultimate decision.

A second possible explanation for the *ASARCO* result may have been the Court's preoccupation with the state trial court's findings. In a footnote, the *ASARCO* majority responded to Justice O'Connor's dissent by emphasizing that *Mobil* was decided "after applying enunciated principles carefully to the facts of the case" and that in *ASARCO* "[we] have reached a different result because the facts differ in critical respects."[116] Elsewhere in the opinion, the Court emphasized that the state trial court had "found" that ASARCO's management contract "insures that [ASARCO] will not be able to control [Southern Peru]" and that Southern Peru "operates independently of" and had minimal contact with ASARCO, based on testimony that ASARCO did not "control Southern Peru in any sense of that term" and that Southern Peru did not seek ASARCO's direction on major

---

113. *Id.*

114. *Id.* at 4968 (quoting *Mobil,* 445 U.S. at 439, 442) (emphasis added).

115. *See id.* at 4963-64; Transcript of Oral Argument (April 19, 1982) at 22-23, in ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

116. 50 U.S.L.W. 4967 n.22.

policy decisions.[117] The Court stated that Idaho did not contest these "facts."[118] It also relied on a trial court "finding" that ASARCO's stock holdings were "not integral to nor a necessary part of [ASARCO's] business operation."[119] Both these findings and the testimony on which they were based, however, were conclusory expressions of opinion inconsistent with the undisputed facts of functional integration and the necessity of ASARCO's vote to pass any resolution.[120] They therefore provide an unsatisfactory basis for reconciling *Mobil* and *ASARCO.*

There is, however, another and even more important factor which can explain the apparent inconsistencies and omissions in the Court's analysis. As we have previously observed, the Court in *Mobil* noted with apparent equanimity the apportionment of Mobil's ARAMCO dividends even though ARAMCO was only an affiliate in which Mobil held a ten percent stock interest.[121] Comparing *ASARCO* and *Mobil,* one must assume that either the Court did not focus adequately on the existence of the ARAMCO dividends in *Mobil,* or that it did not give sufficient weight to the factual basis for apportioning Southern Peru dividends in *ASARCO.* As the ARAMCO situation was heavily emphasized in the *Mobil* briefs[122] and was specifically noted in the Court's opinion,[123] the former assumption is unwarranted. But an examination of the briefs and the oral arguments in *ASARCO* provides substantial evidence that the gaps in the Court's reasoning in its most recent opinion can be attributed largely, if not entirely, to the litigation strategies of the parties and their failure adequately to focus on the critical facts of record.

IV. The Briefs and Arguments in *ASARCO*

A foreshadowing of potential confusion to come was evident in the responses of the State and the Multistate Tax Commission as amicus curiae in opposition to ASARCO's Jurisdictional Statement. In that statement ASARCO characterized the primary question presented as whether, under *Mobil,* "Idaho's in-

---

117. *Id.* at 4966 (quoting Juris. Stmt. at 42a, 121a, 124a).

118. *Id.*

119. *Id.* at 4967 n.21.

120. *See supra* text accompanying notes 87-96.

121. *See supra* text accompanying note 50.

122. *See, e.g.,* Brief Amicus Curiae in Support of Appellee on Behalf of Standard Oil Company of California, at 2-3, 16-17, *Mobil,* 445 U.S. 425 (1980).

123. *See* 445 U.S. at 430 n.5.

clusion in Appellant's apportionable business income of dividends paid to Appellant by *functionally independent subsidiaries* contravenes the Due Process Clause . . . ."[124] After briefly describing the facts with reference to the five dividend paying subsidiaries involved, with a heavy focus on Mexicana and M.I.M., ASARCO asserted that

> [t]he decision below would permit such dividends to be taxed even though: (1) the recipient corporation admittedly 'did not exercise its right to control' the payor corporation; (2) the payor corporation 'operated independently of' the recipient corporation; and (3) the two corporations 'did little if any business' with each other.[125]

Although this characterization had some foundation with respect to the Idaho Supreme Court's treatment of M.I.M. and Mexicana, it does not accurately characterize the general approach taken by that court. The general approach of the Idaho Supreme Court in *ASARCO* was consistent with *Mobil* and with the basic principles subsequently announced by the United States Supreme Court itself in *ASARCO* and *Woolworth.* The Idaho court had expressly stated that "we reject the notion that such [intangible] income is to be automatically considered business income simply because the taxpayer's business operations may receive some incidental benefits from those investments"[126] and that "[t]he incidental benefits from investments in general, such as enhanced credit standing and additional revenue, are not, in and of themselves, sufficient to bring the investment within the class of property the acquisition, management or disposition of which constitutes an integral part of the taxpayer's business operations"[127] within the meaning of UDITPA. After rejecting the argument that dividends were not properly apportioned under the "business income" provisions of UDITPA merely because the operations of the subsidiaries in question were not closely enough connected to those of ASARCO to re-

124. Juris. Stmt. *supra* note 104 at i (emphasis added).

125. *Id.* at 12-13 (quoting *id.* at 22a-23a App. A).

126. *Id.* at 17a App. A (footnote omitted); American Smelting & Ref. Co. v. Idaho State Tax Comm'n, 99 Idaho 924, 933, 592 P.2d 39, 48 (1979) (footnote omitted), *vacated,* ASARCO, Inc. v. Idaho State Tax Comm'n, 445 U.S. 939 (1980), *reinstated,* American Smelting & Ref. Co. v. Idaho State Tax Comm'n, 102 Idaho 38, 624 P.2d 946 (1981) [hereinafter cited as *American Smelting*].

127. Juris. Stmt., *supra* note 104 at 17a-18a App. A; *American Smelting,* 99 Idaho 924, 933, 592 P.2d 39, 48 (1979).

quire *combined reporting,*[128] a subject which is addressed above, the Idaho Supreme Court concluded:

> the record does not contain clear and convincing evidence to rebut the statutory presumption [that the dividends constitute business income] and does not support the trial court's finding that those dividends were not business income. For the years in question ASARCO owned a controlling or at least a very substantial interest in each of these corporations. They are all engaged in businesses closely related to ASARCO's mining and smelting operations and, with the exception of M.I.M., ASARCO did a substantial amount of business with them and provided them with a variety of technical services. The clear inference from these facts is that ASARCO's interest in these companies was not merely that of a passive investor but that this dividend income arises from ASARCO's mining and smelting business and that ASARCO acquired and maintained its ownership interest in these companies as an integral and necessary part of its mining and smelting business. . . . ASARCO does own a majority of M.I.M. stock and M.I.M. is engaged in virtually the same business as ASARCO. Given these facts *and the statutory presumption* we conclude that the trial court erred in concluding that ASARCO's interest in M.I.M. was merely a passive investment unrelated to ASARCO's mining and smelting business.[129]

With the exception of M.I.M. and Mexicana (as to which the Idaho Supreme Court's assumption of significant intercompany business was not supported by the record), both the record and the reasoning of the Idaho Supreme Court were consistent with *Mobil's* focus on functional integration between the underlying business of the dividend payor and that of the dividend payee. The only major point of difference in approach appears to be in the extent of the showing required for the taxpayer to carry its due process burden of demonstrating a lack of relation between its out-of-state operations and those within the taxing state. Accordingly, one might have expected the Motion to Dismiss or Affirm to meet head-on the assertion in the Jurisdictional Statement that the Idaho Supreme Court had sustained the apportionment of dividends from "functionally independent

128. Juris. Stmt., *supra* note 104 at 21a-22a App. A; *American Smelting,* 99 Idaho 924, 935, 592 P.2d 39, 50 (1979).

129. Juris. Stmt., *supra* note 104 at 22a-23a App. A; *American Smelting,* 99 Idaho 924, 935, 592 P.2d 39, 50 (1979) (emphasis added).

corporations operating entirely outside the taxing state."[130] To the contrary, however, virtually the opening submission in the Motion to Dismiss was

> [t]he issue is *not*—as ASARCO would have it—whether or not unitary connections exist between the payor corporations and the payee corporation but whether or not the intangible assets (represented by shares of stock or evidences of debt) are held and managed by ASARCO as part of its own overall unitary business a part of which is conducted in Idaho.[131]

Further, "[t]he dividends are ASARCO's own income. *That is why the relevant 'underlying activity' is ASARCO's own activity—its own business purpose for acquiring, managing or selling these intangible assets.*"[132] The supporting Brief Amicus Curiae of the Multistate Tax Commission asserted among other things, that "[t]o condition the constitutionality of inclusion of income from stock investments upon a finding that the investments are in corporations which conduct a unitary business with the investor is illogical and should not be read into Mobil."[133]

Since no reasonable person reading the *Mobil* opinion could have had any doubt that the Supreme Court had focused on the existence of an "underlying unitary business" between the dividend payor and the dividend payee as the essential basis for dividend apportionability in that case,[134] the arguments advanced are difficult to comprehend. On the facts, an excellent argument that the very functional integration *Mobil* had contemplated was present could have been made with respect to three of the divi-

---

130. Juris. Stmt., *supra* n.104 at 9-10.

131. Motion to Dismiss or Affirm at 6, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

132. *Id.* at 7 (emphasis added). Counsel for Idaho failed to contest the assumption of absence of functional integration or unitary business presented by the Jurisdictional Statement in favor of a broad and amorphous contention that the underlying activities of the dividend payor were irrelevant to the issue of apportionability—an argument which can only be seen as incredible in light of the language and holding of *Mobil.* The Motion to Dismiss or Affirm then proceeded to argue that there was no necessity for an adjustment in the factors of the payee corporation for the purpose of apportionment. This argument was grounded on the fact that "dividend income is the payee corporation's income [and therefore] it is entirely inappropriate to add the payor corporation's property, payroll or sales to the payee's factors. They are simply different taxpayers." *Id.* at 16.

133. Brief of Amicus Curiae Multistate Tax Commission in Support of Appellee's Motion to Dismiss or Affirm, at iii, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

134. *See* 445 U.S. at 439-42, and *supra* text accompanying notes 36-50.

dend-paying subsidiaries in question. Yet neither the State nor the supporting Amicus emphasized those facts in opposing the Jurisdictional Statement. The record suggests two primary explanations for this incongruity. First, the strategic objectives of the State and its supporting Amicus led to a broad attempt to prevail on all issues relating to dividend apportionment in the face of a more limited and thus apparently contrary approach in *Mobil.* That strategy succeeded in losing even in those areas where there should have been no question under the *Mobil* standards themselves. Second, perhaps even more fundamentally, there emerged a basic difference in vocabulary between the Supreme Court on the one hand, and the State and the supporting Amicus on the other, in their use of the "unitary business" terminology.

The second point is well illustrated in the Amicus Brief in Support of the State's Motion to Dismiss or Affirm. The Multistate Tax Commission there asserted:

> That *Mobil* does not limit the apportionability of dividends to only those cases or circumstances where the payor corporations and the payee corporation are engaged in a single unitary business, is supported by the fact that *Mobil* upheld the apportionment of Mobil's ARAMCO dividends in which it owned only a 10% stock interest, which limited ownership precluded a finding that Mobil conducted a unitary business with ARAMCO. Inasmuch as Mobil's investment in ARAMCO stock assured it of a supply of crude oil in its petroleum business, ARAMCO dividends are clearly apportionable because the ARAMCO stock investment of Mobil is related to the petroleum business of Mobil.[135]

Inasmuch as the Supreme Court in the *Mobil* opinion itself had assumed that ARAMCO could be characterized as part of the "unitary business" of Mobil despite only ten percent stock ownership,[136] it is apparent that the amici were using the term in a different sense. Minority stock ownership should indeed preclude the finding that ARAMCO was part of Mobil's unitary business for the purpose of *combined reporting.*[137] But the absence of a controlling ownership interest clearly does not pre-

135. Brief of Amicus Curiae Multistate Tax Commission in Support of Appellee's Motion to Dismiss or Affirm at 15-16, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

136. *See* 445 U.S. at 430 n.5, 435.

137. *See supra* text accompanying note 86.

clude a finding of sufficient "minimal connection" and "rational relationship" between the underlying business of the dividend payor and that of the dividend payee to justify due process apportionability—a significantly different question. It was in the latter sense that the *Mobil* Court is properly understood to have used the phrase "underlying unitary business."

The confusion of dividend apportionment criteria with unitary business combined report standards established by the Jurisdictional Statement and the Motion to Dismiss in *ASARCO* continued on all sides in the briefs on the merits, with additional emphasis. The "Questions Presented" by ASARCO specifically asserted, in the face of overwhelming record evidence to the contrary in the case of Southern Peru, that

> Idaho's inclusion in appellant's apportionable business income of dividends paid to appellant by *five functionally independent subsidiaries* and affiliates contravenes the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States.[138]

With respect to the fact that General Cable and Revere were customers of ASARCO, ASARCO pointed out that

> [t]he sale of a product by one independently managed corporation to another on an arm's length basis is the most common sort of transaction. If both corporations could be treated as being engaged in the same unitary business by reason of such sales, virtually the entire United States economy would constitute a single unitary business. Obviously more is required.[139]

The same point emerged in the discussion of Southern Peru:

> [I]t was perfectly possible to determine Southern Peru's separate income in an accurate, reliable fashion because the sales made to appellant were made on the same arm's length basis and at the same average prices which appellant paid to other completely unrelated suppliers who sold copper to appellant under long-term output contracts. . . . Where, as here, there is uncontradicted evidence establishing that the taxpayer has dealt with an affiliated supplier on the same arm's length basis as it has dealt with "many" other suppliers "in which [it] has no interest" . . . the profits made by the affiliated supplier are no more a part of the taxpayer's unitary business income than

138. Brief of Appellant at i, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982) (emphasis added).

139. *Id.* at 22.

the profits made by the unrelated suppliers.[140]

In focusing on the profits of the affiliated supplier rather than the apportionability of dividends, ASARCO was invoking combined reporting concepts. Moreover, ASARCO's effort to diminish the significance of functional integration by reliance on its alleged arm's length transfer pricing policy was inconsistent with *Exxon*. One would therefore have thought that the fact of functional integration and the inappropriateness of using combined reporting or separate accounting concepts as the test of apportionability of dividend income would have been the primary thrust of the arguments of the State and the Multistate Tax Commission. Such, however, was not the case.

At the outset of its brief, the State asserted that " 'functional integration' is not the proper due process test."[141] "Intangibles are part of a unitary business if they are acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business. . . . If the income is part of ASARCO's own unitary business, the minimal connection requirement is satisfied."[142] "[I]t is the unitary business purpose not the functional integration which is controlling."[143] "In short 'functional integration' is not and cannot be the exclusive test for determining whether dividend income may be subjected to apportionment."[144]

Similarly, in its argument directed to whether the factors of the dividend payor must be taken into account in apportioning the dividend income in question, the State left no doubt concerning its position that the existence of a "unitary business" was unnecessary to support dividend apportionment in the case before the Court:

> ASARCO admits that the five dividend payor corporations at issue in this appeal are *not* conducting a unitary business with ASARCO . . . . Because these companies were not engaged in a single unitary business together with ASARCO, including them in a combined report is inappropriate. . . . Instead, as we have shown, because the intangible assets generating this income were related to ASARCO's own unitary business, the

---

140. *Id.* at 24-25 (quoting Joint App., *supra* note 96, at 125a-127a).

141. Brief of Appellee at 3, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

142. *Id.* at 4.

143. *Id.*

144. *Id.* at 16.

dividends may be apportioned among those states in which ASARCO's unitary business is conducted. Because the unitary business is ASARCO's business—not the payor corporation's business—reflecting the payor's property, payroll and sales in the payee's apportionment formula is illogical.[145]

In rejecting "functional integration" as the *exclusive* test for dividend apportionability, the State was no doubt technically correct, as examples such as short-term investments of working capital needed in the business demonstrate.[146] But none of those alternative circumstances were present in *ASARCO* and the ar-

---

145. *Id.* at 29 (footnote omitted). The brief of the supporting Amicus Curiae Multistate Tax Commission is to the same effect:

> [ASARCO] bases its entire argument on the erroneous assumption that dividends must be attributable to the activities of payors, for apportionment purposes, which conflicts with *Mobil, supra,* and numerous other decisions of this Court.
>
> . . . .
>
> In disposing of the "form of dividends" argument, the *Mobil* Court did not differentiate dividends, for due process purposes, from any other class of income. It clearly did not limit the apportionability of dividends to situations in which the payor corporations and the payee corporation are engaged in a single unitary business. *Mobil* upheld the apportionment of Mobil's dividends from ARAMCO in which corporation it owned only a 10% stock interest. Because this limited ownership is less than 50%, it precludes a finding that Mobil conducted a unitary business with ARAMCO. . . .
>
> Obviously, apart from the unitary ties between the business of a payee corporation and that of a payor corporation, a relationship can exist between stock investments and the business of the payee corporation which is sufficient to justify the apportionment of income from intangibles. The key question as to the apportionability of income under UDITPA is: Whether the income is derived from investments made in connection with the taxpayer's unitary trade or business?
>
> . . . .
>
> To Condition the Constitutionality of Inclusion of Income from Stock Investments Upon a Finding that the Investments are in Corporations Which Conduct a Unitary Business with the Investor is Illogical and Should Not be Read into Mobil.
>
> . . . .
>
> . . . ASARCO premises this argument [requiring adjustment of apportionment factors to include those of the payor] on analogy to the results obtained by the combined reporting method. However, this argument is based on the fallacious assumption that the dividends in question were received from corporations with which it conducts a unitary business. But, the court below found that the payee corporations were not conducting a unitary business with ASARCO. . . . Therefore, ASARCO's reliance on "combined reporting" results and Justice Stevens' dissent in *Mobil,* is totally misplaced. Id. at 17.

Brief of Amicus Curiae Multistate Tax Commission and Participating States at 5, 11, 15, 17, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982) (citations and footnotes omitted).

146. *See infra* note 170.

gument was therefore wide of the mark. Similarly, if "unitary business" is used in the combined reporting sense, it is correct that the existence of a unitary business should not be the *sine qua non* for dividend apportionment. But the Supreme Court had stated that the "unitary business principle" and the existence of an "underlying unitary business," in the sense of relation or contribution to the in-state business of the taxpayer, *were* central to apportionability of dividend income in *Mobil.* There is no indication that the Court understood the different and more limited sense in which the "unitary business" terminology was used by the State and the Multistate Tax Commission in *ASARCO.* Their arguments could therefore have only been perceived as a frontal assault on the principles announced in *Mobil.*[147]

Having succeeded in running the gauntlet without any substantial challenge to its assertion that there was *no* functional integration between its own business and that of the dividend payors, including Southern Peru, ASARCO's Reply Brief was predictable. It asserted that Idaho and the Multistate Tax Commission had conceded their case:

> Idaho asserts . . . that "functional integration between the business activities of the payor and the activities of the payee is not a constitutional requirement" for the apportionment of dividends. But Idaho concedes, as it must, that "[i]n *Mobil,* the Court looked to functional integration between Mobil's operations and the business operations of the dividend-paying subsidiaries in order to conclude that there was a connection between the intangible assets held by Mobil which generated the income and Mobil's unitary business."[148]
> Nothing in Idaho's discussion of the facts . . . refutes the showing in appellant's opening brief . . . that the operations of the five dividend-paying companies were "distinct" and "separate" . . . from appellant's unitary business operations in the United States. As previously stated, Idaho has conceded . . . that the five dividend-paying companies "were not engaged in a single unitary business together with ASARCO." Under *Mobil,* the dividends are therefore not apportionable.[149]

147. *See supra* Section IV.

148. Reply Brief of Appellant at 2, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982) (quoting Brief of Appellee at 15-16, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982)).

149. *Id.* at 2 (quoting *Mobil,* 445 U.S. at 439, 441, and Brief of Appellee at 29, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982)).

The State's unwillingness to respond on the issue of functional and operational integration, thus disregarding the apparent factual record in *ASARCO,* continued in oral argument. Counsel for ASARCO, although conceding for purposes of argument that income from short-term investments for the purpose of providing working capital might be apportioned, characterized the investments at issue in the case before the Court as long-term investments in major operating companies, as to which the test was whether

> the underlying operations that generate the income used to pay the dividends [were] functionally related with the business activities of the recipient, so that it is impossible to unscramble the business and break it into separate component parts. If so, then it is a unitary business and the dividends ought to be apportioned along with all the other income of the unitary business.[150]

The Court then raised the following question:

> Do you think . . . our cases have laid down any criteria by which one determines functional integration?[151]

In response, counsel for appellant suggested,

> [B]asically you need to look at three factors . . . . *Ownership of the different enterprises is clearly necessary, but not sufficient* . . . . The second factor that I think should be looked at is the . . . management participation at an operational level.
>
> . . . .
>
> The third and most important criteria that I think you have to look at is the degree to which the various business activities involved are interrelated in some sort of functional working or operational sense.[152]

Counsel then addressed the question of the supply relationship of ASARCO with Southern Peru, which he contended could not justify apportionment because

> ASARCO had numerous supply contracts with many other unrelated parties who sold copper ores and concentrates to ASARCO under long-term contracts comparable to those

150. Transcript of Oral Argument (April 19, 1982) at 8, ASARCO, Inc. v. Idaho State Tax. Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

151. *Id.* at 14.

152. *Id.* at 15-16 (emphasis added).

> which ASARCO had with Southern Peru. There was testimony establishing that the prices charged under those contracts were the same as the prices paid to Southern Peru.[153]

The ensuing discussion then focused on the absence of management control as one of the three criteria for a unitary business that had been suggested by appellant.[154]

Counsel for Idaho, rather than challenging directly the ownership and control criteria for dividend apportionment that had been suggested by ASARCO's counsel, or discussing the significance of the supply relationship with Southern Peru, embarked on a discussion of the unitary concept that ultimately proved fatal to the State's case, and was a significant factor in shaping the ultimate *ASARCO* decision. He stated that:

> I think there are a couple of things that are sort of getting confused here. One of the prior questions was, are there two things here. Are there just unitary and not unitary. We don't think there are just two things here. We think there are three things. That is, you have this situation like with the asbestos companies [whose dividends were not apportioned] where the shares—the companies are not functionally integrated with the taxpayer, nor are the shares of stock held for purposes related to the business activities.
>
> You then have on the other end of the spectrum, and there were six subsidiaries with ASARCO that were held to be so functionally integrated, so interdependent in their business operations that they should be included in a combined report . . . . That is the issue that you will have later this afternoon in the Chicago Bridge and Iron v. Caterpillar case.
>
> This is really the third case. This is the case where the payor and the payee corporations *are not so functionally integrated that they are together conducting one single unitary business operation, but the shares of stock, the assets are held for purposes that are an integral and necessary part of that unitary—*.[155]

The Court responded with the following question:

> May I ask, to be sure we have it clearly understood, do you concede that this intermediate category is not part of the unitary business?[156]

---

153. *Id.* at 18.
154. *See id.* at 20-21.
155. *Id.* at 30-31.
156. *Id.* at 31.

Counsel for appellee responded:

> We have conceded, or we have not asserted that those subsidiary corporations are themselves together engaged with ASARCO in one unitary business. . . .[157]
>
> . . . .
>
> QUESTION: But then how are they different from acquisition, management, and shares of stock in a hotel company or an asbestos company?
>
> [Counsel for Appellee]: Because if they did own stock in the hotel company, there would be no relationship with the mining business. That is, that intangible asset would be unrelated to the mining business. This intangible asset, the shares of stock in the mining company that provided them a guaranteed source of supply, is related to this unitary business, part of which is conducted in the state of Idaho.
>
> QUESTION: Well, just being related, then, satisfies the integral and necessary part standard? Just being related. As long as your intangible relates to the mining business, it is ipso facto an integral and necessary part.
>
> . . . .
>
> [Counsel for Appellee]: What they [ASARCO] have said is that in the case of the shares of stock, there is an additional standard, that is, functional integration, and as we read Mobil, what this Court rejected in that Mobil decision was the idea that some special due process standard applied to dividends, that instead, whether—whatever the category of intangible or whatever the category of asset producing the income, the Court said that it was still incumbent upon the taxpayer to carve out some clear and cogent exception.
>
> Now, the functional integration language in ASARCO is useful to help show that there was a business purpose, that . . . Mobil had not shown that these assets were not part of its regular trade or business activities, but it is the business purpose for which those intangibles were held, in our view, that is

---

157. *Id.* Given the remarkable course of appellee's argument, which disclaimed reliance on any functional integration or unitary connection between the business of the dividend payor and that of the payee in *ASARCO,* despite *Mobil*'s repeated emphasis that the unitary business is the "linchpin" of apportionability, counsel for appellant's rebuttal was not surprising:

> [Counsel for appellee] has twice said during oral argument today that the five dividend-paying companies involved in this case were not part of ASARCO's unitary business. We think the undisputed facts in the record of this case . . . bears out the correctness of that concession, and on that we rest our case.

Id. at 53.

the significant thing for due process purposes, *not whether or not there was or wasn't functional integration.*

If there was functional integration, then we would combine, and we would view that as one single business entity, and we would in Idaho recognize the property, payroll, and sales of the entire business activity, and we would eliminate the intercompany transfers, including the dividends.

. . . .

And that is why we say that rather than there being simply two circumstances, unitary or not unitary, there is really three, because we are talking about, are they functionally integrated as one business activity, or are they—are the assets held for business purpose or is neither true.

QUESTION: How many states have the—follow the Idaho approach of there being a third category? Do you know?[158]

There were no doubt many reasons for the potentially self-destructive approach taken by appellee and the Multistate Tax Commission in their briefs and oral argument in *ASARCO.* Five subsidiaries were involved, and yet there was little apparent functional or operational interdependence between two of these, M.I.M. and Mexicana, and the operations of ASARCO in the United States.[159] Accordingly, the State could not rely excessively on the existence of functional integration. Perhaps of greater significance was the fact that a major issue presented in *ASARCO* was the troublesome question of whether the factors for apportionment of dividends received from subsidiaries and affiliates must be adjusted to take account of the underlying property, payroll, and sales of those subsidiaries and affiliates, as suggested by Justice Stevens in his dissent in *Mobil.*[160] The issue was not reached by the Court, since it held any apportionment to be a due process violation. However, by emphasizing their contention that the businesses of the dividend payors were not unitary with that of the payee, Idaho and amicus Multistate Tax Commission no doubt intended to lay the foundation for a holding that no adjustment of the factors of apportionment was necessary, because apportionment was based on the purpose of the taxpayer's holding of the stocks in question, and not on any relationship between the underlying businesses of the dividend payors and the taxpayer. Thus, the income should be viewed ex-

158. *Id.* at 36-37, 42-44 (emphasis added).
159. *See* 50 U.S.L.W. at 4966-67.
160. *See* 445 U.S. at 460-61.

clusively as that of the payee, not merely as a substitute for income of the payor, and for that reason no adjustment in apportionment factors would be necessary.[161] A third factor underlying the litigation strategy adopted by appellee and amicus was no doubt the recognition that the Court in *Mobil* could not have intended to permit apportionability of dividends only in situations involving functional integration between the business of the dividend payor and that of the dividend payee—as illustrated by situations in which stocks or other intangibles are held as a necessary part of the working capital of the taxpayer, as necessary security, or for other purposes which are an essential and integral part of the business of the taxpayer itself.

Even accepting all the foregoing, however, the review of the briefs and arguments set out above leaves the unmistakable impression that a primary reason for the result in *ASARCO,* in its unwarranted focus on management control, and its lack of attention to the significance of the supply relationship with Southern Peru, was a simple failure of communication. With the benefit of hindsight, it is apparent that the references to the absence of a "unitary" business in the briefs of the Multistate Tax Commission and the State were meant to refer to the absence of such "unitariness" as would permit combined reporting under the standards normally employed by the states as a matter of tax policy. The remarks of the Justices at oral argument show that they were contemplating a very different concept of "unitariness" as a basis for the dividend apportionment under *Mobil.* The absence of common vocabulary on the existence of a "unitary" business and the litigation strategy of appellee directly contributed to the result in *ASARCO* and to the imprecise language of the opinion which gives rise to potential misinterpretation regarding the principles consistently endorsed by the Court from *Butler Brothers* through *Mobil* and *Exxon.*

The reasons for the Supreme Court's failure in *ASARCO* to recognize the different considerations relevant to the "unitary" business concept for the purpose of combining reporting, on the one hand, and for dividend apportionment, on the other, are clear. ASARCO had emphasized the familiar "three unities" of the combined report test, based on *Butler Brothers*[162] and

---

161. *E.g., see supra* the arguments quoted at notes 132 and 145.

162. Butler Bros. v. McColgan, 315 U.S. 501 (1942).

Edison California Stores,[163] in its briefs. The State, pursuing its own litigation strategy, not only failed to challenge the correctness of that approach in the area of dividend apportionment, but affirmatively disclaimed the existence of a "unitary business" between Southern Peru and ASARCO. Although this disclaimer was no doubt intended to be limited to the existence of a unitary business in the combined reporting sense, the briefs and oral arguments did not make that limitation clear to the Supreme Court. This was especially true because the Court had never before had occasion to consider in depth the differing requirements that should be imposed for combination, as opposed to apportionment. Its opinion in *Mobil* had merely noted the apportionability of ARAMCO dividends, without commenting on the significance of the absence of majority stock ownership or management control.[164] Moreover, the potential for confusion was especially great in the *ASARCO* case, because on the very same day the Supreme Court heard arguments in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*[165] which presented purely a combined report issue.

In this posture, the Supreme Court's apparent assumption that "management control" is a necessary precondition to dividend apportionment is understandable but nonetheless erroneous.

V. The Supreme Court's Treatment of the *UDITPA* "Business Purpose" Test

The Supreme Court's *ASARCO* opinion is doubly unfortunate. Not only does it appear to elevate the form of management control over the underlying substance of due process contribution to the in-state business, but in so doing the Court appears to have called into question the constitutionality of UDITPA's general treatment of apportionment of intangible income. UDITPA provides for the apportionment of "business income," which is defined to mean

> [i]ncome arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral

163. Edison California Stores v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947).
164. 445 U.S. at 430 n.5.
165. 50 U.S.L.W. 3857 (U.S. set for reargument May 3, 1982) (No. 81-349).

parts of the taxpayer's regular trade or business operations.[166]

Based on this language, the Multistate Tax Commission has promulgated regulations, influential in the 29 states which have adopted the basic UDITPA approach, which make the characterization of income as apportionable "business" income (as opposed to allocable "non-business" income) turn largely on the "business purpose" for which intangibles are acquired or held.[167] A very similar approach has proved persuasive in a number of leading state court decisions.[168] This relatively uniform, workable, and sensible development has occurred without legislative guidance from the Congress under the commerce clause, and without constitutional guidance from the Supreme Court, which has remained above the fray. In *ASARCO,* however the Supreme Court stated,

> Idaho's proposal is that corporate *purpose* should define unitary business. It argues that intangible income should be considered a part of a unitary business if the intangible property (the shares of stock) is "acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business."
> . . .

---

166. UDITPA, *supra* note 4, § 1(a), 7A U.L.A. 93 (1978).

167. *See* Multistate Tax Commission Apportionment Regulations § IV.1(c) (3)-(5):

> Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.
>
> . . . .
>
> Dividends are business income . . . where the purpose for acquiring and holding the stock is related to or incidental to [the taxpayer's] trade or business operations.
>
> . . . .
>
> Patent and copyright royalties are business income . . . where the purpose for acquiring and holding the patent or copyright is related to or incidental to [the taxpayer's] trade or business operations.

ALL STATES TAX GUIDE (P-H) ¶¶ 633.20-633.30 (1977).

168. *See* Atlantic Richfield Co. v. State, 198 Colo. 413, 417-18, 601 P.2d 628, 632 (1979); Johns-Manville Products Corp. v. Commissioner of Revenue Admin., 115 N.H. 428, 430, 343 A.2d 221, 222-23 (1975); Sperry and Hutchinson Co. v. Department of Revenue, 270 Or. 329, 332-34, 527 P.2d 729, 731 (1974). *See also* Times Mirror Co. v. Franchise Tax Bd., 102 Cal. App. 3d 872, 162 Cal. Rptr. 630 (1980); Champion Int'l Corp. v. Bureau of Revenue, 88 N.M. 411, 414-15, 540 P.2d 1300, 1303-04 (1975); Montgomery Ward & Co. v. Comm'n of Taxation, 276 Minn. 479, 482, 151 N.W.2d 294, 296: "Intangible property is employed in a business if the corporation owning the intangible property holds it as a *means of furthering* the business operation of which a part is located within the territorial confines of this state." (Emphasis added.)

> This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently *all* of its operations, including any investment made, in some sense can be said to be "for purposes relating to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.[169]

These remarks were made without apparent awareness of their broad and potentially disruptive implications, and may well have thrown out the baby with the bathwater. It may be assumed that the Court was correct in rejecting the concept that the mere making of money in itself is a sufficient basis for due process apportionment in the absence of some showing of a more direct relationship between the intangible holdings and the business conducted within the taxing state, a fact recognized by the Idaho Supreme Court. One reason, however, why the briefs and arguments in *ASARCO* took the course that they did was that the functional integration language of *Mobil* took too little account of numerous situations in which the apportionment of dividends is appropriate under the due process clause even absent any relationship between the business of the dividend payor and that of the dividend payee. Functional integration between the business of the dividend payor and that of the payee is a *sufficient*, but not a necessary condition for apportionment.

As the examples contained in the regulations of the Multistate Tax Commission show,[170] stocks may be held as working

---

169. 50 U.S.L.W. at 4967. The primary basis for the Court's conclusion that the "business purpose" test might lead to "arbitrary" results was Idaho's failure to attempt to apportion dividends received from Lake Asbestos of Quebec, 50 U.S.L.W. at 4967 n.22. However, as Lake Asbestos was engaged in an unrelated line of business (extracting and processing asbestos fibers), the management ties present there provided a much less compelling basis for finding the necessary due process nexus with or contribution to ASARCO's domestic metals business than did the obvious functional and management relationships present in the case of Southern Peru.

170. Multistate Tax Commission Apportionment Regulations §§ IV. 1(c) (4) (i)-(vi) provide:

> Example (i): The taxpayer operates a multistate chain of stock brokerage houses. During the year the taxpayer receives dividends on stock it owns. The dividends are business income.
>
> Example (ii): The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A

capital, as security, or otherwise as an integral and necessary part of the taxpayer's business. Such situations are encompassed in a broader "business purpose" test, which is closely tied to the basic due process concept of contribution to the business conducted within the taxpaying state. As used in the UDITPA regulations, "business purpose" is not a potentially arbitrary test depending on hidden, subjective state of mind. It is a shorthand reference to the existence of underlying objective facts demonstrating a close or integral relationship between the business of the taxpayer and the income producing property. There is no basis under the due process clause to question the appropriateness of dividend apportionment under these circumstances, and, indeed, the oral argument[171] and footnote discussion in the Court's *ASARCO* opinion[172] suggest that it did not intend to do so. Yet, if the language of the Court condemning "business purpose" as a test of dividend apportionability is broadly construed,

---

portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business income.

Example (iii): The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer *acquired the stock in order to obtain a source of supply of materials used in its manufacturing business*. The dividends are business income.

Example (iv): The taxpayer is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business income.

Example (v): The taxpayer receives dividends from the stock of its subsidiary or affiliate *which acts as the marketing agency for products manufactured by the taxpayer*. The dividends are business income.

Example (vi): The taxpayer is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of which are unrelated to the manufacturing business. The dividends and interest income received are nonbusiness income.

ALL STATE TAX GUIDE (P-H) ¶ 633.25 (1977) (emphasis added). The approach of the Multistate Tax Commission regulations is strikingly similar to that taken in regulations under section 864(c)(2) of the Internal Revenue Code in determining whether domestic source dividend income of a foreign corporation is subject to regular U.S. tax rates because it is "effectively connected" with the conduct of a domestic trade or business. 26 C.F.R. § 1.864-4(c)(2) (1972).

171. *See* Transcript of Oral Argument (April 19, 1982) at 6-7, 9-10, ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982).

172. 50 U.S.L.W. at 4967 n.21.

it could be argued that *ASARCO* has declared the entire concept of the UDITPA apportionment provisions to be unconstitutional, at least insofar as they relate to income from intangible property.

The Supreme Court's broad language was unnecessary to resolve the specific issue before it. After *ASARCO* and *Woolworth*, it will be futile for the states or the Multistate Tax Commission to continue to argue for the equivalent of full apportionment of all dividend income based on the concept that any investment which makes money to that extent contributes to the underlying business of the taxpayer, and thus is subject to apportionment. The Court's analysis has retained the concept of geographic sourcing of income arising from the underlying business activities, and the necessity that activities conducted outside the taxing jurisdiction make some contribution to those within it. Where the objective facts indicate that the business purpose of the taxpayer's holding of a particular intangible is directly connected with the operation of the taxpayer's business in the taxing jurisdiction—beyond any enhancement that may flow from the increased availability of funds standing alone—there is no due process warrant for concluding that apportionment of income or profits received from such intangibles is "simply arbitrary."

VI. Factors for Apportionment

A second issue in *ASARCO* and *Woolworth* was that posed by Justice Stevens' dissent in *Mobil,* in which he argued that if apportionment of dividends were permitted, then the underlying factors of the dividend paying corporation should be taken into account in the denominator of the apportionment formula because otherwise "the inclusion of earnings attributable to those corporations in the apportionable tax base will inevitably cause Mobil's Vermont income to be overstated."[173]

Although the Court did not reach this issue because of its holding that the dividends of ASARCO's subsidiaries were not apportionable, its presence in the background may well have had an impact on the course of the proceeding and the Court's ultimate decision.[174] The effort of Idaho and the Multistate Tax Commission to resist the inclusion of the factors of the dividend

173. 445 U.S. at 461 (Stevens, J., dissenting).

174. *See supra* text accompanying notes 160-61.

payor in the apportionment formula led them to argue broadly that there was no unitary business between ASARCO and its subsidiaries under the facts of that case, and that the existence of such a unitary business was not necessary to dividend apportionability. This argument was the fatal flaw in their presentation which contributed significantly to the ultimate result reached by the Court in *ASARCO.* It is also reasonable to assume that the difficulties posed by the question of apportionment may have prompted the Court to avoid that issue by finding no basis for apportionability at all.

At the very least, the Court's decision on the apportionability of the Southern Peru dividends is incorrect.[175] For that reason, the Court should have reached the question of whether an adjustment of the factors in the apportionment formula was necessary in order fairly to reflect the contribution made by the activities of the dividend payor to the in-state activities of the taxpaying corporation. The answer to that question is far from clear.

To the extent that Justice Stevens assumed that the amount of dividend income received by a taxpayer could under no circumstances be apportioned without adjustment of the apportionment formula to take account of the factors of the dividend payor, he was mistaken. In several instances cited in the regulations of the Multistate Tax Commission,[176] such as the holding of working capital or security in the form of intangibles, the intangibles are just as much a part of the business of the taxpayer conducted within the taxing jurisdiction as any other asset or activity. Any profits or income realized on such intangibles in the normal course of business should obviously be included in the income subject to apportionment without any adjustment of the apportionment formula to reflect the factors of the dividend payor, for it is not the underlying business activities of the payor which provide the due process connection necessary to justify apportionment, but the holding of the intangibles themselves, standing alone, and without regard to that activity.

The more complex problem arises, however, where the intangibles reflect an ownership interest in an integrated out-of-state business, the operations of which contribute in some mea-

---

175. *See supra* text accompanying notes 87-96.

176. *See supra* note 170.

sure to the profitability of the enterprise within the taxing state. In that circumstance, a stronger argument for adjustment of the apportionment formula can be made, at least where the corporation operates essentially like a partnership in corporate form.[177] The literature[178] and the briefs in *ASARCO*[179] have debated variations of the suggestion that, in effect, the courts should evaluate a state's apportionment formula against the amount which would be attributed to the taxing jurisdiction by a combined report approach if such were permitted in the case of a noncontrolled corporation. By proportionately reducing the factors included in the denominator of the apportionment formula, such a "partial combination" approach would take into account both the minority interest of the taxpayer in the dividend-paying corporation, and the fact that not all profits of the dividend payor are paid to any shareholder in any particular year. Thus, for the purpose of apportioning dividend income, the payor's factors would be reduced in proportion to the dividend payee's ownership interest or, perhaps, by the ratio of dividend income received by the taxpayer to the entire dividends paid by the dividend payor to all of its shareholders. An additional proportionate reduction might be made to reflect the fact that not all of the net income of the dividend-paying corporation would be paid out in the form of dividends.

Even in the setting of the functionally integrated subsidiary, however, the case for adjustment of the apportionment formula in the manner suggested is far from clear. The due process clause does not impose any such detailed formula on the states as a matter of constitutional requirement. The states have wide latitude in defining factors and selecting formulas for apportion-

---

177. In California, a share of the factors of a partnership is attributed to the partners for the purpose of apportionment. Cal. Admin. Code 25137(e)(6), 1 CAL. STATE TAX REP. ¶ 12-448 B (CCH 1976).

178. *See e.g.*, Dexter, *supra* note 34 at 121-29; Hellerstein, *Allocation and Apportionment of Dividends and the Delineation of the Unitary Business*, 14 TAX NOTES 155, 160 nn.42, 45 (Jan. 25, 1982); Hellerstein, *supra* note 34 at 127-30; Keesling, *supra* note 34 at 101-03; Lathrop, *Due Process Considerations and the Apportionment of Dividend Income: A Dissent from the* ASARCO *and* Woolworth *Decisions*, 16 TAX NOTES 3, 16-17 (July 5, 1982); Peters, *Sup. Ct.'s* Mobil *decision on multistate income apportionment raises new questions*, 53 J. TAX'N 36, 39-40 (1980).

179. In ASARCO, Inc. v. Idaho State Tax Comm'n, 50 U.S.L.W. 4962 (U.S. June 29, 1982), see Brief of Appellant at 27-37, Brief of Appellee at 24-39, Brief of Amicus Curiae Multistate Tax Comm'n at 16-28. In F.W. Woolworth Co. v. Taxation and Revenue Dept., 50 U.S.L.W. 4957 (U.S. June 29, 1982), see Brief of Appellant at 32-41, Brief of Appellee at 25-33, Brief of Amicus Curiae Multistate Tax Comm'n at 20-25.

ing income, and only a "rough approximation" of income attributable to the taxing state is required.[180] The method of apportionment selected by a state is invalid under the due process clause only if the taxpayer can demonstrate that in actual operation it results in a *Hans Rees*[181] gross misattribution of income to the state. There is no a priori reason to believe that in every case of dividend apportionment, failure to include a portion of the factors of the dividend payor in the apportionment formula results in such a malattribution of income. Indeed, where stock in a functionally integrated but non-controlled subsidiary is held for the primary or sole purpose of obtaining assured supplies or markets, such stock would appear even more integrally connected with the conduct of the taxpayer's business within the taxing jurisdiction than stock held as working capital or security, as to which it seems obvious that no adjustment of the apportionment formula is required.

These questions in themselves constitute a major topic which departs from the main theme of this article and their resolution will not be attempted here. The present suggestion is simply that in many instances dividend apportionment should be permissible without regard to the factors of the dividend payor, and that the case for an automatic adjustment of the formula where apportionment is based on a functional integration between the business of the dividend payor and that of the payee is less clear than some commentators may have supposed.

Conclusion

The Supreme Court's opinion in *ASARCO* contains errors in reasoning, which, if interpreted without regard to the briefs and arguments before the Court, could lead to serious disruption in the field of state taxation. At this writing, the states of Idaho and New Mexico have petitioned for rehearing in *ASARCO* and *Woolworth*. Those petitions are supported by a brief amicus curiae on behalf of the Multistate Tax Commission and virtually all other interested states. Although the Supreme Court has been exceedingly chary of granting petitions for rehearing in recent years, the errors apparent on the face of the *ASARCO* opinion provide ample occasion for doing so, and we may hope that the Court will take that opportunity to grant rehearing and re-

180. *E.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273-74 (1978).
181. Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931).

consider the basic due process test for dividend apportionment, as opposed to combined reporting. If it does so, we may feel confident that the Court will realize that its decision in *ASARCO* was erroneous, at least insofar as the dividends received from Southern Peru were concerned, and perhaps with respect to General Cable and Revere Copper as well. A rehearing would also give the Court an opportunity to resolve the important issue of the approach that due process requires the states to take in adjusting the apportionment formula to take account of the underlying factors of the dividend payor.

Should rehearing be granted, the Court will issue opinions in the present Term, which, we may hope, will provide as enduring a foundation in the areas of combined reporting and dividend apportionment in the modern era as the Court's *Butler Brothers* decision did respecting general constitutional limitations on state taxation forty years ago. Should the Court determine to leave the confusion created by its *ASARCO* opinion unremedied, however, we may expect many years of turmoil in the state courts and in the Supreme Court itself before the issues that have been raised are finally resolved.