No. 89-1106

In The
Supreme Court of the United States

October Term, 1989

Trinova Corporation,
Petitioner,
v.
State of Michigan,
Respondent.

On Writ of Certiorari to the Michigan Supreme Court

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, U.S. CONFERENCE OF MAYORS, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL LEAGUE OF CITIES, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, AND INTERNATIONAL CITY MANAGEMENT ASSOCIATION; JOINED BY THE MULTISTATE TAX COMMISSION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

Benna Ruth Solomon *
Chief Counsel
Charles Rothfeld
State and Local Legal Center
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445

* *Counsel of Record for the* Amici Curiae

Wilson - Epes Printing Co., Inc. - 789-0096 - Washington, D.C. 20001

QUESTION PRESENTED

Whether Michigan's Single Business Tax, Mich. Comp. Laws § 208.1 *et seq.*, is consistent with the Commerce and Due Process Clauses of the federal Constitution.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES: Page

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-1106

TRINOVA CORPORATION,
Petitioner,

v.

STATE OF MICHIGAN,
Respondent.

On Writ of Certiorari to the Michigan Supreme Court

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, U.S. CONFERENCE OF MAYORS, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL LEAGUE OF CITIES, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, AND INTERNATIONAL CITY MANAGEMENT ASSOCIATION; JOINED BY THE MULTISTATE TAX COMMISSION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF THE *AMICI CURIAE*

Amici Council of State Governments, U.S. Conference of Mayors, National Conference of State Legislatures, National League of Cities, National Governors' Association, National Association of Counties, and International City Management Association are organizations whose members include state, county, and municipal governments and officials throughout the United States; they have a compelling interest in legal issues that affect state and local governments. *Amicus* Multistate Tax Commission is the official administrative agency of the Multistate

Tax Compact.[1] The Commission has a vital and continuing interest in tax disputes that may affect the administration of state tax systems.

This case involves a constitutional challenge to Michigan's Single Business Tax, the State's principal levy on business. Petitioner's argument calls into question methods that now are used by virtually all States to apportion the values of interstate businesses for purposes of state taxation; it also, at a time that many States are facing severe budget problems, challenges an innovative system of taxation that encourages investment and produces stable revenues. *Amici* therefore submits this brief to assist the Court in the resolution of this case.[2]

STATEMENT

1. Michigan's principal tax on business is a Single Business Tax (SBT), Mich. Comp. Laws (MCL) § 208.1 *et seq.*, that it imposes on all "business activity in [Michigan] which is allocated or apportioned to [Michigan]." MCL § 208.31(1). This taxable "business activity" is broadly defined to include the "transfer of legal or equitable title to or rental of property, * * * or the performance of services, or a combination thereof." MCL § 208.3(2). As interpreted by the Michigan Supreme Court, "[t]he subject of the [SBT] thus encompasses the complete range of entrepreneurial activities of which compensating employees is but one part." Pet. App. 22a.

Calculation of the value of this taxable "business activity" begins with federal taxable income. MCL §§ 208.3 (3), 208.9. See Pet. App. 11a; *Mobil Oil Corp. v. Department of Treasury*, 373 N.W.2d 730, 732, 741-742 n.15

---

[1] The Compact has been entered into by 18 States and the District of Columbia as full members; 12 additional States have joined the Compact as associate members. This brief should not be read to reflect the views of any member State that files a separate brief in this case.

[2] The parties' letters of consent pursuant to Rule 37 of the Rules of this Court have been filed with the Clerk of the Court.

(Mich. 1985). To this figure the taxpayer makes several additions that "reflect the business consumption of labor and capital" (Pet. App. 11a), including "compensation, depreciation, dividends, and interest *paid* by the taxpayer to the extent deducted from federal taxable income." *Ibid.* See MCL §§ 208.9(2)-(6). If the taxpayer is a multistate business, it then determines the portion of this business activity that is taxable in Michigan. It does so by attributing to Michigan the percentage of the firm's tax base (that is, the portion of its business activity) that is equivalent to the percentage of the firm's total business activity that it conducts in Michigan, as calculated by use of a three-part formula that itself is the average of three ratios: the ratio of the firm's in-state sales to its total sales; the ratio of its in-state property to its total property; and the ratio of its in-state payroll to its total payroll. MCL § 208.45. See Pet. App. 11a-12a.[3] Once apportioned (and as modified by certain adjustments not at issue here), the tax base is multiplied by the SBT tax rate of 2.35% to determine the taxpayer's liability. MCL § 208.31(1). See Pet. App. 13a.

2. Petitioner is an Ohio corporation that manufactures automobile components. Although most of its manufacturing takes place elsewhere, petitioner has fourteen sales and clerical personnel in Michigan. In 1980, the tax year at issue here, petitioner also made some 26.6% of its sales—worth $103,981,354—in the State. Pet. App. 7a.

For the year in question, petitioner had a total tax base of $221,125,319. Pet. App. 11a n.10. Using the SBT's three-part formula, petitioner concluded that just under 9% of this base, or $19,838,700 should be attributed to Michigan. *Id.* at 12a-13a n.12. Petitioner then was permitted to reduce this figure to $12,492,671 through application of a so-called excess compensation deduction

---

[3] The apportionment formula is taken from the Uniform Division of Income for Tax Purposes Act (UDITPA), 7A U.L.A. 322. See Pet. App. 12a n.12.

(the details of which have no bearing on the constitutional issues now before the Court). *Id.* at 13a n.13. Petitioner owed $293,528 on this amount, which it paid. *Id.* at 7a.

Petitioner subsequently brought this suit, seeking a refund and challenging the constitutionality of the SBT apportionment formula under the Commerce and Due Process Clauses. Pet. App. 7a-8a, 20a-21a. While petitioner acknowledged that the business income (or loss) portion of the tax base was subject to formulary apportionment, it contended that the three-part formula could not be applied to the compensation and depreciation elements of the tax base. Instead, petitioner argued that Michigan could tax only "actual" Michigan compensation and depreciation. See *id.* at 24a. Because petitioner's actual Michigan compensation was $511,774 and its actual Michigan depreciation was $2,152—and because petitioner had a substantial business *loss* for the year in question—it concluded that it had a negative tax base and accordingly had *no* tax liability. See *id.* at 8a & n.4. The Michigan Court of Claims accepted petitioner's contention (*id.* at 42a-51a), but the Michigan Court of Appeals reversed. *Id.* at 30a-41a.

The Michigan Supreme Court affirmed that judgment, sustaining the constitutionality of the SBT's apportionment provision. Pet. App. 1a-28a.[4] The court noted that this Court "long ago upheld the constitutionality of formulary apportionment" (*id.* at 23a), "reject[ing] separate accounting as a means to identify business activity by reference to a discrete geographic boundary." *Id.* at 22a. The court added that it did "not believe that

---

[4] Petitioner had brought suit under MCL § 208.69, which authorized relief when the statutory apportionment formula failed fairly to reflect the extent of the taxpayer's business activity in Michigan. See Pet. App. 5a-9a, 13a-14a. The court concluded that relief was available under Section 208.69 only when failure to modify the formula would result in a constitutional violation. Pet. App. 16a-17a. The court went on to find no such violation here. Section 208.69 has since been amended. See page 13, *infra*.

'business activity' as defined under the act is susceptible to accurate analysis when only one component of the total business effort is examined." *Id.* at 23a. Noting the enormous volume of petitioner's sales in Michigan (*id.* at 24a), the court concluded that "the averaged ratios of Trinova's payroll, property, and sales 'actually reflect a reasonable sense of how [its Michigan business activity was] generated,' clearly satisfying the constitutional requirements of internal and external consistency." *Id.* at 25a (bracketed material added by the court).

SUMMARY OF ARGUMENT

A. Petitioner concedes, as it must, that this Court repeatedly has upheld use of the three-part apportionment formula in dividing *income* for purposes of state taxation. Its attempt to avoid the force of these holdings rests on three propositions: that the SBT is a tax on segregable increments of "value added"; that these increments of value (in contrast with concededly apportionable income) are readily capable of precise territorial allocation; and that the use of sales ratios in the apportionment formula is in any event inappropriate because sales activity is irrelevant to the determination of a value added tax. Each of these propositions is incorrect. Petitioner mischaracterizes the SBT, and petitioner's economic assumptions are inconsistent with this Court's holdings.

1. At the outset, it is clear that the SBT was not intended to tax individual increments of value. It reaches all of a firm's "business activity," a term that is defined to include sales. And the incidence of the tax—the "business activity" upon which it is imposed—expressly was understood by the legislature to be a unitary and indivisible course of conduct commencing with a firm's purchase of raw materials and ending with its sale of the manufactured product. The theory of the tax therefore is that a firm cannot identify the "value added" by isolated elements of its activity, a theory that makes formulary apportionment unavoidable.

2. Petitioner contends that the taxed activity is not unitary because the costs of production (which petitioner equates with the "value added") can be localized. But that assertion is inconsistent with the analysis that this Court traditionally has used to decide tax apportionment cases. The same factors that make it impossible to tie the generation of income to a particular location—centralization of management and purchasing, economies of scale, functional integration, and so on—also frustrate attempts to compartmentalize the costs associated with particular elements of business activity. In this case, for example, the existence of a large market for petitioner's goods in Michigan necessarily affected the efficiency with which petitioner was able to make use of its labor and capital further up the production chain; it hardly is necessary to prove that an effective marketing operation is important to assure full use of production facilities.

3. Similar problems inhere in petitioner's argument that sales activity is irrelevant to the concept of value added. Sales are prerequisites to the effective use of manufacturing and a labor force; in fact, the Court has approved the use of sales ratios in apportionment precisely because they reflect a share of the activities by which value is generated. And since the services that Michigan provides to petitioner and its customers make possible petitioner's continuing business operations, there is nothing unfair in the State's seeking to tax a share of the values generated by those operations. Against this background, it is not surprising that the Court *already* has upheld use of the familiar three-part formula to apportion a tax that was virtually identical to the SBT. *Armco Steel Corp. v. Department of Revenue*, 102 N.W.2d 552 (Mich.), app. dismissed, 364 U.S. 337 (1960).

Indeed, invalidating the SBT would be an exercise in the most wooden formalism because—as petitioner concedes—the tax would be immune from constitutional attack were it simply labeled a levy on gross receipts. And the artificiality of petitioner's argument is especially apparent because value added taxes almost universally are understood to be, in practical operation, a form of sales tax. The label placed on the tax cannot change the nature of the economic values reflected in the tax base.

B. Petitioner also argues that the SBT discriminates against out-of-state businesses because, through use of a sales factor in the apportionment formula, it taxes "site-specific" out-of-state values while not taxing "site-specific" in-state values. But this claim rests entirely on petitioner's prior assertions that the costs of production are, in fact, "site specific," and that sales have no relationship to value added. Once it is understood that Michigan imposes the SBT on a unitary course of business activity that includes both production and sales, it is evident that out-of-state firms have no ground to complain because values are transferred neither into nor out of the State.

ARGUMENT

I. THE SBT IS FAIRLY APPORTIONED AND THEREFORE IS CONSISTENT WITH THE COMMERCE AND DUE PROCESS CLAUSES.

The principles that control the resolution of this case have become familiar. States may, of course, tax enterprises that operate in interstate commerce, so long as they do so within the parallel constraints set by the Commerce and Due Process Clauses. In relevant part,[5] those

[5] Under the now-familiar test first set out in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), the Court will "sustain[] a state tax 'against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.'" *Amerada Hess Corp. v. New Jersey Taxation Division*, 109 S.Ct. 1617, 1621 (1989), quoting *Complete Auto*, 430 U.S. at 279. The Court also has made clear that "the *Complete Auto* test encompasses due process standards." *Amerada Hess*, 109 S.Ct. at 1625. In this case, petitioner concedes the existence both of nexus and of a fair relationship between the tax and the services provided by the State; its principal challenge is to the apportionment prong

provisions require that any state tax be " 'fairly apportioned' " (*Amerada Hess Corp. v. New Jersey Taxation Division,* 109 S.Ct. 1617, 1621 (1989), quoting *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977)) so that there is "a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 436-437 (1980). See *Exxon Corp. v. Department of Revenue,* 447 U.S. 207, 219 (1980); *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267, 272-273 (1978). As a result, a valid "tax cannot be 'out of all appropriate proportion to the business transacted by the [taxpayer] in that State.' " *Exxon Corp.,* 447 U.S. at 220 (citation omitted). At the same time, however, "[a] state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." *Wisconsin v. J.C. Penney Co.,* 311 U.S. 435, 444 (1940).

The Court also has made clear that, when the tax base of a multistate enterprise "bears relation to benefits and privileges conferred by several States[,] * * * apportionment is ordinarily the accepted method" of determining the share of multistate values subject to taxation by a single State. *Mobil Oil Corp.,* 445 U.S. at 446. This typically is accomplished through use of a formula that attributes to the taxing State a percentage of the multistate firm's tax base (in most States, net income) that is equivalent to the percentage of the firm's total business activity conducted in that State. This latter proportion may be calculated by taking the ratio of the firm's in-state sales to its total sales,[6] the ratio of its in-state property

---

of the *Complete Auto* test. Petitioner also asserts that the SBT is discriminatory, a contention we discuss below.

[6] See, *e.g., Moorman,* 437 U.S. at 273-275.

to its total property,[7] the ratio of its in-state payroll to its total payroll—or, as is true in Michigan (and in most other states), by taking the average of these three proportions. Needless to say, the Court's approval of these formulary apportionment methods means that, "[a]s this Court has on several occasions recognized, a company's internal accounting techniques are not binding on a State for tax purposes." *Exxon Corp.*, 447 U.S. at 221.

In particular, when an enterprise is "unitary"—that is, when its multistate activities are interconnected with one another—the Court has refused to limit taxation of the firm's income to the State in which separate accounting shows that the income was produced. As the Court has noted:

> apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the interstate and extrastate activities formed part of a single unitary business. * * * In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. * * * Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source."

Mobil Oil Corp., 445 U.S. at 438. See *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 181 (1983); *Exxon Corp.*, 447 U.S. at 222-223; *Butler Brothers v. McColgan*, 315 U.S. 501, 508 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282-283 (1924);

---

[7] See, *e.g.*, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120-121 (1920).

Where unitary firms are involved, the Court accordingly has permitted States to use virtually any rational approach in apportioning the tax base. And the three-factor apportionment formula used by Michigan " 'has become something * * * of a benchmark against which other apportionment formulas are judged.' " *Amerada Hess*, 109 S.Ct. at 1621-1622, quoting *Container Corp.*, 463 U.S. at 170. That formula "has gained wide approval precisely because payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated." *Container Corp.*, 463 U.S. at 183.

Petitioner acknowledges the force of these governing principles (Br. 23-24), and evidently recognizes that it is a unitary business of the sort whose tax base ordinarily is subject to formulary apportionment. See Pet. App. 17a n.18. But petitioner nevertheless insists that Michigan may not use the three-part formula in identifying the values that are taxable in-state under the SBT. Petitioner's attempt to escape the force of this Court's decisions approving use of formulary apportionment rests on three propositions: that the SBT is a tax on segregable increments of "value added" by a multistate business (Br. 25); that these increments of value (in contrast, according to petitioner, with concededly apportionable income or profit) "are readily capable of precise territorial allocation both in theory and practice" (Br. 25); and that use of sales ratios in the apportionment formula is in any event inappropriate because "sales, in and of themselves, have no proper independent function in the determination of a value added tax" (Br. 34). In our view, however, each of these propositions is demonstrably incorrect: petitioner's description of the SBT is simply inaccurate, and its economic assumptions are flatly inconsistent with the teachings of this Court.

A. The SBT Is A Tax On The Unitary Course Of Business Activity.

At the outset, petitioner fundamentally misdirects what should be the proper inquiry here. Its arguments are aimed at a sort of imaginary, theoretical value added tax (VAT) that is imposed on individual increments of value, that "is based on the origin principle of taxing value where it is added" (Br. 25), and that entirely disregards sales activity. But that tax is, very simply, not the Michigan SBT. While the SBT is, of course, "a form of value added tax" (Pet. App. 9a-10a), Michigan's levy in terms is imposed on all of a firm's "business activity in [Michigan] which is allocated or apportioned to [Michigan]." MCL § 208.31(1). And the incidence of this tax—the "business activity" upon which it is imposed—was understood by the legislature to be a unitary and indivisible course of conduct commencing with a firm's purchase of raw materials and ending with its sale of the manufactured product.

The SBT accordingly defines taxable "business activity" as broadly including any "transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof." MCL § 208.3 (2). This definition, of course, specifically includes sales activity.[8] As the court below explained, in an interpretation of state law that is conclusive here, "[t]he subject of the [SBT] thus encompasses the complete range of entrepreneurial activities of which compensating employees is but one part." Pet. App. 22a.[9] See *id.* at 18a.

---

[8] As petitioner recognizes (Br. 33 n.24), the SBT treats a sale as having occurred in Michigan whenever a product is shipped to a purchaser in the State, "regardless of the free on board point or other conditions of the sales." MCL § 208.52(a). See Pet. App. 24a-25a n.25. Granting the existence of nexus to tax, petitioner does not—and plainly could not—find anything unconstitutional in this provision.

[9] Petitioner's statement (Br. 25) that the SBT "is based on the origin principle of taxing value where it is added" is nonsensical. As commonly used in the VAT setting, the term "origin principle"

Indeed, while petitioner evidently finds it significant that the SBT makes use of the addition method of computation (Br. 37),[10] the Michigan Legislature has made

---

simply means that the tax is imposed at the point of production; the term "destination principle" means that the tax is imposed at the point of consumption. See, *e.g.*, 3 U.S. Dep't of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth* 11-12 (1984) (hereinafter cited as "3 *Tax Reform*") ("If a product is taxed where it is produced, it is said to be taxed on the basis of its origin or place of production. Alternatively, if a product is taxed where it is consumed, it is taxed on the basis of its destination or location of consumption."). These concepts have relevance in the context of international trade (see *id.* at 11-13); it is not at all clear that they are meaningful in discussing the SBT, which is an apportioned tax on all business activity, from production through sale. But insofar as petitioner's business is concerned, it is plain that the SBT was intended to reach the properly apportioned part of all unitary values associated with the production and sale of its products in Michigan, and in that sense is imposed at the point of consumption.

[10] As petitioner seems to acknowledge (Br. 5) and as economists universally recognize, the method of calculation—whether addition of costs or subtraction of expenses—is irrelevant to the nature of the tax because the two methods will produce identical tax bases; "the result of the subtraction is identical with the sum of the addition." Smith, *Value-added tax: the case for,* Harv. Bus. Rev. 77, 78 (Nov.-Dec. 1970). See, *e.g.*, American Bar Ass'n, *The Choice Between Value Added and Sales Taxation at the Federal and State Levels in the United States,* Fourth Report of the Special Comm. on the Value-Added Tax of the Section on Taxation, 29 Tax. Law. 457, 458-459 (1976) ("The addition method reaches the same result [as the subtraction method] by the opposite means."); Aaron, *Introduction,* in *The Value Added Tax* 1, 2 (H. Aaron ed. 1981); Barlow & Connell, *The Single Business Tax,* in *Michigan's Fiscal and Economic Structure* 673, 673 (H. Brazer ed. 1982) (methods "identically equal"); Haughey, *The Economic Logic of the Single Business Tax,* 22 Wayne L. Rev. 1017, 1018 (1976) ("equivalent methods"). That plainly was the understanding of those who drafted and administer the SBT: addition and subtraction are "two *alternative,* but *equivalent* ways of calculating value added. * * * The important point is that, conceptually, these two calculations are *equal.*" Taxation and Economic Policy Office, Mich. Dep't of Treasury, *Analysis of the Michigan Single Business Tax* 20 (1985) (hereinafter cited as "*SBT Analysis*") (emphasis in origi-

explicitly clear that the tax is a levy on what it meant to treat as a unitary course of business activity. In 1987 the SBT was amended to provide that "the apportionment provisions of this act shall fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of the tax base such as depreciation, compensation, or income." MCL § 208.69(3) (Supp. 1990). This amendment "express[ed] the original intent of the legislature that the single business tax imposed under the single business tax act * * * is an indivisible value added type of tax and not a combination or series of several smaller taxes." 1987 Mich. Pub. Acts 39, § 2, reprinted at Note to MCL § 208.69 (Supp. 1990).[11] The theory of the tax therefore is that it is impossible to identify the "value added" by isolated elements of a firm's business activity, a theory that makes formulary apportionment unavoidable.

The SBT thus includes values associated with all business activity (including sales) in the tax base,[12] and was

---

nal). See Pet. App. 10a. Michigan chose the addition method of computation simply as a convenience for taxpayers, because "taxpayers can use business income as required for federal business taxes as the starting point in the computation." *SBT Analysis* at 21. See Haughey, *supra,* 22 Wayne L. Rev. at 1025.

[11] The Michigan Supreme Court noted this amendment (Pet. App. 19a n.20, 27a n.29), although the court found it unnecessary to rely upon the statutory change in rejecting petitioner's contention that " 'business activity' as defined under the act is susceptible to accurate analysis when only one component of the total business effort is examined." Pet. App. 23a. See also *id.* at 22a. For its part, the court of appeals below noted that under Michigan law the legislature "can amend a statute to make plain what the legislative intent had been all along from the time of the statute's enactment * * *. [The] timing indicates that the [1987] amendment was a legislative interpretation of the original act rather than a substantial change of it." Pet. App. 40a.

[12] In a sense, sales are the foundation of the SBT tax base. In calculating that base, "the starting point is business income" as reflected in the taxpayer's federal return. *Town & Country Dodge,*

written on the understanding that particular business activities (or, in petitioner's terms, particular increments of value added) are not segregable. Whether a theoretical VAT might regard sales as irrelevant, or might treat the value added by particular business activities as divisible—points we address below—accordingly is beside the point. The incidence of the tax actually at issue here, the SBT, is on petitioner's unitary course of business activity, and "[f]or constitutional purposes the decisive issue turns on the operating incidence of a challenged tax." *J.C. Penney*, 311 U.S. at 444. As the court below therefore explained, "to conclude that a taxpayer's business activity is not fairly apportioned because a single component of that activity, when viewed by geographical accounting, is not accurately reflected under the statutory apportionment scheme belies the very definition of business activity" in Michigan law. Pet. App. 22a.

With this understanding of the SBT, Michigan's three-part formula plainly does a constitutionally adequate job of apportioning the tax base upon which the levy expressly is laid. The tax in principal part is imposed upon "values" produced by activity involving sales, labor, and capital; given the incidence of the tax, "the averaged ratios of Trinova's payroll, property and sales 'actually reflect a reasonable sense of how [its Michigan business activity was] generated.'" Pet. App. 25a (bracketed

---

Inc. v. Department of Treasury, 362 N.W.2d 618, 623 (Mich. 1984). See *Mobil Oil Corp. v. Department of Treasury*, 373 N.W.2d 730, 732, 742 (Mich. 1985). Gross receipts are, in turn, the starting point in calculating federal business income; to derive an income figure for federal tax purposes, the taxpayer deducts specified expenses from gross receipts. Under the SBT, this process is then reversed; the taxpayer adds back to federal taxable income most expenses, principally those that were deducted from gross receipts in computing the federal income figure. See MCL § 208.9. See generally Kasischke, *Computation of the Michigan Single Business Tax: Theory and Mechanics*, 22 Wayne L. Rev. 1069, 1079-80 (1976). In the aggregate, these additions produce a tax base that is equivalent to gross receipts minus payments made to other business enterprises.

material added by the court) (citation omitted). Unless the Commerce and Due Process Clauses preclude the State from treating business activity as a unitary course of conduct, then, the SBT cannot be disturbed.

B. Costs Of Production Or Value Added Cannot Be Ascertained Through Geographical Accounting.

Although petitioner never comes to grips with the nature of the SBT as a tax on business activity,[13] the centerpiece of its assault on the apportionment of VATs generally is its contention that increments of added "value" may be—and therefore must be—taxed at the place where they are generated. "In this respect," petitioner adds, "the components of added value are conspicuously unlike the abstruse and elusive elements of profit that justify apportionment of net income" (Br. 26). This assertion is the crucial element both of petitioner's attempt to avoid formulary apportionment of the SBT tax base (see Br. 23-28) and its contention that the SBT taxes values that are added outside of Michigan (see Br. 31, 34-35).

At the outset, as respondent correctly notes (Resp. Br. 47-50), petitioner's attempt to equate the costs of production with particular increments of added "value" misstates the theory of the VAT. VATs typically are understood to operate on the principle that "[e]ach increment in *price* reflects the value added at that stage, with the value or price of the final product equal to the sum of the increments or values added at the various stages." R. Musgrave & P. Musgrave, *Public Finance in Theory and Practice* 400 (5th ed. 1989) (emphasis added). And that value—as reflected in price—has no necessary (and certainly no precise) correlation to the costs of production. The theory of VATs generally, as of the SBT in particu-

[13] Petitioner briefly notes that the court below treated the SBT as a tax on unitary business activity, labeling that court's analysis "simply inconsistent with the practical and intended effect of the tax." Br. 28. In fact, there can be no doubt that the Michigan Supreme Court correctly identified the intended incidence of the tax, which in terms reaches "business activity."

lar, accordingly is that taxable value is determined by the market's reaction to the enterprise's unitary course of business activity.[14]

But even if the case is viewed in petitioner's own terms, its analysis is fatally flawed, for petitioner never explains why costs of production differ in principle from the elements of profit that concededly cannot be confined geographically. And the omission is telling. In fact, the same factors that make it impossible to tie the generation of income to a particular location—centralization of management and purchasing, economies of scale, functional integration, and so on—also frustrate attempts to compartmentalize the costs associated with particular elements of business activity (or, to put it in petitioner's terms, the value added by such activity). In this case, for example, the existence of a reliable (and very large) market and distribution network for petitioner's goods in Michigan necessarily affected the efficiency with which petitioner was able to make use of its labor and capital further up the production chain; the price petitioner paid for labor in Ohio (the measure, in petitioner's view, of the value added there) turned in part on the scope and success of its sales activity in Michigan. This seems self-evident; it hardly is necessary to prove that "[a]n effective marketing operation is important to assure full or nearly full use of [production] capacities." *Exxon Corp.*, 447 U.S. at 226. Plainly, such efficiencies "arise from the

[14] The peculiarity of petitioner's concept of the VAT, in which costs of production are equated dollar-for-dollar with value added, is made clear by considering the case of a firm—like petitioner itself—whose costs of production exceed its value added because it had a net loss. In such a case, under petitioner's view, the "value" added to a product by application of the costs of production must somehow have been reduced by the failures of entrepreneurship that led to the net loss. It is difficult to imagine any coherent theory of value that produces such an effect. In fact, petitioner really seems to imagine that VATs are combinations of two wholly distinct taxes, one on profits and one on the costs of production. But that is not the usual understanding of the VAT and, as we explain above, plainly is not the theory upon which the SBT is imposed.

operation of the business as a whole." *Mobil Oil Corp.*, 445 U.S. at 438.

There is nothing novel in these observations. To the contrary, the very definition of the unitary enterprise "is that there be some sharing or exchange of *value* not capable of precise identification or measurement." *Container Corp.*, 463 U.S. at 166 (emphasis added). See *id.* at 178 (emphasis in original) ("The prerequisite to a constitutionally acceptable finding of unitary business is a flow of *value*"). As a result, geographical accounting "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Id.* at 164-165.

In *Container Corp.*, the Court applied this understanding to reject a multinational taxpayer's argument that, because wage rates were lower at its overseas plants than at its domestic facilities, California's use of the three-factor apportionment formula allocated too much of the firm's income to the State. As the Court explained, it

> may well be that in addition to the foreign payroll going into the production of any given [item] by a foreign subsidiary, there is also California payroll, as well as other California factors, contributing—albeit more indirectly—to the same production. The mere fact that this possibility is not reflected in [the taxpayer's] accounting does not disturb the underlying premises of the formula apportionment method.

463 U.S. at 182. While petitioner asserts (for reasons that it nowhere explains) that the Court's observation has relevance only to taxes on profits (Br. 27-28), the important point for present purposes is what the Court itself has characterized as *Container Corp.*'s recognition that "the costs of a unitary business cannot be deemed confined to the locality in which they are incurred." *Amerada Hess*, 109 S.Ct. at 1622. In *Container Corp.*'s words, costs (or value added) other than those identified by geographical accounting may "go[] into the production of any given" good.

Indeed, only last Term the Court squarely held that, "just as * * * revenue—as part of a unitary business—is not confined to a single State * * *, so too the costs of producing this revenue are unitary in nature. See *Container Corp.*, 463 U.S. at 182." *Amerada Hess*, 109 S.Ct. at 1622. In *Amerada Hess*, unitary oil companies argued that they should be permitted to deduct from the income that was subject to taxation in New Jersey windfall profits taxes that they had paid on the production of oil out-of-state; "[t]hey argue[d] that the denial of a deduction for an out-of-state expense causes a State to tax more than its fair share of a unitary business' income." *Ibid.* But because the costs of a unitary business cannot be confined geographically, the Court held that, "when a State denies a deduction for a cost of a unitary business, the resulting net figure is still a unitary one." *Ibid.* See generally *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939).

Again, the significance of this holding for petitioner's argument is plain: costs of production—which, in petitioner's terminology, are the values added—cannot be localized. Just as the profit that a multistate firm derives from its retail outlet in Wisconsin might be boosted by economies of scale effected elsewhere (see *Exxon*, 447 U.S. at 225-227), so, too, at the other end of the process, petitioner's costs of production in Ohio surely are affected by the scope of its sales operation in Michigan. It accordingly is petitioner's scheme, in which increments of value would be "wrenched from the unitary whole and conceptually confined to operations within a single State" (*ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 333 (1982) (O'Connor, J., dissenting)), that would produce a grossly distorted system of apportionment.

C. Sales Are Crucial Components Of The Unitary Course Of Business Activity And May Be Used To Apportion Petitioner's Tax Base.

Similar problems inhere in petitioner's argument (Br. 30-31, 32, 33-34) that sales activity is irrelevant to the concept of value added and therefore cannot be used as part of Michigan's apportionment formula. In fact, the Court has made clear that sales ratios have an appropriate role in apportionment precisely because, in combination with payroll and property, they "reflect a very large share of the activities by which value is generated." *Container Corp.*, 463 U.S. at 183. After all, as we explain above, sales and marketing are prerequisites to effective use of manufacturing facilities and a labor force. See, *e.g.*, *Exxon Corp.*, 447 U.S. at 226. Indeed, it seems self-evident that, in the most practical sense, many of petitioner's activities (or, more precisely, the 26.6% of petitioner's activities that terminated in Michigan sales) would be wholly value*less* to petitioner were it not for the market made available by Michigan. As a consequence, there is nothing unfair in Michigan's imposition of a tax on the appropriate portion of the values generated by those activities.

Petitioner's conduct of extensive sales activity in Michigan has special relevance to the nature of the due process guarantee that it invokes. In perhaps the Court's most oft-quoted comment on the nature of the constitutional limits on state taxing authority, it explained that "the sole constitutional test for a case like the present one" is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return." *J.C. Penney*, 311 U.S. at 444. And the State plainly has done that here, offering petitioner and its customers " 'police and fire protection, the benefit of a trained work force' " (*Amerada Hess*, 109 S.Ct. at 1624 (citation omitted)), "public roads" (*D.H. Holmes Co. v. McNamara*, 108 S.Ct. 1619, 1624 (1988)), and the other "fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes." *J.C. Penney*, 311 U.S. at 446.[15] It is these benefits provided

[15] See, *e.g.*, *Amerada Hess*, 109 S.Ct. at 1624; *D.H. Holmes Co.*, 109 S.Ct. at 1624; *ASARCO*, 458 U.S. at 315; *id.* at 332 (O'Connor,

by Michigan that make possible the continuing business operations that petitioner conducts elsewhere. This analysis plainly has application to the SBT, for "'[t]he logic or rationale of the [VAT] rests squarely on the benefit received principle of taxation—government services are essential to the operation of any business enterprise * * * and part of these public service costs should properly be included in the cost of doing business.'" Advisory Comm'n on Intergovernmental Relations, *The Michigan Single Business Tax: A Different Approach to State Business Taxation* 4 (1978) (citation omitted) (hereinafter cited as "*Michigan SBT*").

Against this background, it should come as no surprise that the Court already has upheld against constitutional attack another Michigan VAT that was virtually identical to the SBT. From 1953 until 1967 Michigan levied a Business Activities Tax that "employ[ed] as its measure or base the economist's measure of value added." Lock, Rau & Hamilton, *The Michigan Value-Added Tax*, 8 Nat'l Tax J. 357, 357 (1955). While that tax differed from the SBT in some particulars, its principle was the same: it included in the tax base "a company's payroll, profits, and capital outlay less depreciation allowed" (*id.* at 361), and it used the familiar three-factor formula to apportion the values of multistate firms. *Id.* at 363. See Mich. Stat. Ann. §§ 7.557(1)-(24) (1955 Cum. Supp.), repealed 1967 Mich. Pub. Acts 281.[16]

J., dissenting); *Exxon Corp.*, 447 U.S. at 228; *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445 (1979).

[16] While the taxes differed in the exemptions they offered (none of which are relevant here), the principal substantive difference between the Business Activities Tax and the SBT lay in the area of depreciation. The SBT allows firms to exclude apportioned capital expenditures from the tax base in the year incurred (MCL § 208.23(a)); in subsequent years depreciation is included in the tax base. Under the Business Activities Tax, the initial capital expenditure was not excluded, but firms were permitted to exclude

In a case bearing remarkable similarities to this one, the Business Activities Tax was challenged on Due Process and Commerce Clause grounds by an Ohio corporation that paid less than 1/1000 of its payroll, and had less than 1/40,000 of its property—but made almost 10% of its total sales—in Michigan. See *Armco Steel Corp. v. Department of Revenue*, 102 N.W.2d 552, 555-556 (Mich.), app. dismissed, 364 U.S. 337 (1960). Noting that the tax actually levied on the Ohio firm amounted to only about 1/10 of one per cent of its Michigan sales, the Michigan Supreme Court held that "[t]his is not an unreasonable tax on business activities in Michigan. The tax as apportioned bears a real and reasonable relationship to the privileges, opportunities and protection [the taxpayer] enjoys in conducting its interstate business in this State." *Id.* at 563. This Court found so little merit in the taxpayer's challenge to the state court's conclusion that it dismissed the appeal for want of a substantial federal question. 364 U.S. 337 (1960). That judgment should be dispositive of petitioner's essentially identical arguments here.

---

depreciation of real property in subsequent years. See Lock, Rau, & Hamilton, *supra*, 8 Nat'l Tax J. at 359-360; *Michigan SBT* at 17. The taxes also differed in their methods of computation. While the SBT adds together elements of the tax base, the Business Activities Tax used the subtraction method, starting with gross receipts and subtracting certain taxes, amounts paid other firms for raw materials, and real property depreciation. See *ibid.* As we explain above, however, the method of calculation has no effect either on the tax base or on the theory of the tax. See note 10, *supra.* The Business Activities Tax thus is consistently regarded as having been a form of VAT. See, *e.g.*, *Michigan SBT* at 17; Due, *Economics of the Value Added Tax*, 6 J. Corp. L. 61, 61-62 n.4 (1980); Haughey, *supra*, 22 Wayne L. Rev. at 1024, 1026; Lindholm, *The Origin of the Value-Added Tax*, 6 J. Corp. L. 11, 12 & n.10 (1980); Lock, Rau & Hamilton, *supra*, 8 Nat'l Tax J. at 357. In addition, the Business Activities Tax, like the SBT, allowed the taxpayer, at its option, to use as the tax base 50% of its gross receipts apportioned to Michigan. See *id.* at 360.

D. The SBT Should Be Upheld As A Variant Of A Concededly Constitutional Gross Receipts Tax.

1. The wholly artificial nature of petitioner's contentions is made clear by its concession (Br. 35-36)—a concession compelled by this Court's decisions—that Michigan's tax would be immune from constitutional attack were it labeled a tax on gross receipts. As the Court has noted in similar circumstances, in response to a challenge to an Iowa income tax, "it would be an exercise in formalism to declare [the taxpayer's] income tax assessment unconstitutional * * *. For it is evident that [the taxpayer] would have had no basis for complaint if, instead of an income tax, Iowa had imposed a more burdensome gross-receipts tax on the gross receipts from sales to Iowa customers." *Moorman*, 437 U.S. at 280. See *id.* at 281 (Brennan, J., dissenting) ("I agree with the Court that, for purposes of constitutional review, there is no distinction between a corporate income tax and a gross-receipts tax.").

The Court has, of course, repeatedly sustained state authority to impose gross receipts and similar taxes on the in-state sales of multistate businesses.[17] Yet such taxes are considerably more burdensome than the SBT: they need not be apportioned at all. See, *e.g.*, *Goldberg v. Sweet*, 109 S.Ct. 582, 589-591 (1989). In this light, the SBT, which is equivalent to a tax of less than 3/10 of one per cent of the gross receipts from petitioner's Michigan sales (see Pet. App. 7a), is hardly excessive. Compare *Moorman*, 437 U.S. at 280; *Armco*, 102 N.W.2d at 562.

Relying on *McLeod v. J. E. Dilworth Co.*, 322 U.S. 327 (1944), in which the Court struck down a state sales tax despite the State's authority to impose an equivalent use

[17] See, *e.g.*, *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232, 243 (1987); *Complete Auto*, 430 U.S. at 289; *Standard Pressed Steel Co. v. Washington Revenue Dep't*, 419 U.S. 560, 564 (1975); *General Motors Corp. v. Washington*, 377 U.S. 436, 448 (1964); *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 58 (1940). Cf. *Goldberg v. Sweet*, 109 S.Ct. 582, 589-591 (1989); *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 557 (1977).

tax, petitioner nevertheless takes issue with *Moorman's* analysis, asserting that the SBT cannot be validated by the availability of some alternative constitutional tax. But as petitioner elsewhere acknowledges (Br. 28), the Court has since departed from the formalistic approach of holding the label on the tax dispositive, looking instead to the practical operation of a tax and eschewing rules that "stand[] only as a trap for the unwary draftsman." *Complete Auto,* 430 U.S. at 279. See *id.* at 288; *J.C. Penney,* 311 U.S. at 444. *Moorman* accordingly reflects the Court's current thinking, and there is no reason to depart from its eminently practical analysis.

Indeed, the Court's observations in *Moorman* have particular resonance in this case because the SBT may fairly be viewed, in its practical operation, as a form of tax on gross receipts. While a VAT has some relationship to a tax on income, as we explain below, in effect "[a] value-added tax is a multistage sales tax." 3 *Tax Reform* at 5. See *id.* at 14. Economists almost uniformly agree that "the value-added tax is not a genuinely new form of taxation but merely a sales tax administered in different form." R. Musgrave & P. Musgrave, *supra,* at 399. Thus, "[i]t is essential for an understanding of the value added tax to note that the levy is identical to a retail sales tax of equivalent coverage and rate in both revenue and distribution of the tax burden." Due, *supra,* 6 J. Corp. L. at 62. See, *e.g., R.* Musgrave & P. Musgrave,, *supra,* at 401; Carlson, *Value-Added Tax: Appraisal and Outlook,* 6 J. Corp. L. 37, 38 (1980); McDaniel, *A Value Added Tax for the United States? Some Preliminary Reflections,* 6 J. Corp. L. 15, 16-17 (1980). See generally C. Sullivan, *The Tax on Value Added* 6, 209 (1965). The reason is plain: whether computed through addition or subtraction, the tax base of a pure VAT will include most of the costs of production in combination with profit (or loss), an amount that necessarily bears a close relationship to—but typically will be somewhat less than—gross income. See, *e.g.,* R. Musgrave & P. Musgrave, *supra,* at 402 ("the value-added tax of the consumption type has the same base as a retail sales tax with corresponding coverage").[18]

For their part, the drafters of the SBT plainly understood that its real incidence has a close relationship to that of a gross receipts tax. Indeed, as "an alternative tax computation method" (*SBT Analysis* at 38), the SBT provides that, if a firm's adjusted tax base exceeds 50% of gross receipts apportioned to Michigan, "the adjusted tax base may, at the option of the taxpayer, be reduced by such excess." MCL § 208.31(2). As a result, no firm's tax base may exceed 50% of its Michigan sales[19]; because the SBT rate is 2.35%, no firm's tax liability ever should exceed 1.175% of its gross receipts. See *SBT Analysis* at 38.[20]

To be sure, petitioner insists that this element of the SBT is irrelevant, labeling it a "departure[] from a 'pure' VAT" and stating that most Michigan taxpayers compute their tax base "without reference to their gross receipts." Br. 37. "Pure" VATs, however, are most often conceptualized as involving use of the subtraction method of computation, which uses gross receipts as its starting point.[21] Moreover, as we note above—and as petitioner elliptically

---

[18] For a fully integrated company that owns its own raw materials and produces its own capital equipment, the "value-added tax base would be simply its net sales." Smith, *supra* at 78. For non-integrated firms, of course, the base would be equivalent to gross receipts less purchases from other enterprises that have added value to the product.

[19] Petitioner states that "for some taxpayers (but not for petitioner) the tax base is reduced" to 50% of apportioned gross receipts. Br. 37. In fact, petitioner could have used the gross receipts option but declined to do so, instead taking advantage of another deduction that permits a firm with high labor costs to reduce its adjusted tax base by the percentage that its compensation divided by its unadjusted tax base exceeds 63%. MCL § 208.31(5). See Pet. App. 13a n.13.

[20] In fact, for all firms, the SBT averages 0.4% of sales. *SBT Analysis* at 7.

[21] See, *e.g.*, 3 *Tax Reform* at 5; Smith, *supra,* at 78.

acknowledges (Br. 5)—the addition and subtraction methods of computation are interchangeable and yield identical results; the SBT uses the addition method simply as a convenience for taxpayers. See note 10, *supra.* This accounting technicality cannot change the nature of the economic values reflected in the tax base.

In *McLeod's* terms (assuming *McLeod* remains the law), then, one may "look[] behind the labels to the thing described," and validate the tax if "the thing * * * [does] not offend the Federal Constitution." 322 U.S. at 331. The "thing" here is a levy whose base is identical to that of a modified, and plainly constitutional, tax on gross receipts. Under such circumstances, invalidating the SBT would be an exercise in the most wooden semanticism.

2. It should be added that there are other ways of viewing the SBT that also support use of formulary apportionment. In its ultimate economic effect a VAT is similar to a tax on all of the income generated by the taxpayer's business activity. As the Michigan Supreme Court itself has explained, "[i]t is apparent that the income tax and the VAT are in reality opposite sides of the same coin" because, "[p]ractically speaking, the main difference between an income tax and a VAT can be determined by examining *who* is a taxpayer under each system." *Mobil Oil,* 373 N.W.2d at 740 (emphasis in original).[22] Because it is the firm's unitary activities that are responsible for the production of all of this income, formulary apportionment is an appropriate method of taxing it.

Having said this, however, in our view the Court should not attempt to resolve this case by applying highly ab-

---

[22] This is so because the value generated by the enterprise may be characterized as income received (or lost) by someone else: labor costs are equivalent to income received by employees, capital costs are translated into rent and interest received by landlords and lenders, and so on. See *Mobil Oil,* 373 N.W.2d at 740. More precisely, a consumption-type VAT, as its name suggests, uses total consumption as its tax base because it does not exclude depreciation. See Smith, *supra,* at 79; 3 *Tax Reform* at 7.

stract economic concepts—as petitioner urges by propounding one economist's (rather idiosyncratic) concept of where value is added. See Br. 26 (citing Barlow & Connell, *supra*, at 704). Economists differ among themselves on, among many other things, how best to characterize the value added tax. See Note, *Value-Added Taxation: Its Concept and Effects*, 39 U. Cin. L. Rev. 331, 334-335 (1970). Resolution of these conflicts in economic theory is an " 'essentially legislative task' " (*Goldberg*, 109 S.Ct. at 588 (citation omitted)) that is not easily undertaken by the courts. See *ASARCO*, 458 U.S. at 352 (O'Connor, J., dissenting). And needless to say, particular economic theories may not be reconcilable with this Court's understanding of the Constitution.[23] In these circumstances, it would be appropriate for the Court to accept the characterization of the VAT provided by the Michigan Legislature, and to be guided by the levy's practical similarity to (if not identity with) taxes that already have been held constitutional.

II. THE SBT DOES NOT DISCRIMINATE AGAINST INTERSTATE COMMERCE.

Petitioner's remaining argument (Br. 38-44)—that the SBT discriminates against out-of-state firms—is wholly without merit. At the outset, petitioner finds it somehow suspect that the SBT was designed, in part, to encourage the development of Michigan business. Br. 38,

---

[23] This is true, for example, of the economic analysis upon which petitioner principally relies. Among other things, that analysis takes Michigan's apportionment formula to task for "giving equal weight to the labor and capital aspects of a firm's activities, when in fact those inputs are often very unequal." Barlow & Connell, *supra*, at 704. But this Court, of course, has long upheld use of apportionment formulas that give equal weight to payroll and property ratios, without inquiry into the nature of a particular firm's activities. It may be added that the economic analysis cited by petitioner concludes that consumption-type VATs "clearly introduce[] a bias favoring capital-intensive methods" (*id.* at 697); most economists, in contrast, regard consumption-type VATs as neutral between capital and labor. See, *e.g.*, 3 *Tax Reform* at 7.

43. But the Court has made clear that States may "structur[e] their tax systems to encourage growth and development of intrastate commerce and industry," rejecting the contention that "a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336-337 (1977). See *Armco Inc. v. Hardesty*, 467 U.S. 638, 645-646 (1984). The Commerce Clause thus does not "inhibit a State's power to experiment with different methods of encouraging local industry. Whether the encouragement takes the form of a cash subsidy, a tax credit, or a privilege intended to attract investment capital, it should not be characterized as a 'burden on commerce.'" *Hughes v. Alexandria Scrap Co.*, 426 U.S. 794, 816 (1976) (Stevens, J., concurring).

Indeed, the SBT was designed to spur Michigan industry simply by reducing the excessive tax burden that the State previously had imposed on capital. See *SBT Analysis* at 19; *Michigan SBT* at 13, 20. Consumption-type VATs are neutral as between labor- and capital-intensive industries. See, *e.g.*, 3 *Tax Reform* at 5-7. In contrast, "[a]ll of the taxes repealed [upon enactment of the SBT] were strictly on capital." Haughey, *supra*, 22 Wayne L. Rev. at 1022. See Mitchell, *Taxes Repealed and Amended*, 22 Wayne L. Rev. 1029 (1976). Although it was hoped that the SBT accordingly would encourage capital investment in the State, it also was understood that "some labor intensive industries with regional or national markets [might] leave Michigan" in response to the new tax. Haughey, *supra*, 22 Wayne L. Rev. at 1022. But in either case, "these results are due to the shift from one system to another and are not inherent in the nature of the SBT." *Id.* at 1023. This redesign of the State's tax system along lines of neutrality is hardly unconstitutional; any disparate effects that the SBT has on different firms "results solely from differences between the nature of their businesses, not from the location of their activities." *Amerada Hess*, 109 S.Ct.

at 1624. See *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125-129 (1978).[24]

Using a complex hypothetical (Br. 39-41), petitioner also attempts to demonstrate that use of a sales factor in Michigan's apportionment formula discriminates against out-of-state businesses because it "systematically under-attributes to Michigan the site-specific tax base components—compensation and depreciation—of in-state businesses while systematically overattributing to Michigan those same site-specific tax base components of out-of-state businesses." Br. 43. Of course, just who is the victim of this asserted discrimination depends on which ox is being gored; Michigan businesses, viewing the SBT as a form of gross receipts tax, might argue that *they* suffer under the tax because non-Michigan firms are able to apportion some of their Michigan sales out-of-state, while some out-of-state sales by Michigan firms are apportioned back in-state. And even viewing the issue in petitioner's own terms, whether or not a firm benefits from use of a sales factor in apportionment of the SBT turns on whatever varying values are plugged into petitioner's hypothetical.

More fundamentally, however, petitioner's argument is not really one of disparate treatment at all. Petitioner's claim of discrimination rests entirely on the validity of its prior assertions that the costs of production are, in fact, "site-specific," and that sales have no relationship to value added. Once it is understood that the SBT falls on a unitary course of business activity that includes both production and sales, it is evident that neither out-of-state nor Michigan firms have any ground to complain

---

[24] Petitioner finds support (Br. 43-44) for its claim in what it labels the SBT's discriminatory capital acquisition deduction, which apportions the cost of capital assets under a two-part payroll and property formula. MCL § 208.23(a). As petitioner notes, however, the constitutionality of that provision is not at issue here; as the deduction provision's apportionment formula differs from the one under attack by petitioner, the provision plainly has no bearing in this case.

about the statutory apportionment formula because values are transferred neither into nor out of the State.

This comes clear from consideration of the decisions relied upon by petitioner to establish discrimination. See Br. 41-43. In most of them, the state tax statutes at issue were "facially discriminatory" (*Amerada Hess*, 109 S.Ct. at 1623); they imposed burdens (through higher tax rates or lower credits) on out-of-state sales that were not imposed on in-state sales. See *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 393-394, 400, 403-404 (1984); *Maryland v. Louisiana*, 451 U.S. 725, 732-734, 756-758 (1981); *Boston Stock Exchange*, 429 U.S. at 324-325; *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64, 67-68, 70, 73 (1963). That plainly is not true of the SBT, which taxes all business activity at the same rate, wherever it occurs. The remaining decision cited by petitioner, *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (1987), involved a flat tax that failed the Court's "internal consistency" test because, if adopted by every jurisdiction, it would have discouraged interstate activity. See *id.* at 284; *Amerada Hess*, 109 S.Ct. at 1623. But because petitioner does not deny that the SBT passes the test of internal consistency (see Pet. App. 18a-19a),[25] *Scheiner* is irrelevant here.

The SBT thus does not "exert[] 'an inexorable hydraulic pressure on interstate businesses to ply their trade within the State that enacted the measure.'" *Amerada Hess*, 109 S.Ct. at 1623, quoting *Scheiner*, 483 U.S. at 286-287. If all States adopted taxes identical to the SBT, interstate activity would not be discouraged. And a business that moves to Michigan will find itself with higher Michigan payroll and property ratios and, accordingly, a higher Michigan tax bill. Of course, Michigan

---

[25] That is evident from petitioner's example. If Ohio and Michigan each imposed taxes identical to the SBT on petitioner's hypothetical businesses, the tax burdens on the two firms also would be identical and the tax structure would not create any incentive for either firm to operate in one State rather than the other.

may succeed in wooing firms by reducing tax rates on capital below those prevailing in other States, but any advantage it gains from that approach will come because its tax rates are low, not because they are discriminatory. That is a wholly constitutional means of competing for interstate business.

If we are correct, as we argue above, that business activity may be viewed as a unitary and apportionable course of conduct, petitioner's claim of discrimination ultimately amounts to a bald attack on the inclusion of a sales factor in *any* apportionment formula. But the Court has made clear that sales factors are an appropriate part of the gauge of in-state business activity; the Court has, for that matter, upheld use of a *single-factor* apportionment formula based on sales. *Moorman*, 437 U.S. at 277. Michigan's three-factor formula accordingly is a reasonable and nondiscriminatory—indeed, a commendably moderate—means of apportioning interstate business activity.

CONCLUSION

The judgment of the Michigan Supreme Court should be affirmed.

Respectfully submitted,

BENNA RUTH SOLOMON *
Chief Counsel
CHARLES ROTHFELD
STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445

* *Counsel of Record for the* Amici Curiae

June 13, 1990