No. 81-349

In the Supreme Court of the United States

OCTOBER TERM, 1981

CHICAGO BRIDGE & IRON COMPANY,
Appellant,

VS.

CATERPILLAR TRACTOR CO.,
ILLINOIS DEPARTMENT OF REVENUE, *et al.*,
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF AMICUS CURIAE OF THE MULTISTATE TAX COMMISSION IN RESPONSE TO THE JURISDICTIONAL STATEMENT

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COUNTER STATEMENT OF QUESTIONS PRESENTED

Is a state either permitted or required, by either the commerce or due process clauses of the Constitution of the United States, to employ the unitary method to determine the taxable net income of a domestic United States' parent corporation and its domestic subsidiaries doing business in the state if such corporations conduct a worldwide unitary business in conjunction with commonly owned, controlled and managed subsidiary corporations, including foreign subsidiary and affiliated corporations?

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MEMORANDUM OF MULTISTATE TAX COMMISSION IN RESPONSE TO JURISDICTIONAL STATEMENT

INTRODUCTORY STATEMENT

This memorandum is submitted by the Multistate Tax Commission in support of the appropriateness of plenary consideration of the appeal by this Court. The parties to this proceeding have consented to the filing of this memorandum.[1]

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[1] Consent letters have been filed with the Clerk of the Court.

STATEMENT OF INTEREST

The Multistate Tax Commission (the Commission) is the official administrative agency of the Multistate Tax Compact (the Compact) entered into currently by 19 states and the District of Columbia as full members, and by 11 states as associate members.[2]

The purposes of the Compact are to:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatability in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicate taxation.[3]

In fulfillment of these objectives, in the area of state income taxation of multistate-multinational business, Article IV of

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[2] The current regular members are the states of Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Kansas, Michigan, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, Washington and West Virginia. The associate members are the states of Alabama, Arizona, Georgia, Louisiana, Maryland, Massachusetts, Minnesota, New Jersey, Ohio, Pennsylvania and Tennessee.

[3] The constitutionality of the Compact was upheld by the United States Supreme Court in *U.S. Steel, et al. v. Multistate Tax Commission, et al.*, 434 U.S. 452 (1978), affirming 417 F.Supp. 795 (S.D.N.Y. 1976). The Court there noted that the Compact "... symbolized the recognition that, as applied to multistate businesses, traditional state tax administration was inefficient and costly to both state and taxpayer."

the Compact sets forth the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).[4]

The purpose of UDITPA is to provide for the uniform allocation and apportionment of income for state income tax purposes by those states that have adopted it. It has been adopted by a great majority of the income tax states.[5] It applies to all classes of taxpayers (individuals, partnerships, etc.) except financial institutions and public utilities. It provides for the specific allocation or apportionment of all the income of all the included taxpayers except the personal service income of individuals. UDITPA apportions "business income" in accordance with the well-recognized three-factor apportionment formula of tangible property, payroll and sales. "Nonbusiness income" is specifically allocated as provided for therein.[6]

Pursuant to its authority under Article VII of the Compact, the Commission approved uniform allocation and apportionment regulations on February 21, 1973, which implement UDITPA.

A majority of the UDITPA states have adopted these regulations substantially in the form adopted by the Commis-

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[4] UDITPA was promulgated by the National Conference of Commissioners on Uniform State Laws in 1957. Uniform Laws Annotated, Vol. 9A, p.448, et seq.

[5] 11th Annual Report of the Multistate Tax Commission, 1977-1978, App. B pg. 28.

[6] Section 1(a) of UDITPA defines "business income" as:

> Income 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 parts of the taxpayer's regular trade or business operations.

Section 1(e) defines nonbusiness income subject to specific allocation as "all income other than business income."

sion.[7] These regulations, in conformity to the language of UDITPA, provide for the apportionment of the net income of a unitary trade or business, irrespective of the corporate or other form in which the unitary business is conducted.

It is important that UDITPA be interpreted to carry out the purpose of the states which have enacted UDITPA. This purpose is to provide for uniformity and full accountability (without duplication) in the division of income for state income tax purposes by workable and rational division of income rules.[8]

The Commission and its member states are concerned with the position advanced by Appellant, Intervenor, Chicago Bridge & Iron Company (CBI) that the unitary method cannot be utilized by the states for the attribution of net income for state income tax purposes if the unitary business is conducted by two or more commonly owned and controlled corporations.

More particularly, in the instant matter and in the pending appeal of *Container Corporation of America v. Franchise Tax Board*, California Court of Appeals No. 1/Civil 48990 (1981), the Commission and its member states are concerned with the unsubstantiated argument that there exists established international tax policy for the ascertainment of the United States income of United States parent corporations and their controlled foreign subsidiaries and affiliates and that this policy precludes the constitutional employment of worldwide combined reporting (the unitary method applied

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[7] Results of a survey on the Uniformity of State Laws by the State of Indiana dated February 15, 1977.

[8] Prefatory note to UDITPA, Uniform Laws Annotated, Vol. 9A, p. 448; *GTE Automatic Electric v. Allpin*, 68 Ill.2d 326, 369 N.E.2d 941 (1977) and Pierce, "The Uniform Division of Income for State Tax Purposes," 35 Taxes 747 at 748 and 749 (1957).

to a group of corporations or other legal entities which conduct an integrated unitary business in part through "foreign affiliates") by the states.[9]

The acceptance of this argument would require this Court to declare the attribution provisions of UDITPA unconstitutional even though UDITPA requires apportionment of only the unitary income of a unitary business which is carried on in part in the taxing state. Furthermore, it would open the flood gates to state income tax avoidance by large multinational corporations by permitting them to play the "corporate shell game" and rely on their internal accounting for state income tax attribution purposes. They would thus be free by their own accounting devices to shift their profits anywhere in the world.[10]

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[9] While there may be international agreements between the United States and certain other nations pertaining to taxation of the domestic operations of foreign parent corporations, no such agreements exist as to how nations will tax their own domestic corporations, including their foreign affiliated and subsidiary corporations. It should further be noted that there is absolutely nothing in the record in this cause concerning any international standards, agreements or norms to substantiate CBI's argument in its Jurisdictional Statement that the unitary method here involved conflicts with such standards, agreements or norms.

[10] The need for "combined reporting," on the international level, can be illustrated by an actual example of a multinational corporation conducting unitary operations in Canada and Idaho through two subsidiary corporations. The Canadian subsidiary processes pulp used for the manufacture of paper by the American subsidiary. The pulp is transported from the Canadian subsidiary to the American subsidiary by a pipeline crossing international boundaries. Under these circumstances, it is impossible to separate the profits of the Canadian subsidiary from that of the American subsidiary because the profits of the two corporations from the manufacture of pulp and paper products were earned by a series of transactions beginning in Canada and ending in sales in the United States. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 133 (1920). Thus, logic dictates that "combined reporting" be utilized to determine the profits of either of these two subsidiaries.

While we believe that the position of CBI and its amicus is contrary to all of the decisions of this Court which have upheld that apportionability of all of the unitary income of a unitary trade or business, as more fully set forth herein, we recognize that this Court has not specifically passed upon the question of whether the attribution of net income for state income tax purposes, by the "combined reporting" method, is either permitted or required under the commerce and due process clause of the United States Constitution. [Art. I, §8, Cl. 3, and XIV Amend., respectively] Inasmuch as these questions are a subject matter of extreme importance to both the states and multistate-multinational businesses, we believe that this Court should take jurisdiction of this matter for full plenary consideration of these constitutional questions. This memorandum is filed in support of it doing so.

COUNTER STATEMENT OF THE CASE

In determining Illinois' portion of the taxable income of Caterpillar Tractor Co. and its affiliated corporations conducting business in Illinois, the trial court below found that

> "The Unitary Apportionment Method must be applied by the Illinois Deprtment of Revenue in order to fairly represent the Plaintiffs' business activities in Illinois * * *" (Appellant's App., A-1)

It thus upheld "worldwide combination."

In affirming this holding, the Illinois Court of Appeals below noted:

> 1. "* * * the unitary method can be applied where a unitary business is conducted by a number of corporations. The application of the unitary method is intended to solve the problem of accurately identifying the portion of the business income of each member of the unitary business which is attributed to a given state." (Appellant's App., B-11, B-12)

> 2. "The utilization of the unitary method does not ignore the corporate structure. Each individual corporation is taxed separately. The unitary method is only a device to ascertain the income attributable to the Illinois business activity of the taxpaying corporation.
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> * * *
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> "The major advantage of the unitary method is that, with regard to the taxation of the parent company and its various subsidiaries, there is no elevation of form over substance. Without the unitary method were [there] would be a different tax application for an integrated business which is run as a number of separate corporations rather than a single multistate corporation." (Appellants' App., B-13, B-14)

In affirming the Court of Appeals as to use of the unitary method, the Illinois Supreme Court noted that Illinois must attribute income either by separate accounting or the unitary method (Appellant's App. C-10). As to the unitary method, as applied to a group of corporations, it stated that it

> "* * * is used to describe a group of functionally integrated corporate units which are so interrelated and interdependent that it becomes relatively impossible for one State to determine the net income generated by a particular corporation's activities within the state and therefore allocable to that State for purposes of taxation. A classical example of a unitary business is the Caterpillar Tractor Company." (Appellant's App., C-11)

Without challenging any of the foregoing findings and holdings of the courts below, CBI here appeals from the decision of the Illinois Supreme Court on the grounds that "combined reporting" is *per se* unconstitutional.[11]

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[11] Any such holding would place the Illinois Department of Revenue in an impossible position since it found, as a matter of fact, based on substantial evidence, that a worldwide "combined report" was the only method available to arrive at a reasonable apportionment of the net in-

THIS COURT SHOULD TAKE JURISDICTION OF THIS CAUSE BECAUSE IT RAISES FEDERAL QUESTIONS WHICH HAVE NOT BEEN SPECIFICALLY DECIDED BY THIS COURT AND WHICH ARE OF VITAL CONCERN TO THE STATES AND MULTISTATE-MULTINATIONAL BUSINESSES.

Beginning with the early property tax case of *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), rehearing 166 U.S. 185 (1897) down to *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 107 (1980), this Court has uniformly sustained reasonable apportionment of state taxes imposed on property, corporate franchises or income attributable to a unitary business. In sustaining these taxes against due process or commerce clause objections, it has never limited the apportionable tax base to in-state values, properties or income. In the application of apportionment formulae in income tax cases, this Court has uniformly held that the states are free to use the "unitary business" technique even if some components of the unitary business are located outside the taxing jurisdiction. *U.S. Steel v. Multistate Tax Commission*, 434 U.S. 452 at 473, footnotes 25 and 26; *Underwood Typewriter Co. v. Chamberlain*, 245 U.S. 113 (1920); *Bass, Ratcliff & Gretton Ltd. v. New York Tax Commision*, 266 U.S. 271 at 282 (1924); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942); *Mobil Oil Corp. v. Com'r. of Taxes*, 445 U.S. 425 (1980); *Exxon Corp. v. Wisconsin Department of Revenue, supra* 447 U.S. 207 (1980). It has recognized that "net income taxes," unlike gross receipts taxes, are not imposed on specific receipts or transactions

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come of Caterpillar and its subsidiaries doing business in Illinois to Illinois, which is required by the provisions of UDITPA and the decisions of this Court.

from which net income may be derived. *Peck & Co. v. Lowe*, 247 U.S. 165 (1918). Thus, "Neither the privilege nor the burden is affected by the character of the source of the income. For that reason, income is not necessarily clothed with the tax immunity enjoyed by its source." (*N. Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1936) Apportionment of a business has been upheld even though applied to income from foreign and domestic activities of a foreign corporation which earned no taxable income in the United States for federal income tax purposes. *Bass, Ratcliff & Gretton, supra.*

Furthermore, this Court has historically treated an interstate utility system, which was conducted by a group of commonly owned and controlled corporations, as a unit for *ad valorem* property tax attribution purposes. *Chicago, M. & St. P. Ry. v. Minn. Civic Ass'n.*, 247 U.S. 490 (1918); *Southern Ry. Co. v. Kentucky*, 274 U.S. 76 (1927).

Also, this Court has appropriately held that an apportionment formula, as applied to a unitary business, is only a rough approximation of income attributable to the taxing jurisdiction and that an apportionment formula does not purport to identify or tax any income derived from specific sources. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 at 278-280 (1978). It has thus invalidated an apportionment formula only when the taxpayer has established by clear and cogent evidence that the formula resulted from the taxation of income or values which could not be reasonably attributed to the taxpayer's properties or activities within the state. *Norfolk & Western Ry. Co. v. North Carolina*, 297 U.S. 682 (1968); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).

While this Court has repeatedly held that the purpose of the commerce clause was to prevent any undue multiple burden on interstate commerce, it has also uniformly held that any prohibited risk of multiple taxation is satisfied by reasonable apportionment rules. *Northwest Portland Cement*

Co., 358 U.S. 450 at 448, 449 (1959); *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). It has also refused to engage in hypothetical speculation in resolving any alleged multiple taxation question. *Northwest Portland Cement Co., supra*; *Standard Pressed Steel Co. v. Dept. of Revenue*, 419 U.S. 506 (1975); *International Harvester Co. v. Dept. of Treasury*, 332 U.S. 340 at 348 (1944); *Northwestern Airlines v. Minnesota*, 322 U.S. 292 at 295 (1944); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 at 276 (1977); *First Federal S. & L v. Massachusetts Tax Comm'n*, 437 U.S. 255 at 262, footnote 9 (1977).

This Court has recognized that although different state income attribution rules potentially may result in either undertaxation or overtaxation of income of a multistate-multinational corporation, the proscription of uniform rules involves complex questions which require political, not judicial, resolution. *Moorman, supra*, at 437 U.S. 278-280.

In sum, this Court has concluded that if a state tax is fairly apportioned and non-discriminatory and if it is applied to an activity with substantial nexus in the state and if it is designed to reasonably compensate the state for services provided, a state tax does not conflict with limitations on state taxing power under the due process clause, (*Moorman, supra*, 437 U.S. at 272-273) or the commerce clause (*Japan Line*, 441 U.S. at 444-445).

The foregoing principles were before this Court in *Mobil Oil Corp. v. Com'r of Taxes*, 445 U.S. 425 (1980) in the context of the apportionability of dividends received by a taxpayer from its foreign affiliated corporations. In *Mobil*, this Court, based on its prior unitary cases, held that "the linchpin of apportionability in the field of state income taxation is the unitary business principle" (445 U.S. at 439) and that geographically sourcing of income and "separate accounting" was irrelevant in the application of this principle. (445 U.S. at

438)[12] Furthermore, it stated that the corporate form in which the unitary business was carried on was not controlling in the constitutional application of this principle. (445 U.S. at 440-441) However, the Court noted in *Mobil* that it did not have before it for consideration the question as to whether the "combined reporting" method for the attribution of state income taxes was constitutionally required. (445 U.S. at 441, footnote 15)

Although we believe that the application of the unitary business principle to a single corporation is no different in principle or constitutional dimension than its application to a group of corporations which conduct a unitary business;[13] and that prior decisions of this Court in substance foreclose the argument that the utilization of the "combined reporting" reporting method by the states for state net income apportionment purposes is not constitutionally permitted or required; this Court has never expressly so decided. Its consideration of this question in *Mobil, supra* and *U.S. Steel, et al. v. Multistate Tax Commission, supra,* may properly be characterized as *dicta.*

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[12] See also *Exxon Corp. v. Wisc. Dept. of Revenue,* 447 U.S. 207 (1980).

[13] (in both instances the corporate entity is ignored and the entire focus is on the unitary trade or business being apportioned).

CONCLUSION

Inasmuch as there is uncertainty and controversy over whether "combined reporting" is either constitutionally permitted or required, it is respectfully submitted that this Court should note probable jurisdiction in this cause for plenary consideration to resolve the question of whether the linchpin of apportionability in the corporate income tax field is the unitary principle, irrespective of the corporate or other business form in which the unitary business is conducted.

Respectfully submitted,

/s/ WILLIAM D. DEXTER
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