No. 81-523

IN THE

Supreme Court of the United States

October Term, 1982

CONTAINER CORPORATION OF AMERICA,
Appellant,
v.
FRANCHISE TAX BOARD,
Appellee.

ON APPEAL FROM THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FOR THE FIRST APPELLATE DISTRICT

BRIEF OF AMICUS CURIAE MULTISTATE TAX COMMISSION AND PARTICIPATING STATES

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1. This brief is submitted by the Multistate Tax Commission and participating states in support of the Appellee. The parties have consented to the filing of this brief and originals of the consent letters have been filed with the Clerk of the Court.

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STATEMENT OF INTEREST

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

In the area of state income taxation of a multijurisdictional business, Article IV of the Compact sets forth the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA).[3] UDITPA apportions "business income" of a unitary trade or business, irrespective of the corporate form in which it is conducted, in accordance with the well-recognized three-factor apportionment formula of tangible property, payroll and sales. "Nonbusiness income" is specifically allocated by UDITPA §§ 4-8.[4] UDITPA should be interpreted to carry out its purpose which 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.[5]

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2. The constitutionality of the Compact was upheld by the United States Supreme Court in *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978), *aff'g* 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." *Id.* at 456.

3. Uniform Division of Income for Tax Purposes Act (UDITPA §§ 1-22, *reprinted in* 7A U.L.A. 91 (1978). UDITPA was promulgated in 1957 by the National Conference of Commissioners on Uniform State Laws.

4. UDITPA § 1(a) defines "business income" as:

> income arising from transactions and activity 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," which is subject to specific allocation, as "all income other than business."

5. *See* prefatory note to UDITPA, 7A U.L.A. 91-92 (1978); *GTE Automatic Elec., Inc. v. Allphin*, 68 Ill. 2d 326, 369 N.E.2d 841 (1977); Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 749 (1957).

In the instant matter, and in the pending appeal of *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, No. 81-349 (*argued* Apr. 19, 1982, *reh'g granted* May 3, 1982) (hereinafter referred to as *CBI*), the Commission and participating states are concerned with the unsubstantiated argument that an established international tax policy[6] exists for the ascertainment of the United States income of United States parent corporations and their controlled foreign subsidiaries and affiliates. We are further concerned with the argument that this alleged policy precludes the constitutional employment of worldwide combined reporting (the unitary method applied to a group of corporations or other legal entities which conduct an integrated unitary business in part through "foreign affiliates," hereinafter referred to as the combination method, combined reporting, or combination). This Court should not permit the policies of the United States Treasury Department (hereinafter referred to as Treasury) to indiscriminately spill over and dictate state tax policies. We believe that this matter should be resolved by Congress, not by Treasury or this Court. Acceptance of Container's argument would open the floodgates to state income tax avoidance by large multinational corporations by permitting them to use their own internal accounting devices and the corporate form in which they conduct their business to shift their profits anywhere in the world.[7]

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6. 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, including their foreign affiliated and subsidiary corporations, no such agreements exist as to how nations will tax their own domestic corporations, including their foreign subsidiary and affiliated corporations. Absolutely nothing in the record in this cause substantiates Container's argument that any international standards, agreements or norms exist or that the unitary method here involved conflicts with these alleged standards, agreements or norms.

7. 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

We are further concerned with Container's use of abstract theoretical due process arguments to invalidate reasonable apportionment results and with its position that its relationship with its foreign subsidiaries was insufficient to permit combination without violating due process.

SUMMARY OF ARGUMENT

Container and its *amici* contend that the judgment below is unconstitutional because: (1) it conflicts with international tax policy, contrary to the limitations of the commerce clause; (2) worldwide combination "misapportions income to the United States members of the group, resulting in extraterritorial taxation in violation of the due process clause" (Appellants Br. at 9); (3) the "income missapportioned to the United States members of the group is fully taxed in the foreign country where it was earned," (*id.*) and therefore "the income is subject to double taxation, in violation of the commerce clause" (*id.*); and (4) Container did not conduct a unitary business with its subsidiaries for the years in question.

The question of whether an established international tax policy exists, and whether this alleged policy conflicts with worldwide combined reporting, is thoroughly analyzed in the brief *amicus curiae* of the Multistate Tax Commission and participating states in the *CBI* case at III pp. 17-24. No international policy for the attribution of net income exists. If this policy did exist, it would not prohibit or restrict the states' authority to employ combined reporting, or any other method, to ascertain the apportionable net income

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Footnote 7 (con't)

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. 113 (1920). Thus, logic dictates that "combination" be utilized to determine the profits of either of these two subsidiaries.

(hereinafter referred to as apportionable income[8]) of Container, or any other U. S. domestic corporation. *Id.* at 16 n.32. Container and its *amici* are simply asking the Court to require the states to use the intercorporate separate accounting of a multinational corporation (hereinafter referred to as a MNC) which conducts a part of its unitary business in foreign countries through subsidiary corporations, to determine apportionable net income.[9] In this case, Container relies solely on the separate accounting of its book net profits and that of its subsidiaries to support its "facial," "as applied," distortion, and double taxation arguments. Exhibit A at 1-6.

In regard to these arguments, Container does not separate its *facial attack* from its *as applied attack* on worldwide combination; Container does not separate the "facts" it relies on to support its *distortion argument* from the "facts" it relies on to support its *"double taxation" argument.* However, these distinct issues must be separately considered since these issues are not addressed to either common legal or factual questions.

In regard to Container's "double taxation" argument, the record does not show that combination has attributed any net income to the United States which has *in fact* been taxed by the foreign countries in which Container's subsidiaries conducted business for the years in question. Neither does the record establish that California has attributed to U. S.

8. The phrase "apportionable income" refers to a multijurisdictional taxpayer's tax base which is divided by an apportionment formula among those states in which the taxpayer does business. *See infra* note 15.

9. To support its double taxation and distortion arguments, Container erroneously uses the terms "separate accounting" and "arm's-length" synonymously. Further, Container improperly relies on its separate accounting of net profits, not net taxable income. Because IRS § 482 audits are unusual and special procedures, the IRS audit of Container for the years in question was not an "arm's-length" adjustment audit. This is demonstrated by the fact that the tax comparisons between combination results and the results Container asserts are here controlling are based on its own "separate accounting" and not on any so called "arm's-length" analysis by any country.

sources any net taxable income which is not attributable to U. S. sources for federal income tax purposes if any reasonable allowance is made for the admitted understatement of U. S. source net income by Container's "separate accounting." (*See infra* notes 10-11.) Thus, Container's double taxation argument is not supported by any proof of either extraterritorial or double taxation by California.

In regard to Container's "distortion" argument, it has not attempted to prove that the combination method, as applied by California, has attributed any net income to California which is disproportionate to its extensive California operations. A difference between an apportionment result and separate accounting does not invalidate an apportionment result.

Notwithstanding the foregoing, Container and its *amici* *facially* attack worldwide combination on the premise that worldwide combination attributes too much income to U. S. sources because of: (1) the distortion in the payroll factor; (2) the higher expected rate of return of U. S. based MNCs on their foreign operations as compared to their expected rate of return on their domestic operations; and (3) double taxation of income which has been earned in and taxed by foreign countries.

Worldwide combination *per se* has nothing to do with these issues. Combination simply requires a unitary business, which is conducted by a group of corporations, to be treated as a single business for income attribution purposes in the same manner as though the business was conducted as branches or divisions of a single corporation. The arguments of Container and its *amici* to facially attack worldwide combination are equally relevant if the foreign operations of a United States MNC are conducted by overseas divisions. Since the states clearly have the authority to combine the income of overseas branches to determine the boundaries of a unitary business for apportionment purposes (*see Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924) which was cited with approval in *Mobil* and other decisions of this Court), a facial attack against combined reporting cannot be sustained (*see also Mobil*, 425 U.S. at 440-41).

Neither has Container advanced any valid reasons to support its argument that worldwide combination *as applied* to its business affairs results in either distortion or international double taxation. In support of its *as applied* argument, in addition to the reasons advanced by Container to support its facial attack, Container contends: (1) that it has proved that California's use of worldwide combined reporting actually results in the misapportionment of its net income to California and subjects the combined net income of Container and its subsidiaries to double taxation; and (2) that it did not conduct a unitary business with its foreign affiliates. Container has not proved its case because it bases its *as applied* argument (as well as its *facial* argument) on the following erroneous assumptions and erroneous factual conclusions:

First, that its "separate accounting" for its net profits and that of its subsidiaries appropriately determines its net taxable income from U.S. sources, and the "foreign source" net taxable income of its subsidiaries. However, book net profit is not taxable income.[10] The record conspicuously fails to indicate actual net taxable income of Container's subsidiaries as reported to foreign countries for foreign income tax purposes. In addition, Container admits that this "separate accounting" is inaccurate.[11] In any event, separate accounting does not invalidate an apportionment result. *See Exxon; Mobil; Butler Bros.*

Second, Container's argument is based on the erroneous assumption that one-third of net taxable income under UDITPA is attributable to payroll costs (Appellant's Br. at

10. The net book profits of Container and affiliated corporations, which is set forth on Exhibit A, do not constitute the *net taxable income* for U. S. federal tax purposes or for the tax purposes of foreign countries in which its affiliated corporations conduct business. As to Container, this is demonstrated by comparing federal taxable income in Exhibit A at 7 with the net profit figures of Container set forth in Exhibit A at 2, 4, 6.

11. Container was not compensated for some services which it provided its subsidiaries (JA ¶ 144 at 74); it sold used equipment to them at book rather than fair market value (*id.*, ¶ 144 at 76); it brokered equipment to them at a fee less than would be charged a third party (*id.* ¶ 148 at 77); it received no fees for loans it guaranteed for its subsidiaries and it charged minimal interest on loans made to them.

14) and that the unitary apportionment method is based on the premise that each dollar of payroll expense produces an equal amount of net income (*id.* at 11). On the contrary, the UDITPA three factor formula is based on the premise that the location of a taxpayer's tangible property, payroll and sales taken together roughly approximates the geographical locations of the net income of a unitary business. Further, no particular portion of net income is attributable to any one factor or to any geographical location to which that factor assigns net income.

Third, Container's argument is based on the unproven assumption that profits in foreign countries are higher per dollar of investment than in the United States because MNCs anticipate this result. Appellant's Br. at 14. Three of Container's affiliates incurred net losses based on their separate accounting in 1963, four operated at a net loss in 1964 and one in 1965. Exhibit A at 1, 3, 5. These facts destroy Container's argument that its foreign subsidiaries operated at higher profit rates.

Fourth, Container's reliance upon the table at page 17 of its brief, which is constructed from separate accounting of net profits as reported on its federal IRS 2952 information schedules, further demonstrates the erroneous foundation of Container's argument. By definition, the information on these schedules is not accurate and contains estimates and approximations that are determined by separate accounting — they do not represent the net taxable income which was subject to tax by any foreign country or by the United States. For example, Container's IRS form 2952 shows that the Italian subsidiaries had an average income of $34,000 for the tax years at issue. Appellant's Br. at 17. But Container's 2952 form also shows that the Italian subsidiaries had an average tax liability of $121,044 for these same years (JA ¶ 159 at 84), which represents 356% of their average pre-tax income. The inherent inaccuracy of Container's 2952 form is further demonstrated in Exhibit A where Container's net profits are listed as $25,361,936 for 1963; $28,975,400 for 1964; and $30,026,749 for 1965 (Exhibit A at 2, 4, 6) even though Container's federal taxable income substantially exceeded these amounts (*id.* at 7). Thus, Container's distortion and double taxation arguments are not based on amounts actually attributable to either the IRS or to the foreign subsidiaries for income tax purposes.

Fifth, Container's reliance upon the differences between payrolls and rates of return are not substantiated by the claimed misapportionment of income as set forth in the table at page 17 of its brief. Container's allegation that the California wage rate is two hundred fifty percent that of the wage rate paid to workers in Cali, Colombia, if appropriate at all, hardly demonstrates the invalidity of the mere 9.5% difference[12] between net income attributable to the United States by worldwide combined reporting and by Container's net profits assigned to different countries by Container's separate accounting.[13]

In sum, Container simply relies on its internal separate accounting to attack the combination method on its face and as applied by California. Since Container has not attempted to prove California *actually* taxed extraterritorial income, Container has failed to carry its burden of proving that California's use of the combination method took its property without due process of law. Neither has Container proved any *actual* double taxation.

Neither is there merit in Container's argument that the court below denied it due process of law in concluding that it conducted a unitary business with its foreign subsidiaries. The thirty-seven facts taken from the stipulated facts, *infra* pp. 27-29, illustrate that the subsidiaries were not conducted as discrete businesses so unrelated to Container's own business that combination denied Container due process of law. Any reasonable inference from these and other facts support the proposition that Container formed and utilized

12. This is the difference between the total worldwide net profits attributable to the United States by Container's separate accounting as compared to worldwide combined reporting. It is obtained from the figures set forth on page 17 of Appellant's Brief.

13. The tax liabilities shown on the 2952s as having been paid to foreign countries are not accurate (JA ¶¶ 159-61 at 83-85) and otherwise do not prove double taxation of net income.

its foreign subsidiaries to further its container business throughout the world and that it used its total resources as needed in furtherance of this purpose. From the record in this case, we discern little difference between the type of centralized management and control that Container exercised over its foreign operations than it exercised over its domestic operations.

If the unitary business principle is going to have any continued vitality in the field of state net income taxes, consideration must be given to the modern methods of how integrated businesses are conducted. Top management of large multinational corporations realistically cannot control any of their far flung operations except through advanced planning, approval of major decisions, financing, review of operations through the submission of reports, the placing of persons in key positions, and the promolgation of basic corporate policies, etc. throughout the total enterprise. If the states cannot rely on reasonable presumptions that can be drawn from the general character and mode of operations of particular MNCs to determine whether they are conducting a unitary business sufficient to satisfy the "minimal connection" and " rational relationship" due process standard, the states will be completely unable to uniformly and fairly administer the unitary business principle.

THE ARGUMENT

I. General Introductory and Constitutional Considerations

The broad issue before this Court is what constitutes the extent and nature of the fundamental constitutional restrictions on the sovereign taxing powers of the states within our federal system.[14] The narrow issue here is to what extent California can use the combination method[15] to determine Container's net income attributable to its business activities in California.

14. *See generally* P. Hartman, *Federal Limitations on State and Local Taxation* (1981).

15. The term "unitary business principle" is used in two separate and distinct contexts. The first context, the *combination method* at issue here and in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, No. 81-349 (*reh'g granted* May 3, 1982), is used to determine which of two or more

Inasmuch as Container is not a champion of any constitutional rights except its own, *Forthingham v. Mellon*, 262 U.S. 447, 487-88 (1923), these issues must be resolved in regard to the specific facts and circumstances pertaining to Container, not by abstract hypothetical considerations. In resolving these issues, this Court's function is not to determine whether the combination method or any other method employed by the states is the most fair and equitable method. The study and potential promulgation of uniform state tax laws involves complex questions which require political, not judicial, resolution. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-80 (1978). This Court has repeatedly held that a state is free to design any tax system it wishes so long as that tax system does not impinge on a taxpayer's fundamental constitutional rights. *Moorman; Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

An understanding of the basic principles upon which the "unitary business principle"[16] is constructed will aid resolution of the complex issues in this case. Beginning with the early property tax case of *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), *aff'd on rehearing*, 166 U.S. 185 (1897) through *Exxon Corp. v. Department of Revenue*, 447 U.S. 207 (1980))[17] this Court has uniformly

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Footnote 15 (con't)

corporate entities should be regarded as being engaged in one "unitary business" and should therefore be "combined" or treated as a single corporation for state tax reporting purposes. The second context, the *unitary apportionment method* at issue in *ASARCO Inc. v. Idaho State Tax Comm'n*, No. 80-2015 and *F.W. Woolworth, Inc. v. Taxation & Revenue Dep't of New Mexico*, No. 80-1745 (Petition for Rehearing pending), is used to determine what income is attributed to the unitary business and is thus subject to apportionment among the states in which the business is conducted. This brief uses the term "apportionable income" to describe this income. *See supra* text accompanying note 8. *See generally* Dexter, *Post Oral Argument Comments on ASARCO and Woolworth*, 15 Tax Notes No. 11 at 867 (June 14, 1982).

16. *See supra* note 15.

17. Because a Petition for Rehearing is pending and this Court's mandates have not issued in either *ASARCO, Inc. v. Idaho State Tax Comm'n*, ____

sustained reasonably apportioned state imposed property, franchise, or net income taxes. This Court has consistently 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, including foreign countries. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978), *aff'g* 417 F. Supp. 795 (S.D.N.Y. 1976); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

This Court has recognized that "net income taxes," unlike gross receipt taxes, are not imposed on any transactions from which net income may be derived. *Peck & Co. v. Lowe*, 247 U.S. 165 (1918). Thus, "[n]either the privilege nor the burden is affected by the character of the source from which the income is derived." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1936). For purposes of state corporate taxes "net taxable income" is a highly abstract concept,[18] representing only a relatively small part of the taxpayer's business receipts. Taxation of net income is *not* the taxation of any specific item, activity, or property of the business.[19] "Separate accounting" results do not impeach the validity of assignment of net taxable income by the formulary apportionment method.[20] This Court has upheld unitary apportionment, even though applied to income from foreign activities of a foreign corporation which earned no taxable income in the United States for federal income tax purposes.

Footnote 17 (con't)

U.S. ____, 102 S. Ct. 3013 (1982) and *F.W. Woolworth, Inc. v. Taxation & Revenue Dep't*, ____ U.S. ____, 102 S. Ct. 3128 (1982), we believe it inappropriate to refer to these cases as established authority.

18. Dexter, *The Attribution of the Net Income of Multistate-Multinational Corporations for State Income Taxes on or Measured by Net Income*, 1 Multistate Tax Comm'n Rev. No. 1 at 5 (Nov. 1981).

19. Compare *Crew Levick Co. v. Pennsylvania*, 245 U.S. 292 (1917) with *Peck & Co. v. Lowe*, 247 U.S. 165 (1918).

20. *See Exxon; Mobil; Butler Bros.*

Bass, Ratcliff & Gretton. It has also held that all aspects of a business presumptively contribute to the operations of the business as a whole. *Adams Express*, 165 U.S. at 227. Apportionment formulas are based on the premise that geographical sourcing is impossible where the instate and out-of-state activities are interdependent[21] and that it is necessary and constitutionally permissible to assign net income under these circumstances to where the instate and outstate business is conducted, as reflected by the rough approximation of an apportionment formula. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-80 (1978); *International Harvester v. Evatt*, 329 U.S. 416 (1947).

This Court has invalidated an apportionment formula only when the taxpayer has proved by clear and cogent evidence that the formula taxed extraterritorial income or values. *Moorman Mfg. Co.; Butler Bros.; Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931). It has thus upheld a single property factor apportionment formula (*Bass, Ratcliff & Gretton; Underwood Typewriter Co.*) and a single sales factor apportionment formula (*Moorman Mfg. Co.; Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939)).

In applying the foregoing constitutional standards, the Court has held that the taxpayer's corporate business form is not controlling in determining the apportionable net income. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 440-41 (1980). Rather, it has held that the unitary business principle is controlling for this purpose.[22] *Id.* at 439. However, the apportionment of the income or property of a unitary business may be invalidated if the apportionment results in extraterritorial taxation. *Norfolk & Western Ry.; Hans Rees' Sons, Inc.*. Thus, the fundamental due process question is whether a state, regardless of the method used, taxes extraterritorial values or income.

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21. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

22. The linchpin of apportionability should be whether the apportionment result is constitutionally reasonable, not the unitary business method *per se*. *See infra* pp. 23-25.

While this Court has held that the purpose of the commerce clause is to prevent any undue multiple burdens on interstate commerce, it has also held that any prohibited risk of multiple taxation is satisfied by reasonable apportionment rules. *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 448-49 (1959). It has also refused to engage in hypothetical reasoning or speculation in resolving any alleged multiple taxation question. *Moorman*, 437 U.S. at 276; *First Fed. Sav. & Loan v. Tax Comm'n Ass'n*, 437 U.S. 255, 262 n.9 (1978); *Standard Pressed Steel Co. v. Dep't of Revenue*, 419 U.S. 560 (1975); *Northwestern States Portland Cement Co.; Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292-95 (1944); *International Harvester Co. v. Dep't of Treasury*, 322 U.S. 340, 348 (1944).

This Court has properly noted that "[c]oncurrent federal and state taxation of income, of course, is a well-established norm" (*Mobil*, 445 U.S. at 448) and that "[a]bsent some explicit directive from Congress, we [the Court] cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States." (*id.*; bracketed material added). It has thus emphasized that "absent congressional action . . . the States' power to tax can be deprived only under 'the clearest constitutional mandate' *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 293 (1976)." *United States v. New Mexico*, __ U.S. __, 102 S. Ct. 1373, 1384 (1982).

In sum, this Court has concluded that if a state tax is fairly apportioned and non-discriminatory, 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, then a state tax does not contravene either the due process clause (*Moorman*, 437 U.S. at 272) or the commerce clause (*Japan Line*, 441 U.S. at 444-45) limitations on state taxing power. Further, the taxpayer carries the burden of proving that a state tax is unconstitutional by showing a lack of connection between its instate activities and that which the state has sought to tax. *Mobil*, 445 U.S. at 442; *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 537 (1951).

In the application of the foregoing general constitutional principles, the state courts were faced with a question of what criteria to use to determine when a taxpayer conducted a unitary business and what should be the result when a unitary business is conducted by the taxpayer in conjunction with commonly owned and controlled affiliated corporations.

The cases hold that a unitary business is being conducted if the business is owned and controlled by the same interests and the component parts of the business are so interrelated and interdependent that they form one business unit rather than separate discrete business enterprises.[23] In determining whether a business is unitary, no case holds and no study concludes[24] that the corporate form in which the business is conducted is controlling.[25]

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23. The basic tests utilized by the state courts to determine what constitutes a unitary business are set forth in Dexter, *The Unitary Concept in State Income Taxation of Multistate Multinational Businesses*, 10 Urb. Law. 181 (1978).

See also Exxon; Mobil; Butler Bros. v. McColgan; Chase Brass & Copper Co. v. Franchise Tax Bd., 10 Cal. App. 3d 496, 95 Cal. Rptr. 805 (1970); *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal. 2d 214, 238 P.2d 569 (1951); *Zale-Salem, Inc. v. State Tax Comm'n*, 237 Or. 261, 391 P.2d 601 (1964); *Webb Resources Inc. v. McCoy*, 194 Kan. 758, 401 P.2d 870 (1965); *Crawford Mfg. v. State Commissioner of Revenue*, 180 Kan. 352, 304 P.2d 504 (1956); *Western Auto Supply Co. v. Commissioner of Taxation*, 245 Minn. 346, 71 N.W.2d 797 (1955).

24. *See* House Comm. on the Judiciary, *State Taxation of Interstate Commerce*, H.R. Rep. No. 1480, 88th Cong., 2d Sess. Vol. 4 at 1154-55 (Willis Report).

25. *See Mobil; Edison Cal. Stores Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947); *Joslin Dry Goods Co. v. Dolan*, __ Colo. __, 615 P.2d 16 (1980); *In re Morton Salt Co.*, 150 Kan. 650, 95 P.2d 335 (1939); *Caterpillar Tractor Co. v. Lenckos*, 84 Ill. 2d 102, 417 N.E. 2d 1343 (1981), *aff'g* 77 Ill. App. 3d 90, 395 N.E. 2d 1167 (1979), *appeal filed sub nom. Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, No. 81-349 (*argued* Apr. 19, 1982; *reh'g granted* May 3, 1982); *Montana Dep't of Revenue v. American Smelting & Ref. Co.*, 173 Mont. 316, 567 P.2d 901 (1977), *appeal dismissed*, 434 U.S. 1042 (1978); *Coca Cola Co. v. Dep't of Revenue*, 271 Or. 517, 533 P.2d 788 (1975), *aff'g* 5 Or. T.R. 405 (1974).

II. The Worldwide Combination Method Is Not Facially Invalid Under the Due Process Clause

The worldwide combination method is not facially unconstitutional[26] because of the following: (1) Container's distortion and double taxation arguments are equally relevant regardless if Container conducts business through separate foreign subsidiaries or through foreign divisions of a single corporation; (2) *Bass, Ratcliff & Gretton* holds that a state may apply its apportionment formula to a taxpayer's tax base that includes income from foreign divisions of the taxpayer's single business; and (3) *Mobil* holds that corporate form has no effect on resolving the issue of whether a state has denied due process to a taxpayer by taxing the taxpayer's extraterritorial income. Container's distortion and double taxation arguments, if they have any relevance at all, should only be addressed to the *result* when the method is *applied* to Container.[27]

The purpose of the combination method is to treat two or more separate corporations as a single business unit for net income apportionment purposes when they would be treated as a unit if their combined businesses were conducted as divisions of a single corporation.[28] A ruling in favor of Container and its *amici* that worldwide combination is facially invalid would dictate a ruling against Caterpillar Tractor Co. in *CBI*, where both the state and the taxpayer (Caterpillar) agree that application of worldwide combined reporting is necessary to prevent unreasonable and unconstitutional attribution of Caterpillar's income to Illinois. There is thus no substance to a facial attack against the constitutionality of worldwide combined reporting.

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26. See Brief of Caterpillar Tractor Co. as *Amicus Curiae* in support of Appellee at 7-9.

27. Container relies upon hypothetical considerations and attacks the facial validity of worldwide combined reporting because it cannot carry its burden of proving that California's application of worldwide combined reporting taxed income that was not rationally related to California.

28. *See Supra* p. 5; *supra* notes 15, 23 & 25.

III. Container's Due Process Arguments Lack Merit Because Container Has Not Borne Its Burden of Proving by Clear and Cogent Evidence that California's Application of Worldwide Combined Reporting Taxed Any of Container's Extraterritorial Net Income

Container has offered no proof to establish that if it had not conducted any activities in California for the years in question what its net income would have been for those years. Neither has it otherwise proved any extraterritorial taxation by California. Rather, it erroneously assumes that its "separate accounting" analysis proves extraterritorial taxation by California's use of the combination method. While relying on its internal separate accounting to prove its case, Container admits that this separate accounting is not accurate.[29] This argument based on "separate accounting" begs the reasonable attribution question at issue. For, if Container and its foreign subsidiaries in fact conducted a unitary business for the years in question, separate accounting does not establish the invalidity of an apportionment result. *Exxon Corp. v. Dep't of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942).[30]

Notwithstanding the foregoing, in order to prove the validity of its "separate accounting" for its net profits and those of its foreign affiliates, Container argues that "[b]ecause combined apportionment on a worldwide basis fails to account for the lower wage rates and greater profitability of foreign operations" worldwide combined apportionment is invalid on its face and as applied to Container. Appellant's Br. at 15,

29. *See supra* note 11.

30. The distortion in the attribution of income by the apportionment method as compared to separate accounting was far greater in *Exxon* and *Butler Bros.'* than any distortion claimed by Container to exist in this case. In *Butler Bros.*, the taxpayer contended that its California operations were operated at a loss of $82,851 and apportionment assigned a profit of $93,500 to California based on an apportionment of 8.1321 percent of the entire unitary income to California. This represents a difference of $175,000 or a shift of 15% of Butler Bros. net income between net income assigned to California by separate accounting and worldwide combination. In contrast, the average shift here is 2.28 percent.

11-18. It bases its "wage rates" argument (hereinafter referred to as Container's "payroll" argument) on its erroneous assumptions that: (1) "[c]ombined apportionment under the unitary method assumes that a dollar of property, payroll or sales of the parent (Container) produces approximately the same amount of income as a dollar of property, payroll or sales of a subsidiary" (*id.* at 11); and (2) under UDITPA, one-third of net income is attributable "upon the basis of payroll costs" (*id.* at 14). However, apportionment under the unitary method is based on the assumptions that: (1) the net income of a unitary business cannot be realistically divided by "separate accounting" to any particular costs, properties or activities; and (2) it is reasonable to attribute net income to where the business of the taxpayer is conducted as reflected by a composite result of all the factors of an apportionment formula. Thus, UDITPA assumes that the attribution of net income of a business in reference to the location of a taxpayer's sales, payroll and tangible properties *as an average* is a reasonable rough approximation for the geographical distribution of this net income. The fact that the factors are equally weighted for this purpose does not mean that one-third of net income is attributable to each factor.

Also, an attack on one factor of an apportionment formula does not prove the invalidity of the apportionment result.[31] For example, if property values are higher in a foreign area like Hong Kong or Western Europe, based on Container's theoretical "payroll" argument, the property factor would misapportion net income overseas. The same is true with the sales factor. In fact, California is not constitutionally required to use a payroll factor to apportion net income and could have used a single sales factor formula (*Moorman*) or a single property factor formula (*Underwood Typewriter*).

Container's argument in regard to higher expected (not actual) rates of returns of U.S. MNCs on investments in foreign countries, Appellant's Br. at 14, is also defective. As

31. *See Norfolk & Western Ry. v. North Carolina*, 297 U.S. 682, 688 (1936); *American Cement Corp. v. Graves*, 299 U.S. 517 (1936).

applied to Container, this argument is specifically refuted by the fact that three of its foreign subsidiaries operated at a loss in 1963, four in 1964 and one in 1965. Exhibit A at 1, 3, 5. Expected profits and profits received are separate and distinct factual issues.

Further, Container's distortion argument is not internally consistent. For, if the enormous claimed payroll and profitability distortions were actually reliable predictors of alleged misapportionment (Appellant's Br. at 12-14), the resulting alleged extraterritorial taxation would be *many* times greater than that claimed by Container on pages 16-18 of its brief. For example, while Container asserts that its payroll costs in foreign countries are many times less than its payroll costs in the United States (*id.* at 12-13) and its operations in foreign countries are many times more profitable than in the United States, it claims an actual distortion of $4,000,000 (Appellant's Br. at 17). Using Container's numbers (*id.*), this figure represents only a 14% difference between its separate accounting "net profits" and worldwide combination. This $4,000,000 difference is simply based on the difference of its "separate accounting" for its net profits and that of its subsidiaries for federal tax information purposes as set forth on Container's IRS forms 2952s for the years in question. These net profit figures do not represent the net profits on which any income taxes are computed by any country of the world.[32] Thus, the table on

32. Form 2952 is an information form filed with the Internal Revenue Service as part of the federal tax return of U.S. MNCs. This form is not used to compute any tax liabilities for any taxing jurisdiction and does not purport to accurately reflect any figures appearing thereon either in regard to the net profits or income tax liabilities of the taxpayer or its foreign affiliated corporations. *See supra* p. 7. (JA at 83-85). However, information on Container's 2952s for the tax years 1963, 1964 and 1965 was used to prepare Exhibit A (JAE at 1-6). The net profits disclosed in the 2952s were presumably determined by reference to generally accepted accounting principles which vary from country to country (JA at 83-85) and which differ from net taxable income as determined by various countries in which Container's subsidiaries operate. (*Id.*). Thus, these net profit figures must be treated as guesses or rough estimates. These net income figures hardly validate the *de minimis* misapportionment of net income upon which Container relies in this case.

table on page 17 of Container's brief does not prove distortion or double taxation.

Furthermore, these figures and those on page 16 of Container's brief do not correctly compare Container's U.S. source net income for federal income tax purposes with its U.S. source net taxable income for worldwide combination purposes. This comparison can only be made by comparing Container's U.S. source federal net taxable income in Exhibit A at 7, with Container's worldwide combined net taxable net income which was apportioned to U.S. sources by California's use of combination (factor information is derived from Exhibit A at 1-6 and net taxable income figure from *Id.* at 7). This comparison reveals that Container's average U.S. source net taxable income (including Subpart F income and California additions, such as state income taxes and interest on government obligations, which are clearly U.S. source income) for the years in question is *$32,803,794*. Net income attributable to the U.S. under the California worldwide apportionment method is *$34,244,889*. This represents a difference of *$1,441,109* or an attribution of approximately *3.23%* more to U.S. sources than attributable to U.S. sources for federal income tax purposes. Since Container asserts that its separate accounting profit is 9.43% of its U.S. receipts (Appellant's Br. at 14), this represents an increase of *only three tenths of one percent* of Container's U.S. source receipts based on its admittedly inaccurate separate accounting.

Since only approximately 8% of worldwide income was apportioned to California, increased net income attributable to California is only *$115,289*. When this is multiplied by California's tax rate, the tax result is *de minimus*, particularly when California's net income tax is deductible for federal income tax purposes. Furthermore, if the foregoing adjustments take into account foreign source income which is included in federal taxable income and the difference between federal depreciation and California depreciation deductions, this slight difference disappears.

In sum, the record does not support Container's argument that worldwide combined reporting is unconstitutional on its face or as applied. If Container is entitled to anything, it is apportionment relief[33] which it has not requested.

IV. Contrary To Its Argument,[34] Container Has Not Shown That California's Use of the Combination Method Results in the Taxation of Income That Was Also Taxed By Foreign Countries

Container asserts that "California is not only taxing income which has been *earned* in foreign countries under the system of allocation applied in those countries, California is taxing income which is, in fact, also *taxed* by the foreign countries in which Container's subsidiaries operate." Appellant's Br. at 21. This statement is not correct. Regarding the foreign countries in which Container's subsidiaries operated, the record fails to indicate (1) the allocation methods employed by the foreign countries; (2) the subsidiaries' actual net taxable income reported to those countries; and (3) taxes actually paid to those countries. Container has conspicuously failed to produce the actual tax returns filed by its foreign subsidiaries with foreign countries in which they operated for the years in question. One can only surmise that Container has failed to do this because this information would not have supported either its distortion or double taxation arguments. Rather, as discussed above, Container relies upon the net profit figures in Exhibit A at 1-6 which are taken from its IRS form 2952 which it filed for informational purposes with its federal tax returns. These net profit figures are *not* the net taxable income figures reported to foreign countries (JA ¶ 21 at 11-12) and they are not accurate (JA at 83-85). Furthermore, the taxes paid by the foreign subsidiaries to foreign countries as contained in Container's 2952s (reproduced in Exhibit A at 1-6) are not

33. *See Hans Rees' Sons; Norfolk & Western Ry. See also* UDITPA § 18, Cal. Rev. & Tax Code § 25137, which provides for apportionment relief if a taxpayer can establish that the apportionment provisions do not fairly represent the extent of the taxpayer's business activities in the state. As demonstrated herein, Container has simply not carried its burden of proving that it is entitled to UDITPA § 18 apportionment relief.

34. Appellant's Br. at 21-26.

complete or accurate figures, neither are they based on the net profit figures contained in the 2952s.[35]

In any event, California has taxed only approximately 8% of the combined net income of Container and its subsidiaries and Container has not shown that more than 92% of this combined income has been taxed either by other states or by foreign countries.

Assuming *arguendo* that Container has demonstrated that there is some overlap in taxation between the method employed by California in determining Container's income apportionable to California and the methods used by foreign governments to tax Container's subsidiary corporations, this does not raise a foreign commerce clause issue. California only asserts tax liability against Container for its California activities. California tax is not imposed on and is no more associated with foreign commerce than the New York income tax in *Bass, Ratcliff & Gretton*. In *Bass* the taxpayer's apportioned income was derived in part from foreign activities. In Container's case, its income is derived solely from its domestic U. S. operations. When Container conducts a unitary business with its foreign subsidiaries, worldwide combination is simply a method used to determine its true net income which it derives from its U.S. business which it conducts in the taxing state. Container's argument that the

35. As discussed above, the inaccuracy of the net profit and tax figures in Exhibit A is demonstrated by the fact that they disclose an average of $34,000 in pre-tax income to Italy and tax liability on the average of over $121,000 to Italy based on this profit or 356% of the $34,000 pre-tax net profit figure. *See supra* p. 7.

In spite of the foregoing, Container asserts that the tax figures reproduced on page 84 of the Joint Appendix and the net profits of its foreign subsidiaries, as set forth in Exhibit A at 1-6, establish that California taxes net income which has been taxed by Colombia and Venezuela according to the arm's-length principle *actually applied in those countries*. Appellant's Br. at 22-23. This statement is not supported by the record. Assuming *arguendo* that tax treaties were relevant, no tax treaties exist between the United States and these countries. Neither does the fact that Container filed returns with these countries (as set forth in JA ¶ 140 at 72) support this statement. Furthermore, the long footnote No. 11 on pp. 25-26 of Container's brief is not a source of proof.

attribution of any net taxable income to California which is not reflected in its own separate accounting is the taxation of extraterritorial income earned in foreign commerce is analogous to the taxpayer's argument in *Bass* that New York imposed a tax on extraterritorial foreign income by use of the apportionment method and to the taxpayers' arguments in *Exxon* and *Underwood Typewriter Co.* that extraterritorial domestic income was taxed under the apportionment method. However, in these cases the Court held that the apportionment of the net income of a unitary business was a valid means to determine instate net income. Thus, the instant case is clearly distinguishable from *Japan Line* where the property tax was imposed directly on foreign corporations' property used exclusively in foreign commerce.[36]

Thus, for the reasons set forth above and *supra* pp. 18-20 in reference to Container's distortion argument, Container has clearly not proved any "double taxation." And, as indicated at *supra* p. 13, this Court has refused to resolve "double taxation" claims based on theoretical and hypothetical considerations.

V. Substantial Evidence in the Record Supports the Lower Court's Holding That Container and Its Subsidiaries Conducted a Unitary Business Sufficient to Meet the Rational Relationship Test of the Due Process Clause[37]

The narrow constitutional issue before this Court is whether the lower court's holding that Container and its foreign subsidiaries conducted a worldwide unitary business

36. For further consideration of the foreign commerce clause argument of Container and its *amici* see the *amicus* brief of the Multistate Tax Commission in the pending *CBI* case.

37. As discussed above, this brief will not consider the relevancy of the due process tests as discussed in *ASARCO* and *Woolworth*. *See supra* note 17. In addition, those decisions erroneously resolved a combination method issue (the issue here in *Container*) when the actual issue before the court was a unitary apportionment issue — whether dividend income received by an existing unitary business could be included in the business' apportionable income. *See supra* note 15. In the alternative, as demonstrated in Appellee's brief, this case is factually distinguishable from *ASARCO* and *Woolworth*.

is consistent with the due process clause. The due process clause provides a minimal protection to taxpayers, insuring that the "taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state."[38]

As stated by Professor Lathrop:

> The unitary business concept . . . is not the linchpin of apportionability. The linchpin of apportionability in the due process sense is whether the amount of net income attributed to the state has a rational relationship to the business activities carried on in that state for which the state has given benefits and can ask compensation in return.[39]

The reasonableness of the apportionment result, not the unitary business principle, is the ultimate due process test. *See Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968) (state property tax); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931) (state corporate income tax). In both of these cases the apportionment formula result was invalidated on due process grounds even though the formula only apportioned the unitary income or the unitary property values. To our knowledge, this Court has never invalidated a state income tax apportionment case based on the unitary business principle, except in *ASARCO* and *Woolworth* where a Petition for Rehearing is pending. *It cannot be overemphasized that due process is a result oriented test, not a method oriented test: regardless of the method employed, the crucial issue is whether the taxing result represents a taking of the taxpayer's property without due process of law.*

Although the resulting income attributed to California does not violate the due process clause because it is well within

38. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940).

39. Lathrop, *Due Process Considerations and the Apportionment of Dividend Income: A Dissent From the ASARCO and Woolworth Decisions*, 16 Tax Notes 1 at 3, 20 (July 5, 1982). See the *amicus* brief of Idaho and Utah, filed as a supplement to this brief.

rough approximation apportionment standards,[40] if required, the record supports California's factual decision to combine Container and its foreign subsidiaries into one unitary business.[41] From the states' perspective, the complex factual inquiries necessary to prove that a parent and its subsidiaries are subtly interwoven can present an administrative nightmare.[42] The needed facts are entirely in the possession and control of multinational corporate taxpayers at various locations around the world.[43] As illustrated by the record in

40. See our response to Container's distortion argument in III. above at pp. 16-20.

41. In an effort to address the problem of what facts are necessary to determine which entities are engaged in a single trade or business, *see* Reg. IV.1(b), to the Multistate Tax Commission's UDITPA Allocation and Apportionment Regulations, which is reprinted in 7 Multistate Tax Comm'n Ann. Rep. 64, 65, App. J (1973-74).

42. In order to resolve these complex factual issues, Container suggests that this Court should adopt a due process standard of substantial flow of goods. Appellant's Br. at 47. We submit that this is a simplistic oversimplification of the problem.

43. When a taxpayer needs to prove that it engaged in a single worldwide unitary business, the taxpayer can easily produce the necessary facts to prove their business is a worldwide unitary business. For example, consider the thorough record established by Caterpillar Tractor Co. in the *CBI* case.

On the other hand, the difficulties faced by a state that needs to obtain the necessary facts from an uncooperative taxpayer cannot be overemphasized: the limited and overworked resources of the states are virtually no match for a large multinational corporation that decides to pursue a course of delay and judicial obstructionism. For example, consider the Multistate Tax Commission's protracted dispute with United States Steel Corp. The first round of this controversy lasted six years, required two district court opinions, and concluded with this Court's holding that the Multistate Tax Compact is Constitutional in *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978), *aff'g* 417 F. Supp. 795 (S.D.N.Y. 1976).

The second round of this controversy with U.S. Steel began in 1976 and is currently on appeal for the second time to the Ninth Circuit. In spite of three district court orders requiring U.S. Steel to produce the necessary relevant information, the matter remains stalled in the courts, and U.S. Steel continues to refuse to provide this information. *See generally Multistate Tax Comm'n v. United States Steel Corp.*, No. 1-76-182 (D. Idaho); *Multistate Tax Comm'n v. United States Steel Corp.*, 659 F.2d 931 (9th Cir. 1981); *Multistate Tax Comm'n v. United States Steel Corp.*, No. 82-3181 (9th Cir. Briefs submitted).

this case, the states are forced to rely upon stipulated records and cross examination of the taxpayer's witnesses to prove the necessary factual ties to support a combined report. Judicial presumptions should favor the states while also permitting corporate taxpayers to rebut the presumptions to establish that the states are taxing extraterritorial income.

Resolution of these presumptions revolves around how one views a Multinational Corporation (MNC). If a MNC is presumptively viewed as a single economic unit, "a cluster of corporations of diverse nationality joined together by ties of common ownership and responsive to a common management strategy,"[44] then the taxpayer must shoulder the burden of proving that the result of a state's taxing method violates the taxpayer's due process rights.

Much has been written in regard to the fundamental nature of MNCs.[45] The following general description accords with common sense and business reality:

> Although MNC subsidiary corporations are legally separate, in fact MNC parents tend to view them as parts of the single global system whose overall success, rather than that of any individual component, is considered critical. From a business viewpoint, then, the

44. Vagts, *The Multinational Enterprise: A New Challenge For Transnational Law*, 83 Harv. L. Rev. 739, 740 n.4 (1970) (quoting from Vernon, *Economic Sovereignty At Bay*, 47 Foreign Affairs 110, 114 (1968)).

45. *See* L. Solomon, *Multinational Corporations and The Emerging World Order* (1978); R. Vernon, *Storm Over The Multinationals - The Real Issues* (1977); R. Vernon, *Sovereignty At Bay - The Multinational Spread of U. S. Enterprises* (1971); M. Wilkins, *The Maturing Multinational Enterprise - American Business Abroad From 1914 to 1970* (1974); Vagts, *supra* note 44.

Professor Solomon states that "[a] decentralization ideology masks the reality of centralization, in which one corporate nerve center devised a common corporate strategy and made fundamental decisions regarding production, marketing, finance and research. Discipline and continuity were maintained through common training and coordination." L. Solomon, *Multinational Corporations and the Emerging World Order* 20 (1978).

operations of the MNC largely transcend the geographic boundaries of the various nations of incorporation.[46]

In specifically analyzing the crucial issue of parental control, one author illustrates the broad spectrum of factual relationships that exist between MNC parents and their subsidiaries:

> A survey of the European subsidiaries and other units of 127 American corporations indicated that approximately 40% imposed single "strict" control, 40% evidenced "loose" control and 20% had control that was intermediate, flexible, undeterminable or in the process of being changed. A trend for stricter control was noted, stemming from three factors: the ease of communication and transportation; the development of the European Common Market, which resulted in the reorganization of distribution and marketing functions; and the growth and importance of the European subsidiaries as corporate profit centers. Other expert observers view control by American firms as declining over time as foreign affiliates gained experience.[47]

Unless this Court presumes (subject to clear and convincing proof to the contrary) that a single business exists when a MNC parent and its subsidiaries engage in the same line of business, this Court will be encouraging a multiplicity of suits to review innumerable degrees of factual MNC control relationships. Logic dictates that this Court should presume that MNCs in the same line of business are conducting a unitary worldwide business. Absent this presumption, the states will be faced with the insurmountable burden of making detailed complex factual inquiries of MNC taxpayers.

The facts in the case at bar affirm that a MNC parent, operating in the same line of business as its many foreign subsidiaries, is so inexorably intertwined with the subsidiaries' business affairs that the corporate cluster should be presumed to be acting like a single worldwide

46. Note, *Multinational Corporations and Income Allocations Under Section 482 of the Internal Revenue Code*, 89 Harv. L. Rev. 1202 (1976).

47. L. Solomon, *Multinational Corporations and the Emerging World Order* 21 (1978).

business. Container's numerous admissions in the stipulated record support this presumption by clearly indicating that Container: (1) represented itself as a worldwide company, referred to its foreign operations as divisions, and referred to its foreign employees as its own employees in its 1963 annual report (Exhibit I); (2) engaged in the same line of business with all of its foreign subsidiaries except one (a holding company without tangible property or employees) (JA ¶ 25 at 14); (3) owned a controlling interest in all twenty of its foreign subsidiaries (JA ¶ 25 at 14-15, ¶ 10 at 7); (4) created and founded eleven of their foreign subsidiaries (JA ¶ 25 at 14); (5) studied and made recommendations on whether to create a new subsidiary or enter a new market (JA ¶ 28 at 16-17); (6) admitted that a majority of the positions on the boards of directors on over half of the foreign subsidiaries were held by non-local representatives. (Appellant's Br. at 3); (7) reviewed most of the subsidiaries' "major policy matters" (JA ¶ 74 at 39); (8) entered into detailed written contracts when permitted by local law, to provide an astounding range of technical services, information, and personnel to its foreign subsidiaries,[51] including confidential information (JA ¶ 144 at 74, Exhibit F); (9) loaned money to its foreign subsidiaries (JA ¶ 133 at 69); (10) guaranteed loans made to its foreign subsidiaries

48. These technical service agreements demonstrate that Container was inexorably intertwined in the business affairs of its subsidiaries. For example, consider Container's contract with its German subsidiary:

> II. BREMER PAPIER is engaged in the same industries as CONTAINER. In order to develop its business on the German market, BREMER PAPIER wishes to partake of the experiences accumulated by CONTAINER in the industries as referred to in Recital I hereof by requiring assistance of CONTAINER . . . .
>
> FIRST: CONTAINER binds itself to perform services and to provide advice and consultation to BREMER PAPIER concerning manufacturing techniques, engineering, design, architecture, insurance and cost accounting in accordance with CONTAINER's progress in these areas, and to render any other assistance which BREMER PAPIER may require in connection with any aspect of its industrial or commercial operations. (Exhibit F at 9-10).

Another example of broad spectrum of services that Container provided is the Contract with one of its Mexican subsidiaries:

(JA ¶ 133 at 70); (11) helped subsidiaries "in their acquisition of equipment and machinery" (JA ¶ 147 at 76); (12) assisted the foreign subsidiaries' purchase of equipment from independent suppliers" (JA ¶ 148 at 77); (13) sold "linerboard," "paperboard" and "raw materials" to its foreign subsidiaries (JA ¶ 141 at 73); (14) purchased paper for its foreign subsidiaries (JA ¶ 143 at 74); (15) entered into a joint venture with one Colombian subsidiary (JA ¶ 158 at 81); (16) assisted a foreign subsidiary's contract negotiations (JA ¶ 65 at 33); (17) made its design laboratories and design information (JA ¶¶ 66, 67 at 34-35) and its product information (JA ¶ 86 at 46, ¶ 92 at 49) available to its subsidiaries; (18) assisted the foreign subsidiaries to find qualified personnel (JA ¶ 89 at 48, ¶ 95 at 51); (19) trained key subsidiary personnel (JA ¶ 79 at 42); (20) demonstrated a specific machine or process, and discussed specific topics, with key subsidiary personnel (JA ¶ 108 at 55); (21) established "approximately 10-12 visits per year for 2-6 week periods by foreign employees to the United States to familiarize themselves with the methods of operation of CCA" (JA ¶ 131 at 69); (22) transferred employees to subsidiaries (JA ¶ 120 at 62); (23) paid the salaries of some employees of foreign subsidiaries (JA ¶ 124 at 64-65); (24) maintained a " foreign operations staff" (JA ¶ 126 at 65); (25) had three members of this foreign operations staff make "decisions regarding its foreign subsidiaries" and present

Footnote 48 (con't)

FIRST: Container binds itself to render Carton y Papel technical assistance for the efficient operation of the industrial plants referred to in Recital II hereof, for the efficient production of board and cardboard and corrugated shipping containers, as well as for any other similar activity that Carton y Papel may carry out in the future in Mexico. As a consequence of Container's obligation, Carton y Papel shall have the right to receive technical assistance as far as concerns the purchase of machinery and raw material, the supervision of production methods and the improvement of same in accordance with Container's technical progress, the information of such raw material or finished products markets as may be of interest to it, as well as any other assistance which it may require in connection with any aspect of its industrial or commercial operations. (Exhibit F at 20).

"studies and made recommendations to CCA's Management Committee and Board of Directors" (JA ¶ 129 at 67); (26) stipulated that its Director of Taxes and Insurance was thoroughly experienced with the subsidiaries' tax and financial affairs (JA at 83); (27) had 26 former employees working for the foreign subsidiaries (JA ¶ 120 at 62), at least ten of whom functioned at the corporate or division level (Exhibit D); (28) paid 38 employees who were employed by the foreign subsidiaries (JA ¶ 119 at 60); (29) had officers or employees serving on every subsidiary Board of Directors except one inactive subsidiary (Exhibit E); (30) had nine officers who also served on the Board of Directors of the foreign subsidiaries (JA ¶ 131 at 68); (31) had its accountant, Arthur Anderson & Co., audit all but two of its subsidiaries (JA ¶ 138 at 72); (32) had its insurance agent insure many of its foreign subsidiaries (JA ¶ 149 at 78); (33) had its general counsel devote 40% of his time to insure that the foreign subsidiaries conformed to "CCA's standards for professionalism, profitability and ethical practices" (JA ¶ 128 at 66); (34) developed accounting procedures to facilitate receipt of financial information (JA ¶ 136 at 71); (35) received monthly and yearly profit reports from the foreign subsidiaries (JA ¶ 135 at 71) because Container "worked toward achieving the most efficient systems and procedures possible" (JA ¶ 139 at 72); (36) reviewed the subsidiaries' budgets at its annual meeting (JA ¶ 134 at 70); and (37) had a special Management Committee that made quarterly reviews of the subsidiaries' capital projects (*id.*).

Because these numerous factual admissions support the lower court's holding that Container and its subsidiaries conducted a *de facto* single business, this Court should accept and affirm the trial court's findings of fact. *See Fry Roofing v. Wood*, 344 U.S. 157, 160 (1952); *Grayson v. Harris*, 267 U.S. 352, 358 (1925); *Portland Ry., Light & Power Co. v. Railroad Comm'n*, 229 U.S. 397, 412 (1913). These facts amply demonstrate that Container has thorough knowledge of, and was inexorably intertwined in the business affairs of all of its subsidiaries for the years in question. Although Container's brief characterizes its involvement with its subsidiaries as occurring in "limited instances,"[49] nothing in the record indicates Container's above involvements were not absolutely essential to the business success of the plarent or its subsidiaries.[50] In resolving the question of whether Container's subsidiaries conducted independent discrete business enterprises, the decisive determination requires examination of the quality and character of Container's involvement in the affairs of its foreign subsidiaries, not examination of the mere frequency or quantity of their interactions. In any event, this involvement is sufficient to overcome Container's claimed violation of its due process rights, where, as in this case, the difference between Container's separate accounting and worldwide combination results are well within reasonable apportionment limits.

CONCLUSION

The record does not support Container's due process clause or commerce clause arguments that worldwide combined reporting is unconstitutional on its face, or as applied by California. Container is champion of no legal rights except its own. As an abstract theoretical proposition, Container cannot be denied due process of law or be subject to "double taxation." Worldwide combined reporting is not unconstitutional on its face. Worldwide combined reporting is constitutional as applied by California because Container failed to prove actual taxation of extraterritorial income. The controlling principle should be the reasonableness of the apportionment result, not the unitary business principle *per se*. Container has further failed to carry its burden of proof because ample evidence in the record supports the trial court's factual finding that Container conducted a unitary business with its foreign subsidiaries for the years in question. We therefore respectfully submit that this Court should affirm the judgment of the court below.

Respectfully submitted,
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49. Appellant's Br. at 5.

50. Taxpayers often argue that they provide services (such as those listed above) to protect their investments, not to control the operations of their subsidiaries. We submit that this distinction is illusory and incapable of definition.