The Unitary Tax Method: Are the Factors Used by California in the Determination of Unity Still Viable after ASARCO and Woolworth?

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The Unitary Tax Method: Are the Factors Used by California in the Determination of Unity Still Viable After ASARCO and Woolworth?

A question of constitutional law that has long been settled is that a state can tax the income of a corporation engaged in business within the taxing state. Indeed, most states now levy a tax either on, or measured by, corporate income. For those corporations that confine their business activity to one state, traditional separate accounting methods can be relied upon to produce a sufficiently accurate measurement of income for state taxation purposes.

When a corporate taxpayer is doing business both in and out of the taxing state, however, this income measurement problem becomes difficult. Corporations conducting interstate business, including both multistate and multinational operations, are referred to as multijurisdictional corporations. Under traditional separate accounting concepts, the income from a business transaction can be conclusively determined only upon the completion of the transaction. The problem that a state faces in relying upon the separate accounting method for the purpose of taxing a multijurisdictional corporation centers around what are called "transfer prices." Transfer prices are the

4. Id.
6. For example, if a company manufactures a product at a cost of $10 and then spends another $5 in selling expenses to produce sales revenues of $20, there would clearly be income of $5 from this business activity ($20 income less the total costs of $15). If an attempt is made to determine the income produced by the manufacturing process alone, however, traditional accounting is no longer infallible. The manufacturing would have contributed nothing to income unless the later sale took place, but the sale could not have taken place without the item having been manufactured in the first place. So where and when was the $5 of income earned? See Seago, supra note 1, at 103-04.
7. See Keesling, supra note 3, at 305.

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theoretical or actual prices at which *intragroup* transactions take place.\(^8\) Unless these transfer prices used for internal bookkeeping purposes approximate those which would occur in true arm's-length\(^9\) transactions, the resulting income amount will not reflect the economic reality of the transactions.\(^11\) Thus, under traditional separate accounting methods, a multijurisdictional corporation could manipulate the income reported within California. By adjusting the transfer prices used in the determination of corporate income, the corporation could show a lower portion of total income as having been earned in that state.\(^12\)

As a result, approximately forty-five states have created some apportionment method,\(^13\) generally referred to as "the unitary method." These unitary tax methods determine the portion of a multijurisdictional corporate taxpayer's income apportionable to each individual state in which the corporation has activities.\(^14\) The tax computed on the apportioned income of a multijurisdictional corporation is thus referred to as a unitary tax. The complexity of the accounting problems encountered,\(^15\) the nonuniformity of the apportionment methods that have been devised,\(^16\) and the importance of the constitutional issues involved,\(^17\) have combined to create numerous and intensive controversies between the multijurisdictional corporations and the taxing states.\(^18\)

Since the 1977-1978 term, the United States Supreme Court has accepted an increasing number of cases involving the federal constitutional limits on state apportionment methods for taxing multijurisdictional corporations.\(^19\) The federal constitutional aspects of state income taxation include the privileges and immunities, due process, commerce, and equal protection clauses.\(^20\) Many of the state unitary tax cases involve concurrent challenges under both the due process

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8. *Intragroup* transactions are business exchanges between (1) segments of one corporation or (2) two or more corporations that are part of an affiliated group of corporations. *See* *id.*


10. An arm's-length transaction is one made at the price that would prevail in a true market transaction. *Id.* at 1137.

11. *Id.* at 1138.

12. *Id.*


14. *See infra* notes 111-72 and accompanying text.

15. *See generally* Keesling, *supra* note 3 (for example, income allocation and the identification of proper transfer prices).


17. *See infra* notes 173-252 and accompanying text.


and the commerce clauses. Significantly, in two 1982 landmark decisions, *ASARCO Inc. v. Idaho State Tax Commission,* and *F.W. Woolworth Co. v. New Mexico Taxation and Revenue Department,* the United States Supreme Court has emphasized the importance of a due process analysis of the constitutionality of state formulary apportionment methods. In both of these decisions, the Court found that the attempt by these states to tax foreign source income violated the due process clause and thus there was no need to reach the taxpayers' commerce clause claims. The most recent review of a California unitary tax decision by the United States Supreme Court was *Container Corporation of America v. Franchise Tax Board,* decided on June 27, 1983. The Supreme Court in *Container Corp.* found that the state had properly applied the unitary business concept in taxing the appellant, a multijurisdictional corporation. The *Container Corp.* decision, in addition to dealing with the issue of unity, involved the more complicated issue of whether proportional taxation of income earned outside of the United States violates the commerce clause. Nevertheless, the *Container Corp.* case serves as an excellent example of (1) the principles involved in a due process analysis of the apportionment method of income taxation and (2) the attitude of the United States Supreme Court toward the current controversies between taxing states and taxpayers. Accordingly, this comment will focus on a due process analysis of the constitutionality of the formulary apportionment method used by California for taxing multijurisdictional corporations.

In addition to the emphasis placed upon due process considerations in these recent apportionment cases, the United States Supreme Court has declared that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." The Court has reiterated the vital role of this unitary business concept in all of the current decisions regarding taxation of multijurisdictional corporations. Therefore, this comment will examine the unitary business concept from its inception in early property tax decisions to its current status as

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21. *Id.* A state must have jurisdiction to tax in a substantive due process sense, however, before there can be a question as to whether that tax imposes an improper burden on interstate commerce. *Id.*

22. 102 S. Ct. 3103 (1982).

23. 102 S. Ct. 3128 (1982).

24. *See generally ASARCO,* 102 S. Ct. at 3109; *Woolworth,* 102 S. Ct. at 3134.

25. Foreign in the sense that the income was earned outside of the taxing state's borders. *See ASARCO,* 102 S. Ct. at 3111-12; *Woolworth,* 102 S. Ct. at 3131-34.


29. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 223 (1980); *ASARCO,* 102 S. Ct. at 3110; *Woolworth,* 102 S. Ct. at 3134; *Container Corp.*, No. 81-523, slip. op. at 4.
the central and cohesive element in the recent controversies between the multijurisdictional corporations and the taxing states in general, and California in particular.

California applies the unitary tax method based on apportionment of the income earned in interstate business by multijurisdictional corporations. The resulting tax revenue is an important source of income for this state. A meaningful examination of the effect that ASARCO and Woolworth will have on the unitary tax method used by California must begin with an understanding of the reasons why California adopted an apportionment method for taxing these corporations, as well as the historical development of the current California unitary tax approach. Following a brief description of the way in which the California unitary tax is computed, and a comparison of the factors of unitariness applied in ASARCO and Woolworth with those currently used by the California tax authorities, this comment will discuss the due process requirements involved in evaluating the constitutionality of an apportionment method. This comment will conclude that the approach to apportionment in California will meet the due process challenge exemplified by ASARCO and Woolworth if certain adjustments are made in that approach. The starting point in an analysis of the constitutionality of the California unitary tax method is an understanding of the method as currently applied by the state taxing authorities and courts.

**THE UNITARY TAX METHOD IN CALIFORNIA**

The need for an apportionment method based on the unitary business principle became apparent upon enactment of the first California corporate income tax and franchise tax laws. California was already

30. See Frentz, supra note 2, at 474-512; Container Corp., No. 81-523, slip op. at 3 (the method has gained wide acceptance and one form of it is the basis for the Uniform Division of Income for Tax Purposes Act, now substantially adopted by California and twenty-two other states).
31. Church, Senator Church on Unitary Taxation, 11 TAX NOTES 6, 6 (1980).
32. See infra notes 42-65 and accompanying text.
33. See infra notes 66-110 and accompanying text.
34. See infra notes 111-72 and accompanying text.
35. See infra notes 262-340 and accompanying text.
36. See infra notes 173-261 and accompanying text.
37. See infra notes 345-50 and accompanying text.
38. Frentz, supra note 2, at 475.
39. See generally CAL. REV. & TAX. CODE §§23501-23572. In addition, California imposes a franchise tax on corporations organized in California and foreign corporations doing business in California. See generally id. §§23101-23404. The Code defines “doing business for this purpose as “actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.” CAL. REV. & TAX. CODE §23101. For unitary tax purposes it is immaterial whether a corporation is taxable under the income tax or under the franchise tax provisions. Frentz, supra note 2, at 489.
popular as a distribution point for Eastern manufacturing concerns. These interstate businesses could, with comparative ease, structure and price their intracompany transactions so that the California activity showed little or no income.

A. Necessity

Due to the rapid growth in both the size and the complexity of individual business entities, many corporations have ceased to confine their business activities to one state. Corporations continue to open branch offices or incorporate subsidiaries within California as outlets to distribute and sell products that have been manufactured at plants located in other parts of the country. Therefore, states like California have had to find a method for separating the income of this type of a taxpayer into that income earned outside of, and that income earned inside of, the state. Two alternative methods are available: traditional separate accounting and the apportionment method.

1. The Traditional Separate Accounting Alternative

Traditional separate accounting, the application of commercial accounting principles to determine the source of income, is satisfactory to the state taxing authorities in those instances in which activities are carried on both inside and outside of California if the business carried on within the state is truly separate and distinct from the business outside of the state. If the intrastate and extrastate activities are interdependent, however, accurate measurement of the taxable income generated within the state by application of separate accounting principles is extremely difficult. The unitary business principle is based on the rationale that when the in-state portion of a business is interrelated with the out-of-state portion of that business, the overall operations should be taken into account in determining the amount of joint income that should be taxed by the various states involved. For example, if a corporation manufactures products in Nevada, but sells all of those products in California, the resulting "income" is earned in a series of

40. Frentz, supra note 2, at 475.
41. Id.
42. The principles governing the allocation of income of a unitary business are the same whether that business is conducted by one corporation with divisions or by one corporation with several subsidiaries. Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472, 480, 183 P.2d 16, 21 (1947).
43. See infra notes 45-65 and accompanying text; Container Corp., No. 81-523, slip op. at 3.
45. See supra note 3.
46. 18 CAL. ADMIN. CODE §25101(a).
47. See infra notes 42-60 and accompanying text.
transactions beginning with the purchase of raw materials in Nevada and culminating in the receipt of sales revenues in California. Each state has conferred the benefit of allowing the corporation to do business within the borders of that state, but each is faced with the impossibility of specifically allocating the profits earned within that state. The series of income-producing steps is thus viewed as a unit or as a “unitary business.”

The separate accounting method would account for a transaction of this type by assigning a transfer price, presumably the price that would prevail in a true market or arm’s-length transaction, to the product at the time of transfer from the manufacturing state to the selling state. This theoretical or actual payment would then serve as a “revenue” measurement in the Nevada manufacturing process and as a “cost” measurement in the California sales process. Thus, under the separate accounting method, the income reported in a given state is subject to manipulation by the corporate taxpayer, since that is the party who establishes the transfer price. Multijurisdictional corporations, whether in the form of one large corporation with separate divisions, or a parent corporation with multiple subsidiaries, can easily avoid state income taxes by income shifting effected through the strategic use of transfer prices. Nevertheless, opponents of the apportionment method argue that the opportunity to manipulate transfer prices is more than offset by (1) the internal and external pressures that operate to ensure that prices charged in intracorporate transfers are arm’s-length, and (2) the relatively low level of state taxes.

Manipulation of reported in-state income by multijurisdictional corporations is not, however, the only problem that taxing states have with the separate accounting method. Current use of the arm’s-length method by the Internal Revenue Service for taxing multinational corporations has shown that this method creates an unacceptable level of uncertainty, unreliability and administrative burden for both the Service and the taxpayer. Additionally, application of the separate ac-

50. Seago, supra note 1, at 103.
51. Cory, supra note 9, at 1137 (the price that one division or corporate subsidiary of an integrated company charges other divisions).
52. See supra note 10.
53. See Cory, supra note 9, at 1137-38.
54. Id.
55. Id. at 1137.
56. See supra note 10.
57. See generally Taggart, Arms Length Pricing and the Unitary Method, 11 TAX NOTES 177 (1980).
58. See The GAO on IRS Administration of Section 482, 13 TAX NOTES 877, 877 (1981) (“in the modern economic system of multinational business, a true arm's length price can rarely be identified”); Container Corp., No. 81-523, slip op. at 3.
counting method to each corporation engaged in a unitary business has been compared to "trying to determine which part of a baseball pitcher's body is the key to his success: by the same token, all parts of a unitary business are vital to the overall profitability of the business." 59

Faced with these inadequacies of the separate accounting method, California, among other states, has adopted the unitary method of apportionment for taxing corporations with business activity in more than one state. 60

2. The Unitary Method of Apportionment

Several points favor the use of a unitary apportionment method to allocate the total income earned by a multijurisdictional corporation among the states in which that business is active. When a corporation's business within the state and its business outside of the state are interrelated, an apportionment method of taxation conforms more equitably to economic reality in distributing tax burdens. 61 In addition, the apportionment method precludes the use of separate accounting to engage in tax avoidance or income shifting and eliminates the problem of establishing theoretical arm's-length market prices when standard market prices may not exist. 62 Despite these points in favor of using an apportionment method, many commentators continue to view the unitary tax method as merely the better of two evils because the only alternative is the separate accounting method. 63

The problem with the apportionment approach is the difficulty encountered in developing a method that will do what that method is intended to do without violating the taxpayer's constitutional rights: identify the real economic contribution that the business activity within the state makes to the overall corporate unit and fairly allocate the resulting total unitary income among the states involved. 64 A brief review of the evolution of the unitary tax method in California via statutory and decisional law is a useful preliminary step in understanding the current apportionment method used in this state. That history therefore will be presented in the next section of this comment. 65

59. Corrigan, supra note 44, at 808.
60. Cory, supra note 9, at 1138.
61. Id.
63. Corrigan, supra note 44, at 808. “[T]here is one overwhelming argument for the unitary approach: it can actually be used to collect taxes.” Cory, supra note 9, at 1138.
64. Cory, supra note 9, at 1138.
65. See infra notes 69-113 and accompanying text.
B. History of the California Unitary Tax Method

The earliest application of the unitary principle to apportionment problems occurred in property tax cases involving railroad and telegraph companies operating in more than one state. Fairly simple apportionment formulas, often involving only a single factor as the basis for apportionment, were developed based on the ratio of in-state facilities to total facilities maintained by that corporation. By the early 1920s, the United States Supreme Court had approved state use of an apportionment method for income tax purposes if the method was not "inherently arbitrary" and did not "produce an unreasonable result" or "reached, and was meant to reach, only profits earned within the state." The simple, single factor apportionment formulas that were tested in these early cases were viable for the relatively simple business operations involved, that is, manufacturing or purchasing products in one state and selling them in another. As the complexity and size of multistate business entities increased, so did the complexity of the apportionment methods and the taxpayers' challenges to those methods. For example, California currently uses a method involving a three factor formula based on gross sales, payroll, and property.

In the 1942 landmark decision of Butler Brothers v. McColgan, the United States Supreme Court approved the statutory apportionment formula used in California. Earlier in the Butler case, the California Supreme Court had stated:

> Allocation of income, to the various states in which the business is done, by means of a formula that gives weight to the various factors such as property, services of employees, and sales, which are responsible for the earning of income, appears entirely reasonable.

The California Supreme Court decision in Butler is also the source of the frequently cited "three unities test" for determining the presence of unity in an interstate business:

> The unitary nature of the appellant's business is definitely estab-
lished by the presence of the following circumstances: (1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) Unity of use in its centralized executive force and general system of operation.\textsuperscript{77}

Thus, in \textit{Butler}, the highest court of the state established an approach to the determination of the presence of unity, an approach necessitated by the reluctance of the United States Supreme Court to explicitly define a unitary business.\textsuperscript{78}

Five years after \textit{Butler}, the California Supreme Court, in \textit{Edison California Stores, Inc. v. McColgan},\textsuperscript{79} reiterated the three unities test\textsuperscript{80} and then added another important and distinctive test of a unitary business that has received wide usage by the courts: whether the business done within California is "dependent upon or contributes to"\textsuperscript{81}the operation of the business done outside the state.\textsuperscript{82} Most of the important cases in this area,\textsuperscript{83} from the \textit{Edison} case until present, have involved refinements in the concept of what constitutes a unitary business.\textsuperscript{84} Both the \textit{Butler} three unities test and the \textit{Edison} test are still used by the California courts and taxing authorities as the basic tests for unitariness in California.\textsuperscript{85} The courts frequently apply \textit{both} tests in a single case.\textsuperscript{86} These tests, however, serve only as broad guidelines for developing the factors of unity. The factors are used in assessing actual business operations to decide if the unity present is constitutionally sufficient to support income allocation for tax purposes. What will be considered constitutionally sufficient is discussed in a later section of this comment.\textsuperscript{87}

If the three unities are present in a given factual situation, the unitary nature of the business is definitely established\textsuperscript{88} and the burden shifts to the taxpayer to show that the apportionment method produces an arbi-
The rebuttable "presumption" created by the presence of the three unities,\(^{90}\) and the "strong inference" of unitariness created by the *Edison* test,\(^ {91}\) are the end result of a case-by-case analysis of the various factors into which these two tests can be broken down.\(^ {92}\) No "formula" or "magic combination" of these factors of unity is used by the taxing authorities or the courts to determine whether or not a unitary business is present.\(^ {93}\) The relative weight placed upon the individual factors by the taxing authorities varies not only with the type of business, but even with the passage of time.\(^ {94}\) The resultant shifts in emphasis upon certain factors often represent major and permanent changes in the attitude of the California tax authorities. When these authorities decide that the presence of a certain factor is indicative of a unitary business, and the state courts agree when that factor becomes an issue in a taxpayer challenge, the concurring court decisions create important precedents in this area.

Two decisions in particular have had a significant impact on the current California unitary method. First, a 1963 decision by the California Supreme Court based on a combination of *Superior Oil Co. v. Franchise Tax Board*\(^ {95}\) and *Honolulu Oil Corp. v. Franchise Tax Board*,\(^ {96}\) marked an important turning point in California unitary tax decisions. Up until this time, a major "unity of operations" factor serving to establish the presence of a unitary business was whether or not inventory flowed in or out of California in any appreciable amount.\(^ {97}\) The existence of a flow was almost prima facie evidence that a unitary business existed.\(^ {98}\) Court decisions in *Superior Oil* and *Honolulu Oil* determined that a unitary business was present even though the taxpayers in these cases had no significant intercompany flow of goods.\(^ {99}\) In *Superior Oil* the court stated that "none of the three unities announced [in *Butler*] as determinative necessarily requires the interstate movement of products."\(^ {100}\) The interrelationship between these tests for unity and the factors derived for their implementation will be examined later in this comment.\(^ {101}\)

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\(^{89}\) *Id.*

\(^{90}\) *See id.*

\(^{91}\) *See 18 Cal. Admin. Code §25101(a).*

\(^{92}\) *See Frenz, supra note 2, at 479-85.*

\(^{93}\) *Id.* at 479.

\(^{94}\) *Id.*

\(^{95}\) 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963).

\(^{96}\) 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963).

\(^{97}\) *See Frenz, supra note 2, at 477.*

\(^{98}\) *Id.*

\(^{99}\) *Id.* at 477-78.

\(^{100}\) *Superior Oil*, 60 Cal. 2d at 415, 386 P.2d at 550.

\(^{101}\) *See infra* notes 262-340 and accompanying text.
The second decision having a significant impact on the California unitary tax method was *Chase Brass and Copper, Inc. v. Franchise Tax Board*, decided in 1970. Prior to *Chase Brass*, the California tax authorities had restricted the unitary business concept to affiliated corporations “engaged in similar businesses.” The *Chase Brass* decision represented an expansion of the concept to include affiliated corporations engaged in widely divergent types of business if sufficient other factors substantiated the finding. *Chase Brass* is important because vertically integrated businesses, as well as horizontally integrated businesses, now can be found to be unitary. The extension of the unitary concept to include vertically integrated businesses has received wide acceptance by both federal and state courts. The administrative regulations implementing the California Revenue and Taxation Code now indicate that vertical integration is “strongly indicative” of a unitary business.

California statutory provisions governing the unitary tax method are continuously evolving as legislative amendments and judicial constructions of these provisions reflect the increasing complexity of multijurisdictional business forms and attempts by the state to tax these complex business operations within constitutional limits. The actual computation of the California unitary tax, explained in the next section of this comment, demonstrates the importance of the unitary business concept in a due process analysis of the constitutionality of the apportionment method.

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103. The California administrative regulations interpreting the Revenue and Taxation Code indicate that a strong inference of a unitary business exists when the taxpayer is engaged in the same type of business out-of-state as that engaged in within California. This administrative construction of the California tax laws is entitled to great weight, and the courts generally will not depart from this construction unless it is clearly erroneous or unauthorized. *Container Corp.*, 117 Cal. App. 3d at 1000, 173 Cal. Rptr. at 129, aff'd No. 81-523, slip op. (June 27, 1983); 18 Cal. ADMIN. CODE §25120(b). Upon review, the United States Supreme Court refused to find that the state erred in endorsing this administrative presumption. *Container Corp.*, No. 81-523, slip op. at 16.
105. 18 CAL. ADMIN. CODE §25120(b).
106. “For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices. *Id.*
108. 18 CAL. ADMIN. CODE §25120(b).
109. See FRENTZ, supra note 2, at 474-79.
110. *Id.*
C. Computation of the Tax

The computation of the California unitary tax begins with a determination of the presence of a unitary business, the only kind of business to which this tax applies. The unitary income must then be separated into business and nonbusiness components and the California taxable income computed. This computation may involve the filing of a combined report.

I. Determination of the Presence of a Unitary Business

The starting point in the computation of the California unitary tax is section 25101 of the California Revenue and Taxation Code which declares that if the income of the taxpayer is derived from, or attributable to, sources both within and without the state, the tax must be measured by the net income derived from, or attributable to, sources within the state. Thus, upon a finding that the taxpayer's business activity outside of California is separate and distinct from any California business activity, the taxpayer can comply with this provision by reporting California-source income as determined by traditional separate accounting methods. Income from any out-of-state business activity that is thus determined not to be unitary simply is not taxable in California. Therefore, the only out-of-state income involved in the remainder of the computation is income found to be from a unitary business.

California Administrative Code section 25101(a) describes the procedure to be followed when the taxpayer's activities clearly are not divisible along state lines:

Where the California activities are a part of a unitary business carried on within and without the State, the portion of the unitary income subject to tax in California is generally determined by a three-factor formula of tangible property, payroll and sales.

Section 25101(a) also includes the codification of the Edison test described in a previous section of this comment: if the in-state business operation "is dependent on or contributes to" out-of-state business op-
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operations, the entire operation is unitary. In practice the question of whether the taxpayer's business activity outside of California is unitary with, or truly separate from, the in-state activity, usually arises as follows: (1) a return is filed on the basis that the taxpayer's interstate business activity is not unitary; (2) a contrary finding is made by the Franchise Tax Board [hereinafter referred to as the FTB]; (3) the FTB field auditors present a list of questions to the officials of the corporate taxpayer under examination; and (4) the answers are used by the FTB in determining the extent to which various "factors" of unitariness are present between the in-state and out-of-state segments of the business. These factors of unitariness are those that are believed to be significant by the staff and field auditors of the FTB in deciding whether a unitary business is present.

Although a general list of the factors that will be considered by the FTB can be distilled from the case law in this area, the FTB claims not to use any "formula" in determining whether or not the factors present add up to a finding of unity. The reason that a formula cannot be devised is that one or two factors may be of such importance in a particular business that the business would be treated as unitary even though all of the other factors are either absent or insignificant. In a later section of this comment, the factors currently applied by the FTB will be discussed and compared with the factors that the United States Supreme Court found satisfactorily indicative of a unitary business in the \textit{ASA.RCO} and \textit{Woolworth} decisions. After the factors of unitariness have been considered, and the FTB determines a unitary business is present, the next step in computing the unitary tax is the separation of business and nonbusiness income. This is a very important step because the only income apportionable under the California unitary tax method is business income.

2. \textit{Separation of Business and Nonbusiness Income}

If an interstate business is found to be unitary, the total gross income from the unitary portion of that business should be determined, and then the nonbusiness, and thus nonapportionable, income is separated

\begin{itemize}
  \item[120.] 18 \textsc{Cal. Admin. Code} \$25101(a).
  \item[121.] \textsc{Frentz, supra} note 2, at 477.
  \item[122.] \textit{Id}; see, e.g., \textit{Container Corp.}, No. 81-523, slip op. at 11-13.
  \item[123.] \textit{Id} at 479.
  \item[124.] \textit{Id} at 477.
  \item[125.] \textit{Id} at 479.
  \item[126.] \textit{See infra} notes 262-321 and accompanying text.
  \item[127.] \textit{See infra} notes 262-340 and accompanying text.
  \item[128.] 18 \textsc{Cal. Admin Code} \$25101(f); see \textsc{Keesling \& Warren, Uniform Division of Income for Tax Purposes Act}, 15 \textsc{U.C.L.A. L. Rev.} 156, 167 (1968); \textit{Container Corp.}, No. 81-523, slip op. at 5.
\end{itemize}

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from the business income. Instead of being apportioned on a formula basis like the taxpayer's business income, the nonbusiness income is allocated according to situs. The statutes, and the related administrative regulations, describe the basis for allocation of the various types of nonbusiness income.

Nonbusiness income is defined in Section 25120 of the Revenue and Taxation Code as “all income other than business income.” Thus, it is necessary to use the definition for business income to determine what constitutes nonbusiness income. The statute defines business income as “income arising from transactions and activity in the regular course of the taxpayer's trade or business.” Business income 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. The usual classification of income by "labels," for example, manufacturing income, sales income, interest, dividends, or rents, is of no aid in determining whether income is business or nonbusiness. Income of any type, and from any source, that arises from transactions and activities occurring in the regular course of a taxpayer's trade or business may be business income. The principal types of nonbusiness income, however, are dividends, interest, rents, capital gains, royalties, and partnership income.

Upon completion of the allocation process, the total nonbusiness income allocable to the taxpayer's activity in California will have been determined. After offset of the allowable deductions attributable to

129. 18 CAL. ADMIN. CODE §25101(d).
130. "Apportionment" generally refers to the division of business income between states by the use of a formula containing apportionment factors. Id. §25101(f).
131. "Allocation" generally refers to the assignment of nonbusiness income to a particular state. Id. §25101(d).
132. Id. §25101(d).
133. CAL. REV. & TAX CODE §§25124-25127; 18 CAL. ADMIN. CODE §§25124-25127.
134. In general, income from tangible nonbusiness assets and any gain or loss on the disposition of these assets are allocated to the physical situs of the property. FRENTZ, supra note 2, at 495. The income from intangible property and any gain or loss on disposition of this type of asset are allocated to the physical situs of the property only if the property has acquired a “business situs" there, usually resulting in the income being allocated to the taxpayer's commercial domicile. Id.
135. 18 CAL. ADMIN. CODE §25120(d).
136. Id. §25120(a).
137. Id. §25120(a).
138. Id.
139. Id.
140. 18 CAL. ADMIN. CODE §25120(a).
141. FRENTZ, supra note 2, at 494.
142. Id.
143. See supra notes 130-34 and accompanying text; see generally CAL. REV. & TAX CODE §§25124-25127 (these sections describe the allocation process).
144. See supra notes 130-34 and accompanying text.
this share of nonbusiness income, the result is that taxpayer's net California nonbusiness income. This amount is then combined with that portion of the taxpayer's business income that is apportionable to California, as determined in the remainder of this section, and the result will be the taxpayer's total taxable income in California.

Once nonbusiness income has been separated from the total income of the multijurisdictional corporate taxpayer's entire unitary business, offset by allowable deductions attributable thereto, the applicable California statute requires that all remaining business income be apportioned among the states involved. Apportionment is required to be made by multiplying the income by a fraction. The numerator of this fraction is the property factor plus the payroll factor plus the sales factor, and the denominator is simply the number three. This is the three factor formula used by the California tax authorities and approved by the United States Supreme Court in the Butler case. Basically the formula involves five steps:

1. **Divide California property by total unitary property.**
2. **Divide California payroll by total unitary payroll.**
3. **Divide California sales by total unitary sales.**
4. **Divide the total of (1), (2), and (3) by the number 3 and this will be the percentage of unitary income that is apportionable to California.**
5. **Multiply the total net unitary business income of the multijurisdictional corporation by the percentage arrived at in step (4) to**
yield apportioned California income from the unitary business.\textsuperscript{159} California Administrative Code sections 25101 and 25129 through 25136, inclusive, contain extensive provisions describing the process of ascertaining the three factors in the formula.\textsuperscript{160}

In addition, California Revenue and Taxation Code section 25137 provides that a taxpayer may petition for, or the FTB may require, a deviation from the ordinary three factor formula in any case in which application of this formula does not produce results that are fairly representative of the extent of the taxpayer's business in California.\textsuperscript{161} The "alternatives" offered include: (a) separate accounting; (b) exclusion of one or more additional factors of the formula that will fairly represent the taxpayer's business activity in the state; (c) inclusion of one or more additional factors of the formula that will fairly represent the taxpayer's business activity in the state; or (d) any other method necessary to effectuate an equitable apportionment of the taxpayer's income.\textsuperscript{162} Section 25137 thus gives rise to the "special" formulas that have been developed for a limited number of industries including financial corporations, construction contractors, airlines, and motion pictures.\textsuperscript{163} Regardless of the method used, the share of the unitary business income apportioned to California next must be combined with taxpayer's other in-state income to determine the California taxable income of the corporation.\textsuperscript{164}

3. California Taxable Income and the Combined Report

The final step in the unitary tax computation is to combine the non-business income allocated to California with the unitary business income apportioned to California to produce California income subject to tax.\textsuperscript{165} The tax liability on this income then is computed in the same manner as for corporations doing business only within the state.\textsuperscript{166}

When a multijurisdictional taxpayer is doing business as a group of affiliated corporations, as opposed to operating a single corporation with multiple divisions, the computation of the unitary tax is more complicated.\textsuperscript{167} If a multijurisdictional corporation is operating in a multicorporate form and any two or more of the corporations are

\textsuperscript{159} Frentz, \textit{supra} note 2, at 498.
\textsuperscript{160} 18 \textsc{Cal. Admin. Code} §§25101, 25129-36.
\textsuperscript{161} Cal. Rev. \& Tax. Code §25137.
\textsuperscript{162} Id.
\textsuperscript{163} Frentz, \textit{supra} note 2, at 506-11.
\textsuperscript{164} Id. at 494.
\textsuperscript{165} 18 \textsc{Cal. Admin. Code} §25101(f).
\textsuperscript{166} Frentz, \textit{supra} note 2, at 488-89.
\textsuperscript{167} \textit{See infra} notes 42-65 and accompanying text.
owned or controlled, directly or indirectly, by the same interest,\textsuperscript{168} the FTB may permit or require the filing of a \textit{combined} report to determine apportionable unitary income.\textsuperscript{169} California law, however, requires that every corporation file a separate return even though that corporation is part of a group that is permitted or required to file a combined report.\textsuperscript{170} The California portion of the unitary income for the combined group is first determined by the apportionment formula and then each of the separate corporations is apportioned its individual share.\textsuperscript{171} The individual corporation then combines this “share” of apportioned income with other corporate income taxable in California and reports the total amount on its own franchise tax return.\textsuperscript{172}

Whether or not a combined report is filed, the unitary tax method is not only conceptually complex, but also complex when applied. When a state attempts to tax a multijurisdictional corporation, and traditional separate accounting is found to be inadequate for this purpose because the interstate business activity of the taxpayer is unitary, constitutional issues may arise. The next section of this comment will discuss these constitutional issues with a focus on challenges to the unitary tax based on the due process clause of the United States Constitution.

\section*{The Constitutionality of the Unitary Tax Method—A Due Process Analysis}

Four major recent United States Supreme Court decisions, \textit{Mobil Oil Corp. v. Vermont Commissioner of Taxes}\textsuperscript{173} and \textit{Exxon Corp. v. Wisconsin Department of Revenue}\textsuperscript{174} in 1980 vindicating the right of the states to tax foreign source\textsuperscript{175} income of multijurisdictional corporations,\textsuperscript{176} and \textit{ASARCO} and \textit{Woolworth} in 1982 limiting that same right,\textsuperscript{177} were \textit{all} decided on the basis of a due process analysis and the unitary business principle. The following section will begin with an exploration of the due process limitations on state taxation of multijurisdictional businesses. The section will start with the basic constitutional premise that

\begin{footnotesize}
\begin{enumerate}
\item Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer will constitute control for this purpose. Cal. Rev. & Tax. Code §25105.
\item Id. §25102. The combined report should be distinguished from a consolidated tax return.
\item Frentz, supra note 2, at 487.
\item Frentz, supra note 2, at 487.
\item Id.
\item Id. If a combined report is used in determining the unitary tax, intercompany dividends paid within the combined group are eliminated from the income of the recipient if the dividend was paid out of income already included in the combined report. Cal. Rev. & Tax. Code §25106.
\item 445 U.S. 425 (1980).
\item 447 U.S. 207 (1980).
\item See supra note 25.
\item See Mobil Oil, 445 U.S. at 442; Exxon, 447 U.S. at 225.
\item See \textit{ASARCO}, 102 S. Ct. at 3112; \textit{Woolworth}, 102 S. Ct. at 3129.
\end{enumerate}
\end{footnotesize}
a “taking” of property without due process is prohibited and conclude
with the presentation of the two part test that has evolved to meet due
process requirements. In light of the current emphasis on the role of
the unitary business principle in the due process limitations, the re-
mainder of the section will focus on the relationship of that concept to
the constitutionality of the California unitary tax.

A. The Role of the Unitary Business Concept in a Due Process
Analysis of State Taxation

The United States Constitution expressly prohibits a state from tak-
ing property without due process of law. Thus, the initial due pro-
cess limitation on the taxing scheme of a state is that the state “must
have given something for which it can ask a return.” The earliest
challenge to a state employing the apportionment method of income
taxation was based on the contention that this method violated the due
process rights of the taxpayer on grounds that the result was to tax,
directly or indirectly, income arising from business conducted beyond
the borders of the taxing state. The United States Supreme Court
upheld the tax and based on the unitary business concept, held that
the formula employed was presumptively valid.

Similarly, in Butler the United States Supreme Court approved the
propriety of applying the unitary concept in taxing interstate busi-
nesses, refining and clarifying the concept by establishing the “three
unities” test for unitariness previously described. In addition, the
Supreme Court approved the apportionment formula used by Califor-
nia as “fairly calculated” to “reasonably attribute” income to the busi-
ness conducted in the state. Finally, Butler is the source of the often-
cited proposition that a particular accounting system, although a useful
business tool, may not accurately reflect the amount of income earned

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178. See infra notes 173-252 and accompanying text.
180. J.C. Penney Co., 311 U.S. at 444; Seago, supra note 1, at 102. In the words of the Penney
Court:
A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by
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.

Penney, 311 U.S. at 444.
182. Id.
183. Id. at 121.
184. See Butler, 17 Cal. 2d at 677, 111 P.2d 341, 315 U.S. at 509.
185. Id. at 506.
186. See supra notes 77-78 and accompanying text.
126
within the taxing state.\textsuperscript{188}

Reliance upon the inadequacies of the separate accounting method\textsuperscript{189} to support the presumptive validity of a state apportionment method of taxation,\textsuperscript{190} however, was far from innovative by the time of the \textit{Butler} decision.\textsuperscript{191} In fact, this "theory" continues to be a recurrent theme in the litigation regarding state taxation of interstate business.\textsuperscript{192} Thus, the statement is often made that separate accounting will not yield the "true" income that a multijurisdictional corporation has earned within any one state of operation \textit{if} that taxpayer is engaged in a unitary business.\textsuperscript{193} Furthermore, the litigation format of the apportionment cases\textsuperscript{194} often begins with a finding that the multijurisdictional corporation is engaged in a unitary business so that a presumption of validity attaches to the state apportionment formula. Any attempt by the taxpayer to rebut that presumption by using traditional separate accounting then is found to be inadequate.\textsuperscript{195} If the litigation format sounds circular, that is because it \textit{is} circular. The impossibility of identifying the specific "source" of income earned from a series of transactions is the \textit{definition} of unitariness.\textsuperscript{196} This is a good example of the reason why the earlier decisions involving state taxation of interstate business were circumspect in their use of descriptive "tags" of this nature. In \textit{Wisconsin v. J.C. Penney Co.}, the U.S. Supreme Court cautioned:

\begin{quote}
We cannot. . .be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. . .[t]hese tags are not instruments of adjudication but statements of result in applying the constitutional test.\textsuperscript{197}
\end{quote}

Apparent from the case law is the fact that by the end of the 1960's the constitutional test under the due process clause applicable to the power of a state to tax interstate business had become firmly set.\textsuperscript{198} The next

\begin{footnotes}
\item[188] Id.
\item[189] See supra notes 45-60 and accompanying text.
\item[190] Underwood, 254 U.S. at 121.
\item[191] Butler, 315 U.S. at 506; Underwood, 254 U.S. at 121 ("faced with the impossibility of allocating specifically the profits earned. . .within its borders); Bass, Ratcliff \& Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 281 (1924).
\item[192] Edison, 30 Cal. 2d at 482, 183 P.2d at 22 (plaintiff's evidence of its separate accounting, and the accuracy and reasonableness thereof, did not overcome the correctness of the formula); \textit{Mobil Oil}, 445 U.S. at 438 (although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required).
\item[193] See \textit{Seago}, supra note 1, at 103-04.
\item[194] Id.; \textit{Hellerstein, Recent Developments in State Tax Apportionment and the Circumscription of the Unitary Business}, 21 Nat'l Tax J. 487, 493 (1968).
\item[195] \textit{Seago}, supra note 1, at 104.
\item[196] See id. at 103.
\item[197] \textit{J.C. Penney}, 311 U.S. at 444.
\end{footnotes}
section of this comment will examine the due process requirements for constitutionality of a state apportionment method of taxation and the difficulties the courts have encountered in applying this test.

B. State Apportionment Methods of Taxation: The Test for Constitutionality Under the Due Process Clause

The due process clause of the fourteenth amendment places two restrictions on state power to tax income generated by the activities of an interstate business. First, no tax may be imposed unless a nexus, some minimal connection, can be found between those interstate activities and the taxing state. Second, the income attributed to the state for tax purposes by the apportionment method must bear a rational relationship to the intrastate value of the enterprise. The United States Supreme Court in the Container Corp. decision added that these principles require that the out-of-state activities of the purported unitary business be related in some concrete way to the in-state activities.

The statement of this test for constitutionality under the due process clause appears deceptively simple. The two restrictions stem from the even simpler, but controlling question of whether the state has given anything for which it can ask a return. The basis for the two part test must be remembered when sorting out the complicating elements encountered in the application of the restrictions. For example, application of the test may be more difficult depending on whether the taxpayer is (1) operating as a multistate or as a multinational business, (2) operating in a multidivisional or a multicorporate form, or (3) being subjected to a single factor or a multiple factor formulary apportionment method. The two parts of the due process test will be examined separately in the following sections.

1. The Nexus Test

The purpose served by each of the two parts of the due process test, and the role played therein by the unitary business concept, are most clearly discernible when the due process test is applied to a

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199. Id. at 272-73.
200. Id. at 273; National Bellas Hess, Inc. v. Dept' of Revenue, 386 U.S. 753, 756 (1967); Miller Bros. v. Maryland, 347 U.S. 340, 345 (1954) ("some minimum connection between a state and the person, property, or transaction it seeks to tax"); Container Corp., No. 81-523, slip op. at 4.
203. J.C. Penney, 311 U.S. at 444.
204. See infra notes 173-252 and accompanying text.
205. See supra notes 179-98 and accompanying text.
single corporation operating in interstate commerce through various branches. For example, if a corporation consists of only two operating divisions, one refining oil in California (Division A), and the other selling that refined oil in Nevada (Division B), the total corporate income ($100,000) would be received in the state of Nevada as revenue from sales. California, however, would have the requisite nexus with the corporation, not just with Division A, because the corporation has availed itself of the "substantial privilege" of carrying on business within the state.  

The entire basis for this conclusion, that the California nexus is with the interstate activity as a whole, rests upon the unitary business principle. As the United States Supreme Court has stated: "[T]he linchpin of apportionability is the unitary-business principle." In the previous example, only Division A is truly "availing itself of the privilege of doing business" in California. Therefore, if the income earned as a result of the refining process could be separately determined, the income of that division is all that California could constitutionally tax. The Division A income cannot be specifically determined, however, because the total income of $100,000 was earned in a series of transactions that are inseparable in a traditional accounting sense. The two divisions are engaged in a unitary business because the total income is inseparable. The total income is inseparable because the divisions are unitary. Therefore, what appears to be circular reasoning is actually a conceptualization of a factual state of business activity integrated to such a degree that the required nexus is established, not between the state and the intrastate activity (Division A), but between the state and the interstate activity, the entire corporation. The state taxing authorities have thus developed "factors of unity" as guidelines against which to measure the individual facts of each case for the purpose of detecting the presence of a unitary business.  

Examination of this portion of the constitutional test, the nexus test, in a situation as simple as that portrayed in the example, clearly reveals that the inseparability of the California and Nevada business activity is what necessitates a finding that the interstate business of the corporation is unitary. When any portion of the corporate business, regardless of whether conducted in or out of California, is distinct enough that

208. *Id.* at 439.
210. Frentz, supra note 2, at 479-85.
211. *Id.; see infra* notes 262-340 and accompanying text.
separate accountability for the earnings generated is possible, that portion is by definition, no longer a part of the unitary enterprise.

In applying the due process nexus test, however, the multicorporate form of operation can cloud the issue substantially. In the earlier example, income received by either division would be reflected in the separate accounting records simply as $100,000 of income earned by the corporation, without distinction as to which division originally received that income. If the example is changed so that the California refining operations are organized as the parent corporation (Corporation A) and the selling operations in Nevada are organized as a subsidiary corporation (Corporation B), the results are considerably different. The income of Corporation B, as determined by the separate accounting method, could be reported as anything from zero to $100,000. The same is true for the separate accounting income reported for Corporation A because the business enterprise determines the transfer pricing policy that company will use.212

Nevertheless, if the interstate business in the example is determined to be unitary, the entire $100,000 would be subjected to apportionment. The confusion in applying the nexus test arises in the actual computation of the unitary tax. Assuming that the separate accounting records reflected the entire income in Corporation B, the Nevada subsidiary, the required combined report213 would reflect $100,000 of unitary income from B, plus zero income from Corporation A, for a total combined unitary income of $100,000. This total combined unitary income is the base that will be apportioned according to the apportionment formula employed by the taxing state. In this example, the computation resulted in the true unitary income of $100,000, but the result would not have been correct if any dividends had been paid between the two corporations. Thus, if subsidiary Corporation B had paid dividends of $50,000 to parent Corporation A during the year, the resulting combined report would be distorted. Separate accounting records would show an income of $50,000 for Corporation A, representing the dividends received, and the original income of $100,000 for Corporation B. The required combined report would thus result in an incorrect total unitary income of $150,000. California has eliminated this "computational error" by enacting California Revenue and Taxation Code section 25106, declaring that dividends received from another corporation that is a member of the unitary group need not be included in the

212. But cf. Taggert, supra note 57, at 177 ("complaints against the arm's length method . . . fail to take account of a number of pressures . . . which operate to insure that the prices charged in intercorporate transactions are arm's length").

213. CAL. REV. & TAX. CODE §25102.
combined report if the dividends were paid out of unitary income. Both *ASARCO* and *Woolworth* provide additional insight into a thorough understanding of the due process nexus test.

\[ a. \text{ ASARCO} \]

*ASARCO*, and the *Woolworth* decision discussed in the next section, are landmark decisions because they represent the first time that the United States Supreme Court has employed the due process nexus test to deny a state the right to apportion income. Both of these cases primarily concerned dividends received by a nondomiciliary parent corporation from subsidiary corporations. The special issues inherent in this type of income, dividend income, were never reached in *ASARCO* and *Woolworth* because the nexus requirement was not met.

In *ASARCO* the main issue was whether dividends from five other ASARCO subsidiaries, received by the nondomiciliary parent, were subject to apportionment by Idaho. *ASARCO*, Inc. is commercially domiciled in New York but subsidiaries of the corporation mine, smelt, and refine various metals in other states, including Idaho. The company has various investment interests in other corporations, most involving mining operations, and some located outside of the United States. The United States Supreme Court held in the *ASARCO* case that the Idaho business activity did not have the requisite nexus to the business activities of the five foreign subsidiaries to be classified as a unitary business and therefore, the attempt by Idaho to tax that income violated the due process clause.

In *ASARCO* the taxpayer's trade or business was silver mining. In theory, the determination of whether or not the Idaho subsidiary and the New York parent are a unitary business enterprise is made by

\[ 214. \text{Id.} \text{§} 25106. \]
\[ 215. \text{Seago, supra} \text{note} 1, \text{at} 102. \]
\[ 216. \text{Nondomiciliary here means commercially domiciled in a state other than that of the taxpayer. See generally *ASARCO*, 102 S. Ct. at 3111-13 (taxpayer was an Idaho corporation and the subsidiary in question was domiciled in Peru, the parent corporation in New York).} \]
\[ 217. \text{Id.} \]
\[ 218. \text{Seago, supra} \text{note} 1, \text{at} 102 \text{ (although dividends raised a host of problems specifically related to that form of income, these issues were moot in these cases because the nexus test was not satisfied).} \]
\[ 219. \text{*ASARCO*, 102 S. Ct. at 3105.} \]
\[ 220. \text{Id.} \]
\[ 221. \text{Id.} \]
\[ 222. \text{Id. at 3112.} \]
\[ 223. \text{Id. at 3116.} \]
\[ 224. \text{Only income arising from the taxpayer's trade or business is included in business income. See} \text{CAL. REV. }\text{& TAX. CODE} \text{§} 25120(a).} \]
\[ 225. \text{*ASARCO*, 102 S. Ct. at 3105.} \]
examining the relationship between the silver mining and the business activity of the parent in New York.\textsuperscript{226} This examination is not made in some abstract sense between two entities, but between the Idaho activity, silver mining, and each of the various activities carried on by ASARCO, Inc. in New York. Accordingly, upon the finding of the Court in \textit{ASARCO} that the parent corporation and the Idaho taxpayer were operating as a unitary business,\textsuperscript{227} the Court still had to determine the portion of the activity of the New York parent company that should be unitized on the basis of this determination. "One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability."\textsuperscript{228} For example, one segment of ASARCO, Inc.'s business was engaged in by the parent corporation in the form of a Peruvian subsidiary that had paid dividends to the parent during the tax year.\textsuperscript{229} The \textit{ASARCO} Court held that this particular activity was not sufficiently connected with the Idaho silver mining to be classified as part of the unitary group.\textsuperscript{230} The basis for this holding of the Court focused on the functional and managerial relationships between the Peruvian subsidiary and the parent corporation, the dividend payee.\textsuperscript{231}

One of the main causes for the current controversy between taxpaying corporations and the taxing states is exemplified by the major contention of the dissenting opinion\textsuperscript{232} in \textit{ASARCO} that the majority approach erred by even examining the source of the dividends. This goes to the heart of the nexus test issue because to meet the test, a state apportionment method must reach only income from activity with which the taxing state has some minimal connection.\textsuperscript{233} The unitary

\textsuperscript{226} \textit{Id.} at 3115. The Court quotes \textit{Mobil Oil}: We cannot accept, consistently with recognized due process standards, a definition of 'unitary business' that would permit nondomiciliary States to apportion and tax dividends [w]here the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State. (emphasis added)

\textit{Id.}

\textsuperscript{227} This determination was made at a lower level before reaching the United States Supreme Court. \textit{Id.} at 3107.

\textsuperscript{228} \textit{Mobil Oil}, 445 U.S. at 440 (as quoted in \textit{ASARCO}, 102 S. Ct. at 3116).

\textsuperscript{229} \textit{ASARCO}, 102 S. Ct. at 3111-12.

\textsuperscript{230} \textit{Id.} at 3112.

\textsuperscript{231} \textit{Id.} at 3111-12

Although Southern Peru sold ASARCO 35 percent of its output and was potentially subject to its control, the Court, after examining the details of management contracts, cited trial court findings and evidence to the effect that ASARCO did not 'control Southern Peru in any sense of that term.' It therefore concluded that 'ASARCO's Idaho silver mining and Southern Peru's autonomous business are insufficiently connected to permit the two companies to be classified as a unitary business.'


\textsuperscript{232} The dissenting opinion was written by Justice O'Connor, with Justices Blackmun and Rehnquist joining in the dissent. \textit{ASARCO}, 102 S. Ct. at 3117.

\textsuperscript{233} See supra notes 204-14 and accompanying text.
business principle embodies this limitation. The way unity is determined thus becomes the essence of the nexus test. The conclusion of the dissent was based on the premise that once the taxpayer and the parent corporation were found to be a unitary enterprise, all income from their respective activities must be included in the unitary base subject to apportionment. The weakness in this reasoning is revealed by noting the result that would be reached if the facts in ASARCO are changed only slightly. Assume that instead of carrying on the Peruvian operations in the corporate form, the parent had simply engaged in that particular activity through the use of a Peruvian Division of the New York corporation. This change would not alter the finding of the Court that under the majority approach in ASARCO, the activity in Peru still would not be part of the unitary operations engaged in by the New York parent and the Idaho taxpayer since the activity in Peru did not change. Thus, just a technical change in the form of the business clearly shows that the portion of the parent’s income arising from the Peruvian operations simply did not arise from the same trade or business as the portion of the parent’s income unitized with the Idaho silver mines. Furthermore, as discussed earlier in this comment, whether the parent received the income from the Peruvian operation directly, or in the form of dividends from an affiliated corporation is irrelevant. This would merely be a triumph of form over substance and would frustrate the purpose of the due process nexus test. Thus, if the California apportionment method is to meet the nexus test, the income from out-of-state activities that is to be unitized and taxed by California must be identified by factors that focus on the inseparability of the underlying economic activity. The Supreme Court in Woolworth further clarified the teaching of the ASARCO decision regarding the unitary business principle and the due process nexus test.

b. Woolworth

Similar to the attempt made by Idaho in the ASARCO case, the Woolworth case involved an attempt by New Mexico to tax an apportioned share of the dividends received by the New York parent corpo-
ration from foreign subsidiaries of the parent. The United States Supreme Court again held that the state could not include these dividends in apportionable income because of a failure to meet the nexus test, or in the words of the Court: "We conclude that this tax does not bear the necessary relationship to opportunities, benefits, or protection conferred or afforded by the taxing state." F.W. Woolworth, Co., a parent corporation commercially domiciled in New York, operates a chain of retail stores located in several states, including New Mexico where the taxpayer in this case was operating. In addition, Woolworth owns four foreign subsidiaries in Germany, Canada, Mexico, and England.

The issues regarding the nexus test in ASARCO and Woolworth basically were the same, but an important difference existed in the two cases arising from their organizational form. ASARCO, Inc. is organized on a vertically integrated basis, whereas F.W. Woolworth, Co. is a horizontally integrated multijurisdictional corporation. This difference has a bearing on the nexus test because of the difference upon the unitary business principle. Instead of finding a unitary business present because of an inseparable series of income producing transactions, the detection of unitariness in a horizontally integrated business becomes a question of whether contributions to income by the subsidiaries resulted from functional integration, centralization of management, and economies of scale, or from activities that are separate and discrete. Thus, the difference between the ASARCO and Woolworth cases, vertical versus horizontal integration, is reflected in the issue of whether interstate activity is part of a unitary business. This issue requires a finding of unity that, in turn, involves the application of "factors of unitariness." The second half of the due process test for constitutionality, the rational relationship test, was not reached in Woolworth or ASARCO for reasons discussed in the following section of this comment. While the nexus test examines constitutional limitations upon the income a state may include in the apportionable base, the rational relationship test relates to the apportionment process itself.

2. A Rational Relationship

The second restriction on the power of a state to tax income generated by interstate business activities is often called the "rational rela-

240. Woolworth, 102 S. Ct. at 3132.
241. Id. at 3139.
242. Seago, supra note 1, at 114.
243. Woolworth, 102 S. Ct. at 3131.
244. Mobil Oil, 445 U.S. at 438.
245. See Seago, supra note 1 at 114-18.
tionship test." Basically, this part of the due process test questions whether the state apportionment formula is doing the job it was developed to do. This is satisfied if "the method of relating the income to the jurisdiction is 'fairly calculated' to reasonably attribute the income to the business conducted in the state." In the Butler decision, the United States Supreme Court approved the California method of apportionment and specifically approved the three factor formula currently used by the state. The development of the rational relationship portion of the due process test in the case law reveals an early and unwavering predisposition of the United States Supreme Court to presumptively support state formulas.

If, however, the state method is inherently arbitrary, or the state formula as applied to a particular taxpayer produces an unreasonable result, the apportionment method would be unconstitutional under the due process clause. The decisions in this area have been invariable, however, in holding that the burden of proof is on the taxpayer to show that the result of the apportionment method was unfair or arbitrary.

With respect to the burden of proof, the rational relationship test and the nexus test are the same:

To exclude income from apportionment, the taxpayer must show by clear and cogent evidence that the income is earned from a separate and distinct business operating outside the taxing state, and not from a unitary business that conducts some activities within that state.

Although formula issues were raised in ASARCO and Woolworth, these issues were not reached because the nexus test was not satisfied.

3. The Due Process Constitutionality of the California Unitary Tax Method: Proposed Statutory Amendments

This comment has thus far discussed the development of the due process test for constitutionality as applied to the California formulary apportionment method of taxing multijurisdictional corporations. A careful examination of the current application of California Revenue and Taxation Code section 25101 has shown a problem may arise because not all income that the state might attempt to reach for apportionment, etc.
tionment would be considered constitutionally apportionable by the United States Supreme Court. 254 One possible resolution to this problem would be to amend section 25101 and administrative regulations implementing that section, to clarify exactly what income cannot be constitutionally reached in light of the United States Supreme Court decisions in ASARCO and Woolworth.

In these two cases the Supreme Court has left no doubt that income arising from out-of-state business activity cannot be apportioned by a state for tax purposes if the activity in question is discrete from the activity in the taxing state. 255 ASARCO and Woolworth thus expressly focused the question of constitutionality on the issue of unity. California Revenue and Taxation Code section 25101 should be amended to insure that the FTB and the California courts will interpret that section to preclude the inclusion of income from any out-of-state business whose activities are unrelated to the taxpayer's activities in California. 256 The United States Supreme Court in the Container Corp. case made note of this weakness in the California statute by stating that:

Although the statute does not explicitly require that income from distinct business enterprises be apportioned separately, this requirement antedated adoption of the Uniform Act [from which the relevant provisions of the statute are derived], and has not been abandoned. 257

Amending section 25101 to state expressly that the form of the out-of-state income will not be determinative could prevent the errors in application exemplified by the apportionment process used by Idaho and New Mexico in ASARCO and Woolworth. If section 25101 stresses the concept of substance over form, the law will guide those interpreting the section in the right direction and prevent them from going off on the incorrect tangent of examining the relationship between the out-of-state activity in question and the activity of a non-domiciliary affiliate. 258 In addition to amending section 25101 and the pertinent California administrative regulations, the current factors of unity used in this state must be updated to reflect views of the United States Supreme Court as expressed in ASARCO and Woolworth. 259

As previously discussed, 260 the initial step in computing the unitary tax is to determine the presence of a unitary business. This determination is based upon those factors of unity that "signal" the presence of

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254. See supra notes 208-14 and accompanying text.
255. See supra notes 215-45 and accompanying text.
256. Id.
257. Container Corp., No. 81-523, slip op. at 5.
258. See supra note 216.
259. See supra notes 204-45 and accompanying text.
260. See infra notes 262-340 and accompanying text.
261. See supra notes 114-28 and accompanying text.
unity to taxing authorities. A heavy emphasis is placed upon the unitary business concept by the United States Supreme Court in *ASARCO* and *Woolworth* as the basis for constitutional apportionment. This emphasis necessitates a careful examination of the unitary operation. The following section will discuss the importance of the unitary business concept. In addition, the section will examine the factors of unitariness found appropriate in *ASARCO* and *Woolworth* and compare those factors with the factors currently used by the California taxing authorities.

THE UNITARY BUSINESS CONCEPT AND THE FACTORS OF UNITARINESS

The United States Supreme Court has made the unitary business concept an extremely important concept to understand. The Court repeatedly has stated that in theory, the concept of unity is the central and cohesive element of the apportionability issue. First, in *Mobil* and *Exxon*, the Supreme Court suggested that a due process limitation would prevent a state from apportioning the income of a multijurisdictional corporation arising from interstate business activities if that taxpayer sustained the burden of proving the corporate activity outside of the taxing state was unrelated to the in-state business of the taxpayer. Later, in *ASARCO* and *Woolworth*, the Court determined that the taxpayers had met this burden of showing the income at issue was earned from discrete out-of-state activities. The income thus could not be reached by the taxing states.

Undoubtedly, *ASARCO* and *Woolworth* have been encouraging to multistate and multinational corporations in the ongoing controversy between multijurisdictional businesses and taxing authorities of the various states. The current nationwide increase in challenges to the apportionment method is indicative of this fact. The United States Supreme Court in the recent *Container Corp.* decision, however, has clarified the reasoning supporting the rejection of state attempts to unitize the multijurisdictional taxpayers in *ASARCO* and *Woolworth*. The Court in *ASARCO* concluded that factual findings by the state

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263. *Mobil Oil*, 445 U.S. at 442; *Exxon*, 447 U.S. at 223.
266. *Container Corp.*, No. 81-523, slip op. at 15, n. 15.
court did not support a unitary business finding because the partial subsidiaries were "not realistically subject to even minimal control" by ASARCO and thus were "passive investments in the most basic sense of the term."267 The decision by the Supreme Court in Woolworth represented a much closer case on the issue of unity. The finding of the Woolworth Court that a unitary business was not present was based on the conclusion that the state court had made "specific and crucial" legal errors in both the conclusions drawn and the legal standards applied in analyzing the case.268

Any serious threat to the apportionment method of taxation, however, is alarming to the many states currently relying on an apportionment approach.269 The apportionment method has not only been the subject of tightening constitutional restrictions via case law, but since 1965, a continuing Congressional effort has been underway to legislate restrictions on the use of apportionment methods by the states.270 While serious questions remain regarding the constitutionality of antiapportionment legislation,271 the debate produced by the Congressional proposals has revealed the basis for state concern over a possible loss of the apportionment method.272 Multijurisdictional corporations that have been allowed to rely upon the separate accounting method in reporting their taxable income have provided many examples of abuse.273 In addition, the states stand to lose a major portion of their annual tax revenues if the apportionment method is banned by legislation or judicial decision. In California alone, the revenue loss would total over $485 million in one year.274

The Supreme Court thus, has certainly brought home to the states the importance of properly identifying when a unitary business is present. Nevertheless, the Court has avoided every opportunity to define a unitary business.275 Some commentators believe this is because a "definition with such broad implications for issues not yet raised would be improvident."276 The Container Corp. decision, however, clarifies the

267. Id.
268. Id.
269. See Corrigan, supra note 44, at 803.
271. Id.
272. See id. at 715-16.
273. Cory, supra note 9, at 1137. For example "Colorado Gulf and Cities Services reported no taxable income in 1978, despite combined sales in the state of $33.7 million" and "in 1979, Conoco, Amoco, Exxon, and Mobil paid state income taxes amounting to 0.3 percent, 0.4 percent, 0.9 percent, and 1.4 percent of their total corporate profits in state income taxes, respectively. These figures are less than the rate paid by the average family of four making $16,000 [a] year." Id.
274. Church, supra note 31, at 6.
275. Seago, supra note 1, at 104.
276. Id.
reasoning behind the reluctance of the Court to define the concept by stating that:

[T]he unitary business concept is not, so to speak, unitary: there are variations on the theme, and any number of them are basically consistent with the underlying principles motivating the approach.277

State taxing authorities, therefore, are left to their own devices to arrive at foolproof factors to guide them in identifying unitariness in various factual circumstances.278 A number of factors useful in identifying a unitary business can be distilled from the long line of apportionment cases.279 Furthermore, factors that have stood the test of time in the evolution of the unitary concept usually are relied upon by the states to serve as general guidelines for recognizing when interstate business is not divisible along state lines.280 This factor-selection process was observable in the California history of the apportionment method discussed earlier in this comment.281 A comparison of the current California factors applied by the taxing authorities and state courts with the factors applied in ASARCO and Woolworth is illuminating as to the viability of current state apportionment methods in light of these 1982 decisions.

A. Current Factors of Unity Applied in California

As discussed previously,282 California currently uses two basic tests, often employing both tests in one case, in the search for “unity” in interstate business:

(1) Whether or not the three unities of ownership, operation, and use are present.

and/or

(2) Whether or not the in-state business activity contributes to, or is dependent upon, the out-of-state business activity.283

These tests have been expanded due to interpretation and development by California courts and tax authorities into factors of unity, that is, factors which tend to be present in a unitary business.

Under the unity of ownership, considered to be one factor of unitariness, the FTB has stated that a corporation may be part of a unitary group although the degree of common ownership or control is less than

278. Seago, supra note 1, at 104.
279. See FRENZ, supra note 2, at 479-85.
280. Id.
281. See supra notes 66-110 and accompanying text.
282. See supra notes 66-128 and accompanying text.
283. See supra notes 77-86 and accompanying text.
100 percent.\textsuperscript{284} The FTB has made clear, however, that for a corporation to be included in a unitary group, the degree of common ownership or control must be over 50 percent.\textsuperscript{285} California case law indicates that evenly divided ownership, combined with indirect control effected by contractual agreement, will be viewed as control for this purpose.\textsuperscript{286} Indirect,\textsuperscript{287} as well as direct, ownership or control is thus viewed by California as sufficient for meeting this test of unity. In California, unity of ownership does not render a business unitary if the other units are absent.\textsuperscript{288} Unity of ownership, however, did play an interesting role in the recent California Supreme Court decision of Anaconda Co. \textit{v. Franchise Tax Board.}\textsuperscript{289} In Anaconda the ownership percentage between the domestic parent and the foreign subsidiaries was virtually 100 percent.\textsuperscript{290} Despite this fact, the taxpayer contended that the Latin American host government of the subsidiaries had neutralized the parent's nominal control by severely regulating and intervening in company operations.\textsuperscript{291} The California Supreme Court refused to recognize this as an offset to control for purposes of the ownership factor, stating: "Government regulations which restrict the exercise of some familiar attributes of ownership do not establish that there was no unity of ownership."\textsuperscript{292} The United States Supreme Court has agreed to review this 1982 decision and the result will be edifying in evaluating this approach to the unity of ownership.\textsuperscript{293}

In Butler, the California case that developed the unities, unity of operations was said to be evidenced by the factors of centralized purchasing, advertising, accounting, and management divisions.\textsuperscript{294} State tax authorities always review centralized management in apportionment cases.\textsuperscript{295} Centralized management is present not only when officers or departments perform centralized management functions, but also when interlocking directorates exist.\textsuperscript{296} The importance of this factor increases as the degree of centralization increases.\textsuperscript{297} Centralized

\textsuperscript{284} FRENZ, \textit{supra} note 2, at 482.
\textsuperscript{285} Id.
\textsuperscript{286} See Appeal of Signal Oil & Gas Co.; (State Board of Equalization, decided Sept. 14, 1970); FRENZ, \textit{supra} note 2, at 483.
\textsuperscript{287} See Appeal of Shaffer Rentals, Inc. (State Board of Equalization, decided Sept. 14, 1970).
\textsuperscript{288} \textit{Chase Brass}, 10 Cal. App. 3d at 502, 86 Cal. Rptr. at 353.
\textsuperscript{289} 130 Cal. App. at 25, 181 Cal. Rptr. at 646.
\textsuperscript{290} Id.
\textsuperscript{291} Id.
\textsuperscript{292} Id.
\textsuperscript{293} Id., appeal docketed, 51 U.S.L.W. 3314 (U.S. Oct. 19, 1982) (No. 82-298). In this writer's opinion, the Supreme Court will find this "ownership" just potential, as opposed to functional, and thus the unity of ownership will not be found to be present in the Anaconda case.
\textsuperscript{294} Butler, 17 Cal. 2d at 678, 111 P.2d at 341.
\textsuperscript{295} See FRENZ, \textit{supra} note 2, at 480.
\textsuperscript{296} Id.
\textsuperscript{297} Id.
purchasing, advertising, accounting, and legal services are almost always mentioned as factors in apportionment cases.298 The reason is that this type of functional integration is the essence of the unitary business principle.299 In addition, the state considers such factors as shared physical facilities, information and “know how” transfers, common insurance, pension and employee benefit plans, and even union bargaining on a companywide basis.300 These factors are often indicative that economies of scale are present in the interstate operations which is a strong sign of a unitary business.301

As noted in a earlier section,302 the lack of a significant intercompany flow of goods was once thought to be a factor compelling a conclusion that a unitary business was not present.303 The United States Supreme Court reaffirmed this position in Container Corp. by declining an invitation to adopt a “bright-line rule requiring as a prerequisite to a finding that a mercantile or manufacturing enterprise is unitary that it be characterized by a 'substantial flow of goods'.”304 The basis for the decision of the Court was that the “prerequisite to a constitutionally acceptable finding of unitary business is a flow of value, not a flow of goods.”305 Significant intracompany product flow is, however, still a weighty factor when found present.306

Another factor given consideration in California is intercompany financing.307 In Container Corp., financing was one of the major links between the in-state and out-of-state activities.308 In Container Corp., the California Supreme Court, basing the decision on financing and many other factors, concluded that unity was present.309 As to the financing factor, the court said, “The fact that the subsidiaries could readily turn to the parent corporation for financial assistance points toward unity.”310 Upon review of this state court decision, the United States Supreme Court agreed that unity was present between the California and the out-of-state operations of the appellant corporation.311 The Court noted that appellant played a substantial role in

298. Frenz, supra note 2, at 480-81.
299. See Seago, supra note 1, at 118.
300. Frenz, supra note 2, at 481.
301. Id.
302. See supra notes 66-110 and accompanying text.
303. Frenz, supra note 2, at 481.
304. Container Corp., No. 81-523, slip op. at 17.
305. Id.
306. Frenz, supra note 2, at 481; See Superior Oil, 60 Cal. 2d at 415, 386 P.2d at 550.
307. Frenz, supra note 2, at 480.
309. Id.
310. Id.
311. Container Corp., No. 81-523, slip op. at 23.
loaning funds to the subsidiaries and guaranteeing loans provided by others,\footnote{312.} and because there was no indication that these capital transactions were conducted at arm’s length, the resulting flow of value was obvious.\footnote{313.}

Additionally, California considers several more “visible” types of factors including shared names, trade marks, patents, and processes.\footnote{314.} Sharing these assets represents a companywide savings to a multijurisdictional corporation.\footnote{315.} Similarly, if a corporation hires an individual and trains that person in the skills required in that business, that employee becomes an asset to the company. Therefore, the intercompany transfer of personnel is a factor of unitariness.\footnote{316.} Obviously this list of factors is not exhaustive, nor is it static. In addition, the relative weighting of the factors will shift depending on the circumstances in each individual case.\footnote{317.} The mere presence or absence of one of these factors is not itself an impressive argument that two corporations should be considered unitary.\footnote{318.} What is important is whether or not a particular factor enhances the economic advantage gained by a multijurisdictional corporation through interstate operations.\footnote{319.} The United States Supreme Court in \textit{ASARCO} and \textit{Woolworth} did not indicate dissatisfaction with the choice of factors by the taxing states involved, but the Court did express disagreement with the way those factors were applied. Basically, the recent decisions of the Supreme Court have not validated or invalidated specific individual factors used by California or other states in determining unity. The \textit{ASARCO} and \textit{Woolworth} decisions, however, have expressly focused the question of constitutionality upon the question of unity.\footnote{320.} The following section of this comment therefore will discuss the concept of business unity presented in these two decisions.\footnote{321.}

\textbf{B. Unity in \textit{ASARCO} and \textit{Woolworth}, A Comparison}

The effect of \textit{ASARCO} and \textit{Woolworth} has been to refocus the due process test for constitutionality upon the unitary business principle. The Court reiterated the basic objective involved: “to identify situa-
tions in which, because of the interdependence of operations in two or more states, separate accounting will not result in the state's taxing its fair share of income." While these two decisions stressed many of the traditional indicia of unity such as functional interdependence, centralized management, and economies of scale, two definitive aspects of the manner in which the Court used the factors should be noted. First, the importance of trial courts properly establishing a factual basis upon which the factors can be examined was emphasized. This may be useful to the California trial courts in that the list of possible factors of unity employed by the FTB could be used by the courts as a guide in documenting an appropriate factual basis for apportionment cases. Secondly, ASARCO and Woolworth have shown that due process requirements will not be met if the unitariness of interstate business activity is judged by looking only at such broad generalizations as "centralized management." The Court demonstrated an intention to examine the underlying business activities rather than relying on labels of this sort. California must take care not to apply the three unities test in this generalized manner. Some California courts seem to weigh the various elements of the Butler test as though unitariness depended upon some mathematical combination of the three elements of the test. ASARCO and Woolworth have established that the underlying economic realities must be weighed if the unitary business concept is to support a constitutionally sufficient nexus to meet due process requirements.

Furthermore, the individual factors in Woolworth illustrate several points that are enlightening when compared to the current California approach to the unitary business concept: (1) businesses do not have to be completely separate to avoid being classified as unitary, distinctions by the taxing state between business and nonbusiness income are not conclusive, (3) "oversight" by parent corporations of major decisions made by subsidiary corporations may not indicate unity if that overseeing is no more than the amount "typically given to investments in subsidiaries," and (4) potential ownership or control does not equate with actual ownership or control. This fourth point is

322. Seago, supra note 1, at 118.
323. Id.
324. Id.
325. Id.
326. See id. at 114-18.
327. Id. at 118.
328. See id. at 117-18.
329. See Woolworth, 102 S. Ct. at 3137-38.
330. Id. at 3130, 3138.
331. Id. at 3138.
332. Id. at 3134.
particularly indicative that the California approach to the concept of unity is inadequate. The findings of the California Supreme Court in the 1982 Anaconda case,\(^{333}\) regarding ownership and control as mentioned previously,\(^{334}\) would probably be decided differently by the United States Supreme Court based on the indication by the Court in Woolworth that potential control is not ownership. Thus, ownership made ineffectual by circumstances like the interference of the foreign host government in Anaconda does not support a finding that the requisite unity of ownership is present.\(^{335}\) Nonetheless, the United States Supreme Court in Container Corp. found that potential control, while not dispositive of the unitary business issue, is relevant in determining the presence of a unity of ownership.\(^{336}\) Potential control is relevant to both (1) whether or not the various parts of the business share the required degree of common ownership, and (2) whether there might exist a degree of implicit control sufficient to make the components of the business an integrated enterprise.\(^{337}\)

The essence of the effect of the United States Supreme Court decisions in ASARCO and Woolworth upon the factors of unitariness used by California, and other states, is that these factors can have degrees. At some “undefined point” the Court will decide that the factors are sufficiently present to justify classification of the interstate business as unitary.\(^{338}\) As discussed in the previous section, the factors of unity are the “tools” used by the FTB and the California courts to detect the presence of a unitary business in each set of actual circumstances. A directive to those using the California factors of unity can be discerned from ASARCO and Woolworth and employed as a guide to update the state approach as follows: (1) The current California factors must be applied by examining the underlying economic realities of the multijurisdictional corporation in question, as opposed to using the factors in some abstract fashion based on broad “labels,” for example, centralized management, and (2) The three unities test\(^{339}\) and in particular, the unity of ownership, must be applied in the context of actual rather than potential unity.

The viability of the formulary apportionment method currently employed in California for determining the portion of total income earned by a multijurisdictional corporation that the state can constitutionally

\(^{333}\) Anaconda, 130 Cal. App. 3d at 25, 181 Cal. Rptr. at 646.

\(^{334}\) See supra notes 284-93 and accompanying text.

\(^{335}\) See generally Woolworth, 102 S. Ct. 3128.

\(^{336}\) Container Corp., No. 81-523, slip op. at 16, n. 16.

\(^{337}\) Id.

\(^{338}\) Seago, supra note 1, at 116.

\(^{339}\) Butler, 17 Cal. 2d at 678, 111 P.2d at 341.
The unitary tax will depend upon the validity of the California unitary business concept. While the current factors applied in California for making this determination are similar to those used for this purpose by the United States Supreme Court, the *ASARCO* and *Woolworth* opinions should be reflected in the state approach to apportionment.

Significantly, in *ASARCO* and *Woolworth* the Supreme Court indicated an intention not to allow unlimited expansion of the unitary business concept as a vehicle for extension of the right of a state to tax multijurisdictional corporations. If California does not heed this warning and narrow the state approach to the unitary business concept accordingly, the result could be that the state will face numerous successful taxpayer challenges based on the due process guarantee of the fourteenth amendment. The Court in *Container Corp.* made clear, however, that future unitary tax decisions will reflect an attitude of deferring to the judgment of the state courts in deciding whether a particular set of activities constitutes a unitary business. Deferral by the Supreme Court to the state courts, based on the principle that the taxpayer always bears the burden of proving that a state tax has resulted in extraterritorial values being taxed, will be made whenever reasonably possible. The general attitude of the Supreme Court with regard to the proliferating litigation in this area of the tax law is thus best exemplified by the following statement from the 1983 *Container Corp.* decision:

> It will do the cause of legal certainty little good if this Court turns every colorable claim that a state court erred in a particular application of those principles [of the constitutional limits on the unitary business concept] into a *de novo* adjudication, whose unintended nuances would then spawn further litigation and an avalanche of critical comment.

The task of the Supreme Court, as indicated in *Container Corp.*, is to determine whether the state courts have applied the correct legal standards in analyzing the case and if they did, to decide if the state court judgment was "within the realm of permissible judgment."

**Conclusion**

As our economy continues to grow in size and complexity, business entities functioning within that economy will follow similar growth patterns. The number of corporations conducting business activity across

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341. *Container Corp.*, No. 81-523, slip op. at 14.
342. *Id.*
343. *Id.* at 15.
344. *Id.*
state lines will continue to expand. The problem of determining the portion of multijurisdictional corporation income apportionable to California will become continually more vital to revenue production in this state. After *ASARCO* and *Woolworth*, the freedom of California and all other states using a unitary apportionment method of taxation no longer is effectively insulated from United States Supreme Court review.\(^{345}\) Prior to these 1982 decisions, the Supreme Court had "displayed a remarkably relaxed view of its role in policing constitutional challenges to state division-of-income rules."\(^{346}\) *ASARCO* and *Woolworth*, however, reflect a "strikingly different" judicial perspective on apportionment issues.\(^{347}\) The latest decision of the Court, *Container Corp.*, has refined and clarified the attitude of the Court regarding the balance between the roles played by the state courts and the United States Supreme Court in this ongoing unitary tax controversy.\(^{348}\) Apparent from all recent cases is that a more narrow view of the unitary business concept, emphasizing the particular facts of the case, is presently favored by the United States Supreme Court. This approach is destined to create a sharp increase in litigation.\(^{349}\) California must update and refine the state factors used in effecting the unitary tax method if the state is to be prepared for the stormy period of litigation ahead, staying close to any changes that can be distilled from *ASARCO* and *Woolworth*.\(^{350}\)

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346. *Id.* at 187.
347. *Id.* at 189.

Instead of a detached judicial tolerance for inferences a state is 'entitled' to draw from the record, we find the [U.S. Supreme] Court immersing itself in the factual details of the state administrative proceedings and rejecting state court inferences with which it disagrees.

*Id.*

348. See *supra* notes 341-44 and accompanying text.
349. *Id.* at 190.