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the rationale behind denying interlocutory appeals of certification orders demands consistency.

Kathleen M. LaValle

State Taxation by the Apportionment Method Under the Due Process and Commerce Clauses: Mobil Oil Corporation v. Commissioner of Taxes

Mobil Oil Corporation is an integrated petroleum business¹ organized under the laws of the State of New York where it also has its principal place of business and its commercial domicile. Mobil does business in many states, as well as in a number of foreign countries, but its activities in Vermont are limited to the wholesale and retail marketing of petroleum products. The State of Vermont imposed a corporate net income tax² on Mobil's taxable income, calculated by means of a three-factor apportionment formula.³ The taxable income included substantial amounts of foreign source⁴ dividends received from Mobil's subsidiaries and affiliates doing business abroad. Challenging the tax on the grounds that it violated

1. Mobil Oil Corporation engages in exploration for petroleum reserves, production, refining, transportation, and distribution and sale of petroleum and petroleum products. *Mobil Oil Corp. v. Commissioner of Taxes*, 100 S. Ct. 1223, 1227, 63 L. Ed. 2d 510, 515 (1980).

2. The statute provides: "'Vermont net income' means, for any taxable year and for any corporate taxpayer, the taxable income of the taxpayer for that taxable year under the laws of the United States, excluding income which under the laws of the United States is exempt from taxation by the states." VT. STAT. ANN. tit. 32, § 5811(18) (Supp. 1980).

3. The statute provides:

If the income of a taxable corporation is derived from any trade, business or activity conducted both within and without this state, the amount of the corporation's Vermont net income which shall be apportioned to this state, so as to allocate to this state a fair and equitable portion of that income, shall be determined by multiplying that Vermont net income by the arithmetic average of the following factors:

(1) The average of the value of all the real and tangible property within this state (A) at the beginning of the taxable year and (B) at the end of the taxable year . . . , expressed as a percentage of all such property both within and without this state;

(2) The total wages, salaries, and other personal service compensation paid during the taxable year to employees within this state, expressed as a percentage of all such compensation paid whether within or without this state;

(3) The gross sales, or charges for services performed, within this state, expressed as a percentage of such sales or charges whether within or without this state.

VT. STAT. ANN. tit. 32, § 5833(a) (1970 & Supp. 1980).

4. The term "foreign" operations, as used in this Note, refers to a corporation organized under the laws of a foreign country, and "domestic" operations refers to a corporation organized under the laws of one of the states. Brief for Appellant at 4 n.3.

the due process⁵ and commerce clauses⁶ of the United States Constitution, Mobil petitioned the Commissioner of Taxes of Vermont for modification of the apportionment.⁷ Objecting to the inclusion of foreign source dividend income in the preapportionment tax base,⁸ Mobil argued that this income should be deducted from taxable income before apportionment and allocated to New York, the state of its commercial domicile. The commissioner rejected Mobil's due process and commerce clause arguments and decided that the Vermont statute required inclusion of the foreign source dividend income in the tax base. The state superior court reversed the commissioner's ruling,⁹ and the commissioner appealed. Holding that the tax was constitutional, the Supreme Court of Vermont reversed the superior court.¹⁰ Because of the substantial federal question involved, the United States Supreme Court noted probable jurisdiction.¹¹ *Held, affirmed*: Vermont's inclusion in the preapportionment tax base of dividend income from affiliates and subsidiaries doing business abroad violates neither the due process clause nor the commerce clause of the United States Constitution. *Mobil Oil Corporation v. Commissioner of Taxes*, 100 S. Ct. 1223, 63 L. Ed. 2d 510 (1980).

I. THE CONSTITUTIONALITY OF STATE TAXATION UNDER THE DUE PROCESS AND COMMERCE CLAUSES

A. *The Due Process Clause and Apportionment Formulas*

The due process clause precludes a state from taxing income earned outside that state.¹² When a state seeks to tax the intrastate earnings of a

5. "[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . ." U.S. CONST. amend. XIV, § 1.

6. "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States . . ." *Id.* art. I, § 8, cl. 3.

7. VT. STAT. ANN. tit. 32, § 5833(b) (1970 & Supp. 1980) provides for a procedure for modification of the apportionment.

8. Mobil did not challenge the accuracy or fairness of the apportionment formula. Its sole contention was that Vermont lacked jurisdiction under the Constitution to include the dividend income in the preapportionment tax base. Brief for Appellant at 11.

9. The superior court held that inclusion of the dividend income in the tax base subjected Mobil to multiple taxation prohibited by the commerce clause because New York, the state of Mobil's commercial domicile, could tax the dividends in full without apportionment. *Mobil Oil Corp. v. Commissioner of Taxes*, No. c 13-74 (Wash. Super. Ct. June 10, 1977).

10. *Mobil Oil Corp. v. Commissioner of Taxes*, 136 Vt. 545, 394 A.2d 1147 (1978). The court found a sufficient nexus between Mobil and the State of Vermont to justify an apportioned tax on both Mobil's operating and dividend income. The multiple taxation theory relied on by the superior court was rejected because Mobil failed to prove that multiple taxation would actually ensue; New York had not taxed Mobil's dividend income for the tax years in question. For a discussion of the development of the multiple taxation doctrine, see J. HELLERSTEIN & W. HELLERSTEIN, *STATE AND LOCAL TAXATION* 242-44 (4th ed. 1978).

11. *Mobil Oil Corp. v. Commissioner of Taxes*, 441 U.S. 941 (1979).

12. *Norfolk & W. Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968). "[A] State is not entitled to tax tangible or intangible property that is unconnected with the State. . . . The taxation of property not located in the taxing State is constitutionally invalid . . . because it . . . denies to the taxpayer the process that is his due." *Id.* at 324-25. "So far as due process is concerned the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State." *Id.* at 325 n.5. See, e.g., *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940).

business that operates in more than one state, it may examine the extra-state earnings of that business only because specifically allocating profits earned within the borders of the taxing state is virtually impossible.¹³ Although imperfect, an apportionment formula¹⁴ has been accepted by the United States Supreme Court as a method of measuring intrastate earnings¹⁵ so long as the formula meets two due process requirements. First, there must be some minimal connection, or nexus, between the activities taxed and the taxing state.¹⁶ If a corporation avails itself of the privilege of conducting business within a state, the nexus is established with that state.¹⁷ Secondly, there must be a rational relation between the income attributed to the taxing state and the intrastate activities actually undertaken within that state.¹⁸ According to this test, the apportioned tax will be invalid only if it is out of proportion to the activities actually conducted within the taxing state.¹⁹

These requirements may be met notwithstanding the fact that specific income is determined to be extrastate through the use of separate geographical accounting, so long as the intrastate and extrastate activities form part of a unitary business.²⁰ A business is unitary if its operation within the taxing state is dependent upon or contributes to the operation of the business outside the state.²¹ A particular accounting system, although a useful business tool, may not accurately reflect the amount of income

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

14. Under the apportionment method of taxation, the activities within the state are considered to be an inseparable part of a business that engages in activities both within and without the taxing state. The net income of the business as a whole is determined as defined by the state statute. The state then taxes only the portion of net income attributable to the state by application of a three-factor apportionment formula. To determine that portion, net income is multiplied by a fraction that represents the arithmetic average of the ratios of sales, property, and payroll values within the state to those values of the business as a whole. See generally J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 10; Keesling & Warren, *The Unitary Concept in the Allocation of Income*, 12 HASTINGS L.J. 42 (1960). For a background discussion of and current use of apportionment formulas, see TAX INSTITUTE OF AMERICA, STATE AND LOCAL TAXES ON BUSINESS 67-97 (1965); Peckron, *Apportionment Factors Employed by States in the Computation of Corporate Income Tax*, 3 J. CORP. TAX. 388 (1977).

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

16. "[T]he Constitution requires 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'" *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954)).

17. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45 (1940).

18. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978); *Norfolk & W. Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1968).

19. *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

20. See *Exxon Corp. v. Wisconsin Dep't of Revenue*, 100 S. Ct. 2109, 2118-21, 65 L. Ed. 2d 66, 78-82 (1980); *Butler Bros. v. McCollgan*, 315 U.S. 501, 507-08 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'r*, 266 U.S. 271, 282-83 (1924).

21. *Wisconsin Dep't of Revenue v. Exxon Corp.*, 90 Wis. 2d 700, 281 N.W.2d 94, 100 (1979) (quoting G. ALTMAN & F. KEESLING, *ALLOCATION OF INCOME IN STATE TAXATION* 101 (2d ed. 1950)). It appears that the United States Supreme Court has never explicitly defined a unitary business, relying instead on the state court's definition. See *Exxon Corp. v. Wisconsin Dep't of Revenue*, 100 S. Ct. 2109, 65 L. Ed. 2d 66 (1980). For a discussion of the various tests used by the state courts, see Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Businesses*, 10 URB. LAW. 181 (1978).

earned within the taxing state.²² Most states use apportionment formulas to deal with this problem.²³ These formulas are designed to produce only a rough approximation of intrastate earnings, and ordinarily will not generate a figure that represents the income actually earned within the taxing state.²⁴ If the formula is "fairly calculated" to allocate to the state a portion of net income "reasonably attributable" to the activities conducted within the state,²⁵ due process requirements are satisfied.²⁶

The unitary business principle is the controlling element of apportionability for purposes of state taxation of income earned by a business operating in interstate commerce.²⁷ A state is justified in attributing to itself a proportionate amount of the profits earned by a company that carries on a unitary business partly within and partly without that state.²⁸ The unitary business principle was initially developed in a situation involving a single corporation operating in interstate commerce through various branches or divisions.²⁹ Although various state court decisions later extended this

22. *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942). *Butler Bros.*, a wholesale merchandise corporation, operated stores in several states, including California. Although the corporation showed a substantial profit in 1935, the California store, using a separate accounting basis, showed a loss. The Court held that the accounting system was not binding on California in determining the amount of income attributable to the state. *Id.* at 507-08.

23. Forty-five out of the 46 states, including the District of Columbia, that impose corporate net income taxes have adopted the three-factor apportionment formula, consisting of property, payroll, and receipts. See SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE, HOUSE COMM. ON THE JUDICIARY, STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. NO. 1480, 88th Cong., 2d Sess. 170-92 (1964). See also H.R. REP. NO. 952, 89th Cong., 1st Sess. 1121 (1965); H.R. REP. NO. 565, 89th Cong., 1st Sess. 607 (1965).

24. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978).

25. *Butler Bros. v. McColgan*, 315 U.S. 501, 506 (1942).

26. *Id.* at 506-07; see *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924) (Court allowed part of the overall net profits of the corporation to be attributed to the state even though the activities in the taxing state were operated at a loss).

27. When a business conducts activities within the taxing state that are truly separate and distinct from the activities conducted outside the state, the income and expenses attributable to the taxing state can be determined easily and accurately. When the activities are an inseparable part of a business carried on both within and without the state, however, such determinations become extremely difficult. Although segregated figures can be computed, they will necessarily reflect numerous arbitrary assumptions. Thus, the business should be treated as a unit, net income from the entire business computed, and the share attributable to the taxing state determined by an appropriate apportionment formula. *Keesling & Warren*, *supra* note 14, at 44-45. For further discussion of this concept, see *Dexter*, *supra* note 21; *Rudolph, State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171 (1970); *Wood, The Unitary Tax Controversy*, 25 CAN. TAX J. 271 (1977).

28. *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924). Plaintiff, a British corporation, manufactured and sold ale in Great Britain. In addition, a small amount of ale was sold in New York. New York imposed an apportioned franchise tax on the corporation's total net income. The Court sustained the tax, holding that the brewer carried on a unitary business involving "a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales." *Id.* at 282.

29. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920). *Underwood*, a Delaware corporation, was engaged in manufacturing and selling typewriters and supplies. All of the corporation's products were manufactured in Connecticut, but most of its sales were made from branch offices in other states. The Court sustained the validity of Connecticut's tax on the apportioned amount of the corporation's entire net income. *Id.* at 120-21.

principle to include multistate enterprises operating through a multicorporate structure,³⁰ the United States Supreme Court has not addressed this issue. 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.³¹

B. *The Commerce Clause and State Taxation of Interstate Businesses*

In addition to the due process clause, the courts generally rely on the commerce clause in analyzing and resolving disputes arising out of state taxation of multistate businesses.³² Early Supreme Court decisions interpreted the commerce clause to prohibit direct state taxation of wholly interstate commerce,³³ thereby creating a tax-haven for corporations involved exclusively in interstate business.³⁴ The Court abandoned that interpretation in *Western Live Stock v. Bureau of Revenue*,³⁵ holding that the commerce clause was not intended to relieve businesses operating in interstate commerce from bearing their just share of the state tax burden.³⁶ Finally, in *Northwestern States Portland Cement Co. v. Minnesota*³⁷ the Court explicitly stated that the commerce clause does not prohibit a state from levying a fairly apportioned net income tax on a foreign corporation engaged exclusively in interstate business.³⁸

30. *Edison Cal. Stores, Inc. v. McColgan*, 176 P.2d 697 (Cal.), *rev'd on rehearing*, 30 Cal. 2d 472, 183 P.2d 16 (1947); *Zale-Salem, Inc. v. State Tax Comm'n*, 237 Or. 261, 391 P.2d 601 (1964); *Interstate Fin. Corp. v. Wisconsin Dep't of Taxation*, 28 Wis. 2d 262, 137 N.W.2d 38 (1965). Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335, 346 (1976) [hereinafter cited as Hellerstein, *State Taxation*]. "This was a sensible, and indeed, an essential step, since the unitary business apportionment concept is based on an economic approach that ought not be avoided by the technical niceties of legal distinctions between controlled subsidiaries and divisions or branches." *Id.* at 346. For further discussion, see Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 NAT'L TAX J. 487 (1968).

31. *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942). See also *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

32. See *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979); *Department of Revenue v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

33. See *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851); *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824).

34. See Hellerstein, *State Taxation*, *supra* note 30, at 337.

35. 303 U.S. 250 (1938).

36. *Id.* at 254-58. The *Western Live Stock* opinion introduced the multiple taxation doctrine, under which a state tax imposed on businesses operating in interstate commerce would only be invalidated if it subjected interstate commerce to a risk of multiple taxation. *Id.* See, e.g., *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 348 (1944).

37. 358 U.S. 450 (1959).

38. The decision in *Northwestern States* triggered the first congressional action regarding state taxation powers under the commerce clause in 170 years. Congress enacted Pub. L. No. 86-272, 73 Stat. 555-56 (codified at 15 U.S.C. §§ 381-384 (1976)), which led to congressional committee studies and recommendations concerning the overall problems of state taxation of interstate commerce. See SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE, HOUSE COMM. ON THE JUDICIARY, STATE TAXATION OF INTERSTATE COMMERCE, *supra* note 23. These studies and recommendations encouraged many proposed

In several recent cases the Court has attempted to clarify the effect of the commerce clause on state taxation of businesses operating in interstate commerce.³⁹ As a result of these decisions, the Court has established a method of determining the constitutionality of a state tax by examining the practical effect of the tax in relation to four factors: the tax must (1) be levied on activities that have a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce in favor of local commerce; and (4) be fairly related to the services and protection conferred upon the taxpayer by the state.⁴⁰

One of the most vexing problems involving the effect of the commerce clause on state taxation of interstate commerce is the determination of the constitutional implications of attributing income earned from intangible property interests,⁴¹ such as dividend income, to a state for purposes of taxation. The Supreme Court has refused to hold that either the commerce clause or the due process clause requires allocation of income from in-

measures to establish uniform federal restrictions on state taxation of interstate commerce. To date, none have been enacted. See Hellerstein, *State Taxation*, *supra* note 30, at 340.

Two legislative proposals providing limitations on state taxation of interstate and foreign source dividend income were introduced during the first session of the current United States Senate. S. 1688, 96th Cong., 1st Sess., 125 CONG. REC. S11657 (daily ed. Aug. 3, 1979); S. 983, 96th Cong., 1st Sess., 125 CONG. REC. S4458 (daily ed. April 23, 1979). While the scope of S. 1688 is limited to the restriction of state taxation of foreign source income, S. 983 additionally establishes uniform national standards governing state taxation of interstate commerce. In regard to state taxation of foreign source income, the restrictions of S. 1688 are limited to foreign source dividends, whereas S. 983 would apply to foreign source income in general. In further contrast, S. 983 established a broad prohibition on state taxation of foreign source income by providing that foreign source income may not be apportioned or allocated to any state, while S. 1688 allows state taxation of foreign source dividend income, but requires that a certain portion of those dividends be excluded from a state's tax base. The non-excluded portion would be subject to state taxation. In applying a state income tax to a corporation, states would be prohibited by S. 1688 from taxing the income of any foreign affiliates.

In regard to state taxation of interstate income, the primary emphasis of S. 983 is twofold. First, the proposal restricts the power of a state to tax interstate transactions by requiring that certain minimum contacts exist between a state and a seller or purchaser before the state can impose a sales, use, or gross receipts tax. Secondly, the proposal attempts to alleviate the problem of over or under-allocation of multistate income to a particular state by requiring that the states employ a uniform formula for apportioning such income. The uniform formula would apportion income on the basis of three factors: sales, payroll, and property.

The Senate Subcommittee on Taxation and Debt Management generally concluded public hearings on S. 983 and S. 1688 on June 24, 1980. 126 CONG. REC. D950 (daily ed. June 24, 1980).

39. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 431 (1979) (additional factors must be considered when a state attempts to tax instrumentalities of foreign commerce); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) (commerce clause does not prohibit any overlap in the computation of taxable income by the states); *Department of Revenue v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978) (state tax burden impermissibly impedes interstate commerce only when it unfairly burdens commerce by exacting more than its just share of the cost of state government).

40. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 444-45 (1979) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

41. Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 VAND. L. REV. 401 (1976). Multinational and multistate businesses are strongly opposed to the trend that has developed to treat income from intangibles as apportionable income. Instead, these businesses insist that such income should be allocated to a single state for taxation purposes. *Id.* at 401-02.

tangibles to a single state.⁴² In *Curry v. McCanless*⁴³ the Court dispensed with the fiction that an intangible has a location and is taxable only by the state in which it is located.⁴⁴ Because the owner derives benefits and protection from the state in which the intangible is used, the Court concluded that the income is taxable by that state.⁴⁵ The Court stressed, however, that the power to tax the income from an intangible is not exclusive if other states also provide benefits and protection for the intangible.⁴⁶

II. MOBIL OIL CORPORATION V. COMMISSIONER OF TAXES

In *Mobil Oil Corporation v. Commissioner of Taxes* the Supreme Court noted probable jurisdiction to determine whether the Constitution prohibits state taxation by the apportionment method of income earned from investments in affiliates and subsidiaries operating abroad.⁴⁷ Expanding the scope of the unitary business principle to include foreign subsidiaries and affiliates,⁴⁸ the Court held that neither the due process clause nor the commerce clause prohibits taxation of such income by apportionment.⁴⁹ Income is immune from apportionment, under the due process clause, if it lacks a sufficient nexus with the taxpayer's activities in the taxing state, or bears no rational relation to the taxpayer's activities within the state.⁵⁰ Mobil argued that a sufficient nexus did not exist between its activities in Vermont and the dividend income received from its foreign subsidiaries.⁵¹ In determining whether the nature of the income in question precluded a finding of the requisite nexus, the Court examined two factors.⁵² First, the Court considered the foreign source of the income. In *Butler Brothers v. McColgan*⁵³ the Court had previously held that even though the source of

42. See *Curry v. McCanless*, 307 U.S. 357 (1939).

43. 307 U.S. 357 (1939).

44. *Id.* at 367. The decedent, domiciled in Tennessee, transferred stocks and bonds to a trustee in Alabama where the trust was administered until her death. Both states claimed the right to tax the transfer, each claiming to be the situs of the transaction. The Court held that each state could constitutionally impose a tax because the taxpayer had received the benefit and protection of the laws of both states. The Court stated that "when the taxpayer extends his activities with respect to his intangibles, so as to avail himself of the protection and benefit of the laws of another state," there is no reason for a single place of taxation. *Id.*

45. *Id.*

46. *Id.* at 372-73.

47. 441 U.S. 941 (1979).

48. The authors of one book have suggested:

In recent years a controversy has developed as to the propriety of applying unitary apportionment principles to foreign operations. On the merits, unitary apportionment may become a questionable yardstick as a fair measure of a State's share of the earnings of an enterprise, when it is extended world-wide. Some companies may earn considerably higher rates of profit abroad than in the United States; relative ratios of property, payroll and receipts may be an extremely crude method of ascribing profits actually earned in the various countries.

J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 10, at 538.

49. 100 S. Ct. at 1237, 63 L. Ed. 2d at 528.

50. See note 16 *supra* and accompanying text.

51. 100 S. Ct. at 1230-31, 63 L. Ed. 2d at 520-21.

52. *Id.* at 1231, 63 L. Ed. 2d at 521.

53. 315 U.S. 501 (1942). See also note 22 *supra* and accompanying text.

the income can be established as extrastate, apportionability is not precluded if the intrastate and extrastate activities form part of a single unitary business.⁵⁴ Mobil had the burden of proving by clear and cogent evidence that the foreign operations of the dividend-paying affiliates and subsidiaries were not part of its unitary petroleum business that conducted some of its activities in Vermont.⁵⁵ Mobil offered no evidence to meet that burden,⁵⁶ and therefore, the Court held that Vermont was correct in concluding that the foreign source of the dividends did not preclude a finding of the required nexus with intrastate activities.⁵⁷ The second factor considered by the Court was the significance of the form in which Mobil received the income. The Court determined that the integration of the underlying profit-producing enterprise was the controlling factor, not the form of the investment.⁵⁸ The Court treated dividend income from subsidiaries as analogous to income earned by separate divisions of a unitary business that would clearly meet the due process requirements of apportionability.⁵⁹ Although income is received in the form of dividends from legally separate entities, the underlying economic realities of a unitary business remain the same and the form of the income, therefore, should not affect apportionability.⁶⁰ The Court stressed, however, that its decision did not mean that all dividend income received by corporations operating in interstate or foreign commerce would necessarily be subject to apportionment.⁶¹ If the activities of the payor corporation are unrelated to the recipient's activities in the taxing state, due process might preclude apportionment because no unitary business would exist.⁶²

The Court next addressed the commerce clause challenge and followed its reasoning in *Curry v. McCannless*,⁶³ holding that the commerce clause does not require allocation of income from intangibles to a single state.⁶⁴ The Court reasoned that although the state of commercial domicile may have the power to tax some of this income, that power is not exclusive when the dividends reflect income earned from a unitary business, part of which is conducted in another state.⁶⁵ Apportionability is the generally

54. 315 U.S. at 507-08.

55. 100 S. Ct. at 1232, 63 L. Ed. 2d at 522.

56. *Id.*

57. *Id.*

58. *Id.* at 1233, 63 L. Ed. 2d at 523. "So long as dividends from subsidiaries and affiliates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business." *Id.*

59. *Id.*; see *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920), discussed at note 29 *supra*.

60. 100 S. Ct. at 1233, 63 L. Ed. 2d at 523.

61. *Id.*

62. *Id.* at 1233-34, 63 L. Ed. 2d at 523-24.

63. 307 U.S. 357 (1939); see notes 42-46 *supra* and accompanying text.

64. *Id.* at 372-73.

65. 100 S. Ct. at 1236, 63 L. Ed. 2d at 526. Mobil contended that an apportioned tax placed an undue burden on that income because New York, the state of its commercial domicile, could tax the income in full. Mobil argued that the income, therefore, must be allocated to New York. Although New York had not taxed the dividend income during the years in question, the Court agreed with Mobil that actual multiple taxation need not be shown in order to establish the unconstitutionality of Vermont's tax. *Id.* at 1235, 63 L. Ed.

accepted method of allocating to a state its fair share of income for taxation purposes when the income bears a relation to benefits and protection conferred by more than one state.⁶⁶

In a dissenting opinion Justice Stevens objected to the majority's assumption, inherent in its definition of a unitary business, that the dividends from Mobil's subsidiaries and affiliates were analogous to the income of operating divisions or branches of a single, legally integrated business.⁶⁷ Justice Stevens supported his objection on three grounds. First, the record showed a large number of corporations in which Mobil owned minority interests that did not appear to be engaged in the petroleum business, but nonetheless were treated as part of the unitary business.⁶⁸ Secondly, the record did not disclose whether the dividends paid even approximately represented the earnings of the payor corporations.⁶⁹ Finally, and in Justice Stevens's view, most importantly, Vermont made no attempt to incorporate the sales, payroll, and property values of any of the dividend payor corporations into its apportionment formula.⁷⁰ Justice Stevens insisted that if Mobil's world-wide petroleum enterprise was to be defined as a unitary business, it should be consistently treated as such.⁷¹ If income from payor corporations was to be included in the preapportionment tax base as income from the unitary business, then the sales, payroll, and property values of those corporations must also be included in the denominator of the apportionment factors that represent the business's total sales, payroll, and property both within and without the taxing state.⁷²

2d at 525. The absence of actual multiple taxation did, however, alter the nature of Mobil's claim. Mobil sought to establish that in theory, the commerce clause requires allocation of dividend income to a single state rather than apportionment among the states. *Id.*; see notes 8-10 *supra* and accompanying text.

Mobil further argued that the risk of multiple taxation abroad created a burden on foreign commerce, and thus foreign source income should be allocated to a single situs at home. *Id.* at 1234, 63 L. Ed. 2d at 524. To support this argument, Mobil relied on *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). The Court dismissed any analogy to *Japan Line* because that decision involved ad valorem property taxes assessed directly upon instrumentalities of foreign commerce and because it focused on duplicative taxation at the international level. 100 S. Ct. at 1236-37, 63 L. Ed. 2d at 527. The Court concluded that Mobil's argument was irrelevant because it focused on the effect of foreign taxation rather than domestic taxation, which was the only issue in the instant case. *Id.*

66. 100 S. Ct. at 1236, 63 L. Ed. 2d at 526.

67. *Id.* at 1242-43, 63 L. Ed. 2d at 534-35.

68. *Id.* at 1241 n.9, 63 L. Ed. 2d at 532-33 n.9.

69. *Id.* at 1243 & n.18, 63 L. Ed. 2d at 535 & n.18.

70. *Id.* at 1243, 63 L. Ed. 2d at 535. Mobil presented the argument in its reply brief that the income of a taxable corporation must be determined by the taxing state on a combined apportionment basis. Reply Brief for Appellant at 1-6. This method would include the income of subsidiaries and affiliates in Mobil's net income and eliminate intercorporate transfers such as dividend income. The state would then have to include the subsidiaries' and affiliates' sales, payroll, and property in the calculation of the apportionment formula. The majority rejected this argument for three reasons: the court considered it an afterthought; the record was insufficient to evaluate the proposal; and the argument challenged the apportionment formula that the appellant had conceded was fair. 100 S. Ct. at 1233 n.15, 63 L. Ed. 2d at 523 n.15. For a discussion of combined apportionment, see Dexter, *supra* note 41, at 419-20.

71. 100 S. Ct. at 1243, 63 L. Ed. 2d at 535.

72. See VT. STAT. ANN. tit. 32, § 5833(a) (1970 & Supp. 1980) for the statutory require-

Failure to adopt this method inevitably overstated Vermont's proportionate share of Mobil's income.⁷³

The majority did not decide whether combined apportionment would be constitutionally required if a state sought to apportion the income of a multicorporate enterprise. Instead, the Court assumed that the dividends represented income earned by part of a unitary business because Mobil failed to prove otherwise.⁷⁴ The Court implied that had this argument been properly presented it would have been considered,⁷⁵ thus suggesting that combined apportionment might be an acceptable alternative to Vermont's apportionment method. The Court did not decide whether the income attributed to Vermont by its apportionment formula was reasonably related to Mobil's activities within Vermont.⁷⁶ Because Mobil's due process argument focused on the lack of any nexus between the foreign subsidiary dividend income and its activities conducted within Vermont, the Court determined that Mobil was not challenging the fairness of Vermont's apportionment formula.⁷⁷ The Court may not have considered the fact that implicit in Mobil's nexus argument was the contention that no rational relation existed between any income from Mobil's foreign subsidiaries and Mobil's activities conducted in Vermont. Nonetheless, Mobil offered no evidence to support that contention, relying instead solely on the nexus argument. Further, because the issue was not raised, the Court did not decide which elements would be necessary in a fair apportionment formula.⁷⁸ The Court emphasized, however, that accounting methods used by businesses to allocate income to specific sources are not binding on the states in determining the portion of income earned within its borders so long as the activities within the taxing state are part of a unitary business.⁷⁹

III. CONCLUSION

In *Mobil Oil Corporation v. Commissioner of Taxes* the Supreme Court

ment that the total sales, payroll, and property values are to be included in the denominator of the apportionment factors.

73. 100 S. Ct. at 1243, 63 L. Ed. 2d at 535.

74. *Id.* 1233 n.15, 63 L. Ed. 2d at 523 n.15.

75. *Id.*

76. *Id.* at 1230, 63 L. Ed. 2d at 519.

77. *Id.*

78. *Id.* at 1237, 63 L. Ed. 2d at 528; Peters, *Sup. Ct.'s Mobil Decision on Multistate Income Apportionment Raises New Questions*, 53 J. TAX. 36, 39 (1980).

79. The Court re-emphasized in the recent decision of *Exxon Corp. v. Wisconsin Dep't of Revenue*, 100 S. Ct. 2109, 65 L. Ed. 2d 66 (1980). Exxon, an integrated petroleum company, is organized into three major functional departments, Exploration and Production, Refining, and Marketing, but conducts only marketing activities in Wisconsin. It filed Wisconsin income tax returns using separate geographical accounting that reflected only the Wisconsin marketing operations. Wisconsin assessed taxes on Exxon's total income. In upholding the tax, the Court held that "a company's internal accounting techniques are not binding on a State for tax purposes." *Id.* at 2119, 65 L. Ed. 2d at 80. The Court stated that "[i]f a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a 'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing State.'" *Id.* at 2120, 65 L. Ed. 2d at 81 (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978)).

held that neither the due process clause nor the commerce clause prohibits state taxation by apportionment of income earned from investments in affiliates and subsidiaries operating abroad. The Court based its decision on defining Mobil's worldwide petroleum enterprise as a unitary business, thereby expanding the scope of the unitary business principle to include foreign subsidiaries and affiliates. The decision indicates that foreign source income will be treated in the same manner as interstate income, although several questions remain. The Court did not address the power of the state of commercial domicile to tax dividends received by corporations doing business in interstate and foreign commerce. The Court did not determine the elements of a fair apportionment formula. Further left unanswered is the possibility of using combined apportionment as an alternative to Vermont's method of apportionment. The Court emphasized, however, that its decision did not mean that all dividend income is necessarily apportionable. To preclude apportionment, the taxpayer must prove that the dividends are paid by a subsidiary or affiliate whose activities are not related to the activities in the taxing state. Mobil failed to prove this fact, but instead relied on the argument that the income was received in the form of dividends, paid by subsidiaries and affiliates abroad. According to the Court, neither the foreign source nor the form of the income affected the underlying unitary nature of the enterprise.

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