

3-1-1981

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Recommended Citation

William D. Dexter, *Tax Apportionment of the Income of a Unitary Business: An Examination of Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 1981 BYU L. Rev. 107 (1981).

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Tax Apportionment of the Income of a Unitary Business: An Examination of *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*

William D. Dexter*

The United States Supreme Court, in affirming the judgment of the Vermont Supreme Court in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*,¹ upheld Vermont's apportionment of Mobil's dividend income from so-called "foreign sources" even though these dividends constituted substantially all of Mobil's taxable income for the years in question, 1970-72. In so doing, the Court upheld the principle of full apportionment of income related to a unitary trade or business. It also affirmed its prior holdings that the taxpayer carries the burden of proving that apportionment would reach income not reasonably related to in-state sources, events, or transactions or that the state taxing statute as applied is otherwise invalid. The Court rejected the geographical "sourcing" of a unitary business' income by separate accounting and also rejected Mobil's multiple taxation argument. Finally, the Court gave strong support to the principle of worldwide combined reporting.

The reasoning employed by the Court raises questions of vital concern to the states and the multinational business community. The Court's decision turned on the resolution of procedural as well as substantive issues. The procedural aspects of the case, including the status of the record and the *Mobil* arguments, are critically important to understanding the Court's decision. The Court's resolution of certain substantive issues raises additional questions for future resolution. This Article will analyze the *Mobil* record, the litigants' arguments and the general configuration of the issues associated with state taxation of dividends and other income from intangibles.

* General Counsel, Multistate Tax Commission. Asst. Attorney General, Michigan, 1949-70. A.B., 1942, Michigan State University; LL.B., 1948, University of Michigan.

1. 445 U.S. 425 (1980).

I. THE *Mobil* FACTS AND ARGUMENTS

The Vermont corporate income tax is based on federal taxable income. If a corporation's income is "derived from any trade, business, or activity conducted both within and without" Vermont,² the statute provides for state apportionment of the corporation's federal taxable income by the generally accepted three-factor apportionment formula reflecting property, payroll, and sales.

In filing its Vermont income tax returns for the years 1970-72, Mobil excluded from its apportionment base the interest, dividends, and foreign taxes included in its federal taxable income. It then computed its Vermont tax liability by apportioning the balance of its federal taxable income by the Vermont three-factor formula. On its returns, Mobil characterized its interest and dividends as "nonapportionable income" and requested administrative relief from application of the Vermont apportionment formula to its "unadjusted" federal taxable income. However, Mobil did not contend that the apportionment formula, as applied to its federal taxable income, attributed more net income to Vermont than was reasonably related to its Vermont activities and income sources. Nor did it claim that its dividends and stock investments were unrelated to its unitary business operations carried on in part in Vermont.

The Vermont Department of Taxes recalculated Mobil's tax liability by including the excluded items in Mobil's apportionable income. Mobil challenged the taxing authority's action before the Commissioner of Taxes. Vermont did not maintain that the stock and dividends were a part of Mobil's unitary trade or business carried on in part in Vermont. Rather, the dividend exclusion was disallowed for three reasons: (1) The dividends were part of federal taxable income subject to apportionment under the Vermont statute; (2) Mobil had not established that the apportionment result was unreasonable; and (3) The "multiple risk" argument which Mobil advanced to justify the exclusion was not valid.

Mobil's appeal to the Vermont courts was limited to its multiple-risk commerce clause argument. Presumably its argument was so limited because Mobil concluded that prior Vermont Supreme Court decisions³ foreclosed other commerce

2. VT. STAT. ANN. tit. 32, § 5833 (1971).

3. See *In re Goodyear Tire & Rubber Co.*, Corporate Income Tax 1966, 1967, 1968,

clause and due process arguments.

In its appeal to the United States Supreme Court, Mobil contended only that its so-called "foreign source" dividends were not apportionable. It characterized as "foreign source" income all dividends from its foreign subsidiaries and from domestic affiliates which conducted substantially all of their activities outside the United States. It thereby conceded that all of its other income (including other dividends and income from other intangibles) was properly includable in its apportionable income.

Invoking the due process clause, Mobil justified the dividend exclusion on the basis that the stock was located outside Vermont and that all of Mobil's activities directly related to the stock, as well as the business activities of the payor corporations from which the stock dividends were derived, took place outside Vermont. In addition, Mobil contended that New York, its commercial domicile state, had the exclusive right to tax the dividend income under the commerce clause multiple taxation doctrine. It claimed that *Japan Line, Ltd. v. County of Los Angeles*⁴ dictated this result with respect to "foreign source" income.

In its reply brief, Mobil contended that the conducting of part of its worldwide petroleum business in connection with the affiliates that paid the dividends in question was irrelevant except in a "combined reporting" context.⁵ It neither conceded nor

133 Vt. 132, 335 A.2d 310 (1975); *F.W. Woolworth Co. v. Commissioner of Taxes*, 130 Vt. 544, 298 A.2d 839 (1972); *Gulf Oil Corp. v. Morrison*, 120 Vt. 324, 141 A.2d 671 (1958).

4. 441 U.S. 434 (1979). In *Japan Line*, the Supreme Court invalidated an apportioned *ad valorem* property tax levied by the city and county of Los Angeles on cargo containers owned and used exclusively by foreign corporations engaged in foreign commerce. The Court held that foreign commerce could not be taxed by the States in a manner which prevented the United States from speaking with one voice in international affairs or in a manner which would subject foreign commerce to multiple taxation. Mobil consequently argued that the Vermont apportionment of "foreign source" dividends interfered with federal international tax policy and exposed foreign commerce to prohibited multiple taxation.

5. In a combined report, separate corporate entities conducting a unitary business are "combined" to determine the income tax liability of any member of the affiliated group. After the elimination of all affiliated transactions, including dividends, net income is that of the combined group; and the apportionment factors are those of the combined group. As pointed out by the appellant, the combined group includes only affiliated corporations in which the parent owns more than 50% of the stock. Appellant's Reply Brief, Appendix D at 1a. For a discussion of combined reporting, see *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947); Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices*, 42 J. TAX. 106 (1975). See also Note, *Multinational Corporations and Income Allocation under Section 482 of the Internal Revenue Code*, 89 HARV. L. REV. 1202 (1976).

denied that it was conducting a unitary business with any of the dividend payor corporations.

Vermont asserted that Mobil's due process argument was frivolous because Mobil had failed to establish that its stockholdings were not a part of its unitary business carried on in part in Vermont, or that the apportionment formula attributed to Vermont any income not reasonably related to Mobil's Vermont activities and sources of income. In response to Mobil's commerce clause multiple taxation argument, Vermont admitted that the commerce clause does prohibit some overlapping, multiple taxation in the net income tax area but argued that there was in fact no multiple taxation of Mobil's dividend income. Additionally, Vermont contended that the Court should not decide multiple taxation issues in a speculative setting and that *Japan Line* was irrelevant to the *Mobil* situation.

II. ANALYSIS

In defining the *Mobil* issue, the Court explicitly noted that it was not considering "whether application of Vermont's formula produced a fair attribution of appellant's dividend income to that State";⁶ rather, the Court confined its decision to the question of "whether there is something about the character of income earned from investments in affiliates and subsidiaries operating abroad that precludes, as a constitutional matter, state taxation of that income by the apportionment method."⁷

In addressing this question, the majority found that the record lacked detail concerning the payor corporations' activities. It nevertheless found that "from perusal of [the] documents in the record," many of these subsidiaries and affiliates "engage in business activities that form part of Mobil's integrated petroleum enterprise."⁸ While Mobil was "unwilling to concede the legal conclusion that these activities form part of a 'unitary business,' . . . it . . . offered no evidence that would undermine the conclusion that most, if not all, of its subsidiaries and affiliates contribute to [Mobil's] worldwide petroleum enterprise."⁹ Thus, the Court placed the burden of proof on Mobil to establish that

6. 445 U.S. at 434.

7. *Id.* at 435. Justice Stevens' dissent disagreed with the majority's framing of the issue. He argued that a challenge to the apportionable income tax base necessarily implied a challenge to the apportionment formula. *Id.* at 462 (Stevens, J., dissenting).

8. 445 U.S. at 435.

9. *Id.*

the stock investments and dividends in question were dissociated from the integrated petroleum business which Mobil conducted in part in Vermont.

The majority opinion then considered Mobil's three principal constitutional arguments: (1) No nexus existed between Vermont and Mobil's "management of its investments or the business activities of the payor corporations";¹⁰ (2) Mobil was subject to multiple taxation because New York, its state of commercial domicile, could tax the dividends in full; (3) The foreign source of the dividends subjected Mobil to multiple taxation at the international level.

A. *The Due Process Issue*

The Court reaffirmed the principles that interstate commerce is not immune from a fairly apportioned state income tax and that for a state to tax income generated in interstate commerce, due process requires only "a minimal connection between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise."¹¹ It further found that due process does not invalidate a tax simply because it is "contingent upon events brought to pass without a state"¹²

Because "Mobil included all its *operating* income in apportionable net income, without regard to the locality in which it was earned,"¹³ the Court concluded that Mobil did not contest these general principles. It thus found that Mobil's due process nexus argument turned on the nature of dividend income as distinguished from operating income.¹⁴ From Mobil's argument, the Court discerned only two factors that would differentiate dividend income from operating income: the foreign source of the income and the receipt of the income in the form of dividends.¹⁵

The Court equated the foreign source due process argument with an effort by Mobil to "separately account" for its dividends by ascribing a geographical "source" to them. In disposing of this argument, the Court stated:

10. *Id.* at 436.

11. *Id.* at 436-37 (citations omitted).

12. *Id.* at 437 (quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45 (1940)).

13. *Id.* (emphasis added).

14. *Id.* at 437-38.

15. *Id.* at 438.

The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and extrastate activities formed part of a single unitary business. See *Butler Bros. v. McColgan*, 315 U.S. 501, 506-508 (1942); *Ford Motor Co. v. Beauchamp*, 308 U.S. 331, 336 (1939); cf. *Moorman Mfg. Co. v. Bair*, 437 U.S., at 272. In these circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. *Butler Bros. v. McColgan*, 315 U.S., at 508-509. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.

The Court has applied the same rationale to businesses operating both here and abroad.¹⁶

The Court concluded:

As these cases indicate, the *linchpin of apportionability* in the field of state income taxation is the *unitary-business principle*. In accord with this principle, what appellant must show, in order to establish that its dividend income is not subject to an apportioned tax in Vermont, is that the income was earned in the course of activities unrelated to the sale of petroleum

16. *Id.* In *Butler Bros. v. McColgan*, 315 U.S. 501 (1942), the Court upheld the apportionment of the unitary income of Butler Brothers even though Butler Brothers had shown that the apportionment arrived at a substantially different result than its separate geographical accounting. It then held that "the results of the accounting system employed by appellant [*Butler Bros.*] do not impeach the validity or propriety of the formula which California has applied here." *Id.* at 508.

In *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939), the Court held that, for Texas "net worth" franchise tax purposes, a proportional value of Ford Motor Company far in excess of the value of properties located in Texas by separate accounting could be attributed to Texas because, "[i]n a unitary enterprise, property outside the state . . . necessarily affects the worth of the privilege within the state." *Id.* at 336.

In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), the Court noted that apportionment, unlike separate accounting, "does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State." *Id.* at 273.

products in that State.¹⁷

In disposing of the "form of dividends" argument, the Court rejected Mobil's contentions that its ownership or management of stock investments constituted a business distinct from its sale of petroleum products; "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. One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability."¹⁸ The Court then delineated the scope of its holding with regard to the due process issue:

We do not mean to suggest that all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business. Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business. We need not decide, however, whether Vermont's tax statute would reach extraterritorial values in an instance of that kind. Mobil has failed to sustain its burden of proving any unrelated business activity on the part of its subsidiaries and affiliates that would raise the question of nonapportionability. We therefore hold that its foreign source dividends have not been shown to be exempt, as a matter of due process, from apportionment for state income taxation by the State of Vermont.¹⁹

The Court thus implies a link between Vermont's power to apportion the dividends in question and the relationship of the payor corporations' businesses to Mobil. In its concluding statement, the majority opinion held; "Because the issue has not been presented, we need not, and do not, decide what the constituent elements of a fair apportionment formula applicable to such income would be. We hold, however, that Vermont is not

17. 445 U.S. at 439 (emphasis added).

18. *Id.* at 440.

19. *Id.* at 441-42 (footnote omitted)(citations omitted). The Court rejected for lack of evidence Justice Stevens' dissenting argument that unrelated business activity was readily apparent from the record because a large number of the corporations from which Mobil derived significant dividend income appeared neither to be engaged in the petroleum business nor to have any connection with Mobil's Vermont marketing business. *Id.* at 442 n.16.

precluded from taxing its proportionate share."²⁰ This disposition of the due process issue left several unanswered questions which will be considered in this Article.

B. *The Commerce Clause Issue*

The Court examined the commerce clause issue in two parts. First, it considered "whether there was a burden on interstate commerce by virtue of the effect of the Vermont tax relative to [Mobil's] income tax liability in other States."²¹ Second, the Court "determine[d] whether constitutional protections for foreign commerce pose additional considerations that alter the result."²²

Although the Court "agree[d] with Mobil that the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy,"²³ it rejected the claim that the dividend income in question was subject to full taxation at Mobil's commercial domicile, noting that "actual multiple taxation is not demonstrated on this record."²⁴ The Court did not indicate whether the commerce clause limits potential multiple taxation or only actual multiple taxation. It simply declined to speculate on the power of the commercial domicile to tax dividend income in full:

[T]here is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.²⁵

Thus, the Court declined to find multiple taxation by speculating as to the power of the commercial domicile to tax the dividends in full, but in the process cast serious doubt on whether the commercial domicile had such a power.

Ultimately, the Court refrained from clarifying the multiple taxation issue other than to say that such an issue would not be decided on the vagaries of another state's tax policy. Presuma-

20. *Id.* at 449.

21. *Id.* at 442.

22. *Id.* at 443.

23. *Id.* at 444.

24. *Id.*

25. *Id.* at 445-46.

bly, the Court's prior decisions are still controlling in resolving multiple taxation issues under the commerce clause.²⁶ Those prior cases clearly indicate that the Supreme Court will not speculate about a particular state's tax system in order to resolve multiple taxation issues. They also indicate that the Court finds nothing in the commerce clause to preclude potentially duplicative taxation at the state level so long as a particular state's taxing system conforms to previously established standards:

In an endeavor to establish a consistent and rational method of inquiry, we have examined the practical effort of a challenged tax to determine whether it "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."²⁷

Next, the Court addressed the question whether constitutional protections of foreign commerce posed additional problems. Rejecting Mobil's "forced" reliance on *Japan Line*,²⁸ the Court noted that *Japan Line* "focused on problems of duplicative taxation on the international level,"²⁹ while *Mobil* involved the wholly different sphere of multiple state taxation. Furthermore, *Japan Line* involved actual multiple taxation, whereas *Mobil* involved only potential multiple taxation.³⁰ The Court also rejected Mobil's reliance on federal tax policy: "Concurrent federal and state taxation of income, of course, is a well-established norm. Absent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States."³¹

III. COMMENTARY ON THE *Mobil* DECISION

Mobil raises several significant questions which merit comment:

26. See, e.g., *Moorman Mfg. Co.*, 437 U.S. 267 (1978); *Washington Revenue Dep't v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978); *Standard Pressed Steel Co. v. Department of Revenue of Wash.*, 419 U.S. 560 (1975); *General Motors Corp. v. Washington*, 337 U.S. 436 (1964); *Northwest States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

27. 445 U.S. at 443 (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

28. See note 4 *supra*.

29. 445 U.S. at 448.

30. *Id.*

31. *Id.*

(1) How should dividends be treated when the payors' business activities are neither unitary nor related to the business activities of the payee corporation?

(2) How reasonable is the application of the normal three-factor apportionment formula (property, payroll, and sales) when a large portion of net income consists of dividends?

(3) Does a "combined report" provide the constitutional frame of reference by which to determine the reasonableness of the apportionment of the unitary income of a unitary business carried on by more than one corporation?

(4) Can the "commercial domicile" rule, or some other situs rule, be employed to tax dividend income in full in a state even though that same dividend income is included in another state's apportionable tax base?

Although some of the language in *Mobil* clouds the resolution of these questions,³² the answers to them involve only a proper application of the unitary principles and apportionment standards previously established by the Court.³³

A. *Apportionment of Dividend Income From Unrelated Businesses*

Mobil does not support the proposition that the apportionability of dividend income depends upon the income being received from payor corporations conducting businesses related to the payee corporation. In disposing of the due process issue, the Supreme Court in *Mobil* predicated its decision on the relationship between Mobil's unitary operations and the business of its affiliated corporations from which most of the dividends in question were derived. It left open for future consideration the ap-

32. For example, the dissenting opinion in *Mobil* is predicated on the assumption that the dividend income in question was held to be apportionable by the majority solely because Mobil was assumed to be conducting a unitary business with its affiliated corporations. Certain language in the majority opinion may support this position. However, other language in the majority opinion, as well as cases relied on, supports the proposition that the key to the apportionability of the dividends in question was Mobil's unitary business as a single entity.

33. For a general analysis of the alternatives and current controversies concerning the attribution of income from intangible properties, see Dexter, *The Business versus Nonbusiness Distinction Under the Uniform Division of Income for Tax Purposes Act*, 10 URB. LAW. 243 (1978); Dexter, *The Unitary Concept in State Income Taxation of Multistate-Multinational Business*, 10 URB. LAW. 181 (1978); Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 VAND. L. REV. 401 (1976); Peters, *The Distinction Between Business Income and Nonbusiness Income*, 1973 SO. CALIF. TAX. INST. 251.

portionability of dividends from corporations engaged in a business unrelated to that of the payee corporation. However, in upholding apportionability of the Mobil dividends, the Court did focus on the unitary nature of Mobil's business as a single entity and relied on decisions which upheld apportionability on the basis of the unitary nature of a corporation. It did not distinguish dividends from any other type of income, and it declined to "source" the dividend income to the underlying activities of the payor corporations.

While the Court considered the due process issue separately from the multiple-taxation commerce clause issue, its analysis of Mobil's multiple-taxation argument is relevant in resolving the due process issue. The Court implied that intangible property may be related to a taxpayer's activities in more than one jurisdiction:³⁴ "Even for property or franchise taxes, apportionment of intangible values is not unknown."³⁵ In connection with the multiple-taxation issue it noted that,

There is no reason in theory why that power [power of the state of commercial domicile to tax the dividend income] should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.³⁶

Because of an absence of proof, the Court did not have to determine the apportionability of dividend income from corporations not conducting a business related to that of Mobil. But it is of interest to note that even Justice Stevens, in his dissent, justified apportionment of investment income in some instances:

We may assume that there are cases in which it would be appropriate to regard modest amounts of investment income as an incidental part of a company's overall operations and to allocate it between the taxing State and other jurisdictions on the basis of the same factors as are used to allocate operating income.³⁷

Apparently he would support the apportionment of income from working-capital investments in stock and other securities which

34. 445 U.S. at 445.

35. *Id.*

36. *Id.* at 445-46.

37. *Id.* at 458 (Stevens, J., dissenting)(footnote omitted).

would constitute business income under section 1(a) of the Uniform Division of Income for Tax Purposes Act (UDITPA). Business income is there defined as income from property which is acquired, managed, or disposed of as integral parts of the taxpayer's regular trade or business operations.³⁸

A footnote in *Mobil's* majority opinion implied that the due process tie-in of Mobil's dividends to its Vermont activities was dependent upon whether the dividend-payor corporations were engaged in an activity related to Mobil's petroleum business.³⁹ Ultimately, however, the majority stated that it did not reach the issue of apportionability of dividend income "where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State . . ."⁴⁰

The controlling question was whether the stock investments were made in connection with, and were related to, the unitary business of the recipient of the dividends. The Supreme Court's unitary decisions, including those relied on in *Mobil*, indicate that this question is determinative of the issue.⁴¹ All of these unitary cases dealt with the unity of a single corporation and upheld the apportionment of the entire property, value, or income attributable to, or arising in connection with, the operations of a single unitary corporate entity.⁴² There is nothing in

38. UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT § 1(a), reprinted in 9(a) UNIFORM LAWS ANNOTATED 448.

39. 445 U.S. at 442 n.16.

40. *Id.* at 442.

41. See, e.g., *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207 (1980); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Butler Bros. v. McCogan*, 315 U.S. 501 (1942); *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), *aff'd on rehearing*, 166 U.S. 185 (1897).

42. A number of state income tax cases have applied the unitary concept to a single corporation in determining the apportionability of income from intangibles. See, e.g., *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435 (1944); *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940); *Qualls v. Montgomery Ward, & Co.*, 266 Ark. 207, 585 S.W.2d 18 (1979); *John Deere Plow Co. v. Franchise Tax Bd.*, 38 Cal. 2d 214, 238 P.2d 569 (1951), *appeal dismissed*, 343 U.S. 939 (1952); *American Smelting & Ref. Co. v. Idaho State Tax Comm'n*, 99 Idaho 924, 592 P.2d 39 (1979), *vacated*, 445 U.S. 939 (1980), *reinstated*, 624 P.2d 946 (Idaho 1981) (No. 80-2015); *Albany Int'l Corp. v. Halperin*, 388 A.2d 902 (Me. 1978); *W.R. Grace & Co. v. Commissioner of Revenue*, 393 N.E.2d 330 (Mass. 1979); *Montgomery Ward & Co. v. Commissioner of Taxation*, 276 Minn. 479, 151 N.W.2d 294 (1967); *Great Lakes Pipe Line Co. v. Commissioner of Taxation*, 272 Minn. 403, 138 N.W.2d 612 (1965), *appeal dismissed*, 384 U.S. 718 (1966); *Montana Dep't of Revenue v. American Smelting & Ref. Co.*, 173 Mont. 316, 567 P.2d

Mobil that conflicts with these holdings.

Also, *Mobil* did not distinguish dividends from other income for constitutional purposes. Therefore, the same considerations were used to determine the apportionability of dividend income as are applied to determine the apportionability of any other class of income, i.e., whether the income is derived from investments made in connection with the taxpayer's unitary business.

When examining *Mobil's* relationship to the payor corporations, *Mobil* implicitly recognized the distinction between taxing the profits of the payor corporations and taxing the income of *Mobil* which was attributable solely to its business operations. Otherwise, it could not have found that dividends had a domestic source for income attribution purposes.⁴³

In other words, apart from the unitary ties between the business of a parent payee corporation and that of its affiliated payor corporations, there can exist a relationship between the stock investments and the business of the payee corporation which is sufficient alone to justify the apportionment of dividend income. The key question, as to due process apportionability

901 (1977), *appeal dismissed*, 434 U.S. 1042 (1978); *F.W. Woolworth Co. v. Director of Div. of Taxation*, 45 N.J. 466, 213 A.2d 1 (1965); *Champion Int'l Corp. v. Bureau of Revenue*, 88 N.M. 411, 540 P.2d 1300 (1975); *Sperry & Hutchinson Co. v. Department of Revenue*, 270 Or. 329, 527 P.2d 729 (1974); *In re Goodyear Tire & Rubber Co.*, Corporate Income Tax 1966, 1967, 1968, 133 Vt. 132, 335 A.2d 310 (1975); *F.W. Woolworth Co. v. Commissioner of Taxes*, 130 Vt. 544, 298 A.2d 839 (1972); *Gulf Oil Corp. v. Morrison*, 120 Vt. 324, 141 A.2d 671 (1958).

43. In this connection, *In re Goodyear Tire & Rubber Co.*, Corporate Income Tax 1966, 1967, 1968, 133 Vt. 132, 335 A.2d 310 (1975), is instructive:

Goodyear's constitutional argument rests on its allegations that its extra-territorial values are being taxed. This allegation, however, fails to distinguish the foreign dividend income that Goodyear receives from its subsidiaries from the profits those subsidiaries realize from their own business activities conducted without the borders of Vermont. The right to receive dividends is incident to the ownership of stock.

.....

The failure of the county court to make a finding on the issue of whether Goodyear's subsidiaries were operated as separate entities does not constitute error because of the lack of relevance such a finding has to the taxation of foreign dividend income. Vermont's corporate income tax does not seek to tax the profits realized from the business activities of Goodyear's subsidiaries conducted without the borders of Vermont. It is taxing only the dividend income realized by Goodyear itself.

133 Vt. at 134-35, 335 A.2d at 311-12 (citations omitted).

See also *American Smelting & Ref. Co. v. Idaho State Tax Comm'n*, 99 Idaho 924, 592 P.2d 39 (1979), *vacated*, 445 U.S. 939 (1980), *reinstated*, 624 P.2d 946 (Idaho 1981) (No. 80-2015); *Square D Co. v. Kentucky Bd. of Tax Appeals*, 415 S.W.2d 594 (Ky. 1967); *Gulf Oil Corp. v. Clayton*, 267 N.C. 97, 147 S.E.2d 552 (1966).

within the rationale of *Mobil*, is whether the income is derived in connection with a unitary trade or business which the taxpayer carries on in part in the taxing state. This does not mean that the relationship of the payor corporation's business to the payee taxpayer's business is irrelevant in determining whether the income is to be included in the taxpayer's apportionable tax base. A taxpayer might make an investment in the stock of another corporation to obtain a market for its product or a source of supplies. Such considerations would be relevant in determining the relationship of an investment to the business of the taxpayer carried on in part in the taxing state.

There is thus no reason to conclude that *Mobil* would limit the apportionability of dividends to only those cases or circumstances where the payor corporation and payee corporation are engaged in related business activities. The issue is whether the stock is held by the payee for a unitary business purpose. This is supported by the fact that the Court upheld the apportionment of Mobil's ARAMCO dividends even though Mobil owned only a ten percent stock interest—precluding combined reporting based on the ownership test. Inasmuch as Mobil's investment in ARAMCO stock assured it of a supply of crude oil for its petroleum business, ARAMCO dividends are clearly apportionable because Mobil's ARAMCO stock investment is related to its petroleum business.⁴⁴ Thus, nothing in *Mobil* would invalidate the apportionment of dividends as business income as defined in section 1(a) of the Uniform Division of Income for Tax Purposes Act (UDITPA).⁴⁵

In sum, *Mobil* supports the proposition that all net income derived from stock and other investments made in connection with the payee's unitary operations is subject to apportionment.⁴⁶ As held in *Mobil*, the focal point of income apportion-

44. For another example, most of the corporations listed in the dissent as not in the same kind of business as Mobil and not controlled by Mobil are public utilities. If Mobil made investments in the stock of those corporations to ensure sources of energy for Mobil's petroleum business, there would be a sufficient relationship between such stock investments and Mobil's petroleum business to support apportionability of dividends received by Mobil from these investments within the purview of Mobil. We do not here mean to suggest that the ultimate due process test may require more than the reasonableness of an apportionment result.

45. Section 1(a) of UDITPA, as illustrated by *Montana Dep't of Revenue v. American Smelting & Ref. Co.*, 173 Mont. 316, 567 P.2d 901 (1977), *appeal dismissed*, 434 U.S. 1042 (1978), simply requires a tie-in between the taxpayer's unitary business operations and its stock investments from which dividends are derived.

46. Given the history of the taxation of intangibles, the abstract nature of a net

ability is the unitary business principle.

B. *Modification of an Apportionment Formula*

The second unresolved issue raised by *Mobil* is the validity of the three-factor apportionment formula (sales, tangible property, and payroll) when large amounts of dividends or other income from intangible properties are included in apportionable income. As long as the taxpayer has not established by clear and cogent evidence that an apportionment formula reaches extra-territorial income or values, *Mobil* does not require the appor-

income tax, the lack of any fixed situs for intangible properties, and the fact that apportionment does not attempt to "source" income to any situs, this interpretation of *Mobil* is amply justified. An examination of some of the abstract considerations involved in the attribution of intangibles for state taxation purposes supports this interpretation.

The first consideration is the abstract nature of a tax on net income. By its very nature, a net income tax is imposed upon an intangible concept. It is not a direct tax on intangibles or their ownership; nor is it a tax on gross receipts or property per se. It is an abstract concept derived from the operational events pertaining to the taxpayer within a limited time frame called a tax year. See, e.g., *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937). Compare *Peck & Co. v. Lowe*, 247 U.S. 165 (1918) with *Crew Levick Co. v. Pennsylvania*, 245 U.S. 292 (1917). In *Cohn*, in divorcing the taxation of income from the taxable situs of the land producing the income, the Court stated, "Neither the privilege nor the burden is affected by the character of the source from which the income is derived." The fact that the taxation of net income is not the taxation of any particular component from which net income is derived is illustrated by comparison of *Crew Levick* with *Peck*. While the Supreme Court in *Crew Levick* invalidated a state gross receipts tax on receipts from goods sold in foreign commerce under the import-export clause, in *Peck* it rejected the argument that a tax on net income from export sales constituted a tax on exports. In so doing, it held that an income tax

is not laid on income from exportation because of its source The tax is levied after exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he chooses.

Thus, what is taxed—the net income—is as far removed from exportation as are articles intended for export before the exportation begins.

247 U.S. at 174-75.

The second consideration is the abstract nature of the source from which income from intangibles is derived. For example, the dividend income in *Mobil* could conceivably be "sourced" to Mobil's ownership of the underlying stock, to its limited management of the stock, to the activities of the affiliated corporations from which the dividends were derived, to Mobil's commercial domicile, to its legal domicile, or to Mobil's management of its worldwide petroleum business.

The third consideration is the abstract nature of an apportionment formula. The use of such a formula is justified on the basis that it is not possible to identify the true source of net income apart from the totality of the income-producing elements of a taxpayer's trade or business operations. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

These factors lend strong support to the proposition that intangibles, and income derived therefrom, should be apportioned among those states in which the taxpayer conducts business related to the intangibles. They support the *Mobil* principle that all income related to a unitary business should be subject to apportionment.

tionment formula to be modified.

Because Vermont did not permit combined reporting⁴⁷ of Mobil and its subsidiaries, and because the Supreme Court did not find the Vermont apportionment result invalid per se, one may conclude that application of the apportionment formula is appropriate under assumed *Mobil* facts unless it can be established by clear and cogent evidence that extraterritorial taxation results. *Mobil* demonstrates that the unreasonableness of an apportionment formula cannot be established by merely showing that the income subject to apportionment includes large amounts of income from intangibles.

However, the Court at least implied that some type of adjustment, including combined reporting, may have been appropriate under the assumed *Mobil* facts. The Court also implied that there may be some link between the apportionability of dividend income and the underlying activities of the payor corporations when they conduct a unitary business with the payee corporation. This raises the question of what type of apportionment relief, if any, the taxpayer is entitled to if substantial amounts of apportionable income are from stock investments in subsidiary corporations which conduct a unitary business with the taxpayer.

Since the Court held that this issue was not properly before it, *Mobil* sheds little light on the problem. The Court did indicate that Vermont is not precluded from taxing its proportionate share of Mobil's dividend income⁴⁸ and further suggested that combined reporting results may be constitutionally relevant.⁴⁹ Also, in discussing the multiple taxation issue, the Court appeared to reject the notion that the commercial domicile state is entitled to tax in full the income from intangible properties:

Although we do not now presume to pass on the constitutional-

47. Combined reporting is merely an extension of the well-recognized unitary principle. See, e.g., *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947); *American Smelting & Ref. Co. v. Idaho State Tax Comm'n*, 99 Idaho 924, 592 P.2d 39 (1979), *vacated*, 445 U.S. 939 (1980), *reinstated*, 624 P.2d 946 (Idaho 1981) (No. 80-2015); *Montana Dep't of Revenue v. American Smelting & Ref. Co.*, 173 Mont. 316, 567 P.2d 901 (1977), *appeal dismissed*, 434 U.S. 1042 (1978); *Coca Cola Co. v. Department of Revenue*, 271 Or. 517, 533 P.2d 788 (1975). There is thus no reason why it should not be generally allowed by all the states. In fact, *Mobil* may, in some cases, mandate combined reporting to achieve a fair apportionment. See text accompanying notes 62-65 *infra*.

48. 445 U.S. at 449.

49. *Id.* at 441 n.15.

ity of a hypothetical New York tax, we may assume, for present purposes, that the State of commercial domicile has the authority to lay some tax on appellant's dividend income as well as on the value of its stock. But there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method. Since Vermont seeks to tax income, not ownership, we hold that its interest in taxing a proportionate share of appellant's dividend income is not overridden by any interest of the State of commercial domicile.⁵⁰

Further, the *Mobil* Court noted:

Even for property or franchise taxes, apportionment of intangible values is not unknown. See *Ford Motor Co. v. Beauchamp*, 308 U.S. at 335-336; *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1896), *aff'd on rehearing*, 166 U.S. 185, 222 (1897). Moreover, cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails. See *Whelling Steel Corp. v. Fox*, 298 U.S., at 212.⁵¹

In light of the Court's pronouncements in *Mobil* and other tax base attribution cases and granted the proposition that income from intangible properties is subject to taxation by more than one state, resolution of the reasonable apportionment issue is dependent on the competing claims of states for their proportionate share of such income. This, in turn, is necessarily dependent upon the activities or sources to which the income from intangible properties should be attributed. If, as contended by *Mobil*, dividend income and income from other intangible property is attributable solely to the states where certain activities

50. *Id.* at 445.

51. *Id.* at 445. In *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939), the Court upheld the apportionment of the net worth of Ford Motor Company for Texas franchise tax purposes without considering the commercial domicile's interests. In *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185 (1897), the Court upheld the apportionment, by a tangible property factor, of the entire intangibles and going-concern values of the Express Company for *ad valorem* property tax purposes. In *Whelling Steel Corp. v. Fox*, 298 U.S. 193 (1936), the Court, in upholding the commercial domicile's right to tax intangibles for *ad valorem* property tax purposes on "business situs" principles, clearly distinguished the attribution of net income based on apportionment principles. This distinction was made in response to the argument that the intangibles involved arose out of *Whelling Steel's* activities in several states.

concerning those types of investments and income are carried on, only those states would be entitled to any share of such income. The Court, however, rejected this argument. It also apparently rejected the argument that the commercial domicile had a special claim to the taxation of dividend income. It upheld full apportionment of income from intangible properties if derived in connection with the taxpayer's unitary business operations. Therefore, there is no reason to favor the commercial domicile.

The difficulty created by *Mobil* is the Court's identification of dividend income with the business activities of the payor corporations. One cannot ignore the fact that Mobil is a separate and distinct taxpayer from the payor corporations⁵² and that the taxation of dividends is distinct and separate from the taxation of the underlying profits of the payor corporations.⁵³ If the state of commercial domicile is not entitled to tax dividend income in full to the exclusion of the states in which the taxpayer's unitary business is carried on, and if dividend income is not to be attributable to the activities of the payor corporations, the only other logical alternative is to apportion the dividends on the basis of the income-producing activities of the payee corporation. Since Mobil's dividends were received from stocks held in connection with the petroleum operations of Mobil as a separate entity, and since the three-factor apportionment formula assigns all income on the basis of the underlying business activities of the payee corporation, there seems to be little logic in assigning dividend income or other income from intangible properties on any other basis. By their very nature, intangible properties and the income therefrom have no fixed situs or location apart from where the

52. *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436 (1943).

53. In *American Smelting & Ref. Co. v. Idaho State Tax Comm'n*, 99 Idaho 924, 592 P.2d 39 (1979), *vacated*, 445 U.S. 939 (1980), *reinstated*, 624 P.2d 946 (Idaho 1981) (No. 80-2015); *In re Goodyear Tire & Rubber Co.*, Corporate Income Tax 1966, 1967, 1968, 133 Vt. 132, 335 A.2d 310 (1975), and *Gulf Oil Corp. v. Morrison*, 120 Vt. 324, 141 A.2d 671 (1958), the courts treated the ownership of stock in subsidiaries and the income derived therefrom as being distinct from the operations and properties of the subsidiary payor corporations. These cases therefore concluded that the inclusion of dividends from affiliates in apportionable income did not require any modification of an apportionment formula unless the taxpayer could establish by clear and cogent evidence that the formula reached extraterritorial income. *But see Square D Co. v. Kentucky Bd. of Tax Appeals*, 415 S.W.2d 594 (Ky. 1967), and *American Bakeries Co. v. Johnson*, 259 N.C. 419, 131 S.E.2d 1 (1963), which keyed the apportionability of dividends upon the relationship of the subsidiary-payor corporations' businesses to the business of the payee-parent corporation. Dividends were identified with the in-state business of the taxpayer-payee corporation and thus subject to apportionment if derived from payor corporations conducting a unitary business with the payee corporation.

underlying activities of the owner corporation are carried on.⁵⁴

Where stock is held in connection with business conducted by the payee in several states, to give any particular state a special claim to dividend income or to income from other intangibles attributes that income by application of separate accounting rather than by apportionment principles. Furthermore, the three-factor apportionment formula takes into account where dividend income is received and where the taxpayer carries on any activities pertaining to it. The extent to which Mobil employed people, utilized tangible personal property, and received dividend income in New York was reflected in the property, payroll, and sales factors of Vermont's apportionment formula. The only additional issue is whether New York is entitled to any special factor adjustments varying the normal three-factor formula. *Mobil* does not suggest any special adjustments.

Where a corporate business maintains investments as part of its business and uses those investments and the income derived therefrom in its overall business operations, each state in which the corporation conducts those operations has a legitimate claim to tax its share of that income. Since the standard apportionment formula produces the most reasonable and equitable result, it is the appropriate means by which to determine each state's share. The result is consistent with the principle of apportionability; the formula divides the income associated with the totality of the taxpayer's trade or business operations among the states where the taxpayer conducts those operations.

The taxpayer may rebut the reasonableness of an apportionment formula by meeting its burden of showing by clear and cogent evidence that the apportionment formula is unreasonable.⁵⁵ Under this standard, it was incumbent upon Mobil to establish that the apportionment result attributed more income to Vermont than the portion of Mobil's income reasonably attributable to its Vermont sources and activities.⁵⁶ *Mobil* holds that this burden is not met by the taxpayer's attributing part of its apportionable income to particular sources or situses. One can

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

55. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Norfolk & W. Ry. v. North Carolina*, 297 U.S. 682 (1936).

56. Given the abstract nature of net income, the inability to locate intangibles in a geographical sense, and the irrelevancy of geographical source concepts to apportionability, the unitary principle—held to constitute the linchpin of apportionability in *Mobil*—should control the reasonableness of apportionability for both tax base and reasonable apportionment purposes.

only speculate as to what kind of factual showing Mobil could have made to demonstrate that the Vermont apportionment formula actually taxed any extraterritorial income of Mobil—or whether such a showing is even possible.

Notwithstanding the foregoing, one cannot totally escape the fact that the Court did indicate that the dividend income was related to the underlying business activities of Mobil and its subsidiary corporations because the unitary business of Mobil was presumed to be conducted in part by its affiliated corporations. The Court specified that an apportionment formula should take this into account. This is not an illogical premise.⁵⁷ In an integrated unitary business, conducted in part through subsidiary and affiliated corporations, dividend income received by the parent from its controlled affiliated corporations may in substance be more akin to operating income than to income from the unitary ownership and management of the stock.

Granted the premise that the unitary business is the true source of the dividend income, it is reasonable to conclude that the apportionment of this *dividend income* is entitled to special consideration. However, this special consideration does not require the inclusion of the stock value in the property factor and the attribution of this value to the commercial domicile, because there is no congruence between the place of the underlying business activities of the payor corporations and the commercial domicile of the payee corporation. Nor does it require a modification of the apportionment formula for the attribution of any income other than dividend income, because the underlying activities of the dividend payor corporations are irrelevant to the attribution of any income other than dividends.

One suggested adjustment would modify the formula by giving weight to the properties the payor corporations utilized to produce the dividend income. This would be done by including in the formula the tangible properties of each payor corporation in the ratio that its dividends bear to its total profits for the year in question. For example, if subsidiary "X" had earnings and profits of \$1,000 for the tax year and tangible property of \$10,000, and the dividends that the parent "Y" received from

57. Combined reporting is based on the assumption that a reasonable apportionment of the income of any member of a commonly owned and controlled group of corporations carrying on a unitary business can be achieved only by combining the group's income and apportionment factors. See, e.g., *Edison California Stores, Inc. v. McColgan*, 30 Cal. 2d 472, 183 P.2d 16 (1947).

"X" amounted to \$500, the denominator of the property factor would be modified to include \$5,000 of the property of "X" when apportioning the dividend income that "Y" received from "X".

In substance this adjustment would attribute the value of the stock to the location of the underlying tangible property which gave rise to the dividend income. A similar adjustment was made in *Adams Express Co. v. Ohio State Auditor*⁵⁸ for the attribution of intangible properties for *ad valorem* property tax purposes. This modification is also consistent with the apportionment of unitary income under the property factor apportionment formulas upheld in *Underwood Typewriter Co. v. Chamberlain*,⁵⁹ *Bass, Ratcliffe & Greeton, Ltd. v. State Tax Commission*,⁶⁰ and *Maxwell v. Kent-Coffey Mfg. Co.*⁶¹ Such a modification should be held constitutional even though the payor corporations and the payee corporation are to be treated as a single entity for dividend income attribution purposes.

The other formula factors could also be modified. However, the need to modify the property factor arises from the exclusion of intangible properties from this factor. There is no comparable reason to modify the other factors. Thus, attribution of the intangible properties based on the location of the payor corporations' tangible properties should be a sufficient constitutional adjustment of the apportionment formula if *Mobil* requires one.

Also, consistent with the *Mobil* rationale, combined reporting results should satisfy any constitutional apportionment requirements and could be used as a reference in determining the reasonableness of the apportionment results reached in states that do not allow combined reporting. A combined report takes into account the total unitary income and all the apportionment factors of a commonly owned and controlled unitary group. Certainly combined reporting results would conform to the unitary principles affirmed by the *Mobil* Court. For example, in reporting to Vermont for open years not involved in the *Mobil* case, can *Mobil* obtain modification of the three-factor formula by showing—without reference to combined reporting results—that Vermont has taxed extraterritorial income? Based on the *Mobil* rationale, it is doubtful that *Mobil* could do so.

58. 166 U.S. 185 (1897).

59. 254 U.S. 113 (1920).

60. 266 U.S. 271 (1924).

61. 204 N.C. 365, 168 S.E. 397 (1933), *aff'd*, 291 U.S. 642 (1934).

In sum, *Mobil* may require a modification of the three-factor apportionment formula where apportionable income includes substantial dividends derived from corporations conducting a unitary business with the taxpayer. Any modification should be limited to the attribution of dividends. This modification may require an apportionment result in proportion to the result obtained by a combined report. It can be accomplished by adjusting one or more of the apportionment factors to include the payor corporation's factors in the ratio that the dividends bear to the payor corporation's total net income for the year in question. The modification can also be made by permitting a combined report, or by comparing combined report results to the apportionment formula results, to determine the reasonableness of the formula. Apart from the foregoing, there is no reason why an apportionment formula should be modified simply because income from intangibles is included in apportionable income. If such income is apportionable, it is because that income, as well as all other apportionable income, is attributable to the location where the taxpayer's trade or business is carried on.

C. *The Relevance of Combined Reporting Results*

The third question raised by *Mobil* is whether combined reporting prescribes the constitutional limits of apportionability of the income of a member of an affiliated group of corporations conducting a unitary trade or business. This question is closely associated with the need to modify an apportionment formula to reach a constitutional result. Although the *Mobil* Court did not pass upon this question because of *Mobil*'s failure to challenge the validity of the Vermont apportionment formula, it did suggest that the results achieved by combined reporting might represent an appropriate constitutional limitation.⁶²

In light of the fact that most multistate-multinational corporations oppose combined reporting and the majority of the states do not utilize it, the *Mobil* comments on combined reporting are indeed interesting. Combined reporting is clearly supported by Justice Stevens' dissenting opinion. In addition, it is advocated by the Multistate Tax Commission. Further support for use of a combined report to reach reasonable apportionment results is found in a series of combined reporting cases beginning

62. 445 U.S. at 441 n.15.

with *Edison California Stores, Inc. v. McColgan*.⁶³ These cases are based on the premise that combined reporting is required to effect a reasonable apportionment of the income of a unitary business carried on by two or more commonly owned and controlled corporations. Mobil supports this principle:

Superficially, intercorporate division might appear to be a more attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from those divisions would meet due process requirements for apportionability.⁶⁴

Stated otherwise, the Court attached no significance to the form in which a unitary business is conducted.

Certainly, *Mobil* permits a taxpayer to argue the unreasonableness of an apportionment formula by reference to a combined report result. *Mobil* would also support a tax administrator's argument that an apportionment formula reaches a fair result if it does not materially exceed combined reporting results. In the recent case of *Caterpillar Tractor Co. v. Lenckos*,⁶⁵ the Illinois Supreme Court held that a combined report was necessary to properly reflect the income of a unitary business carried on by Caterpillar and its subsidiary corporations in Illinois.

Thus, although the *Mobil* Court did not have the issue of the validity of combined reporting before it, in light of the foregoing, *Mobil* may be cited for the proposition that worldwide combined reporting is a constitutionally approved method for income attribution of a multinational business conducted in part by affiliated foreign corporations.

D. *The Commercial Domicile's Power to Tax Dividends*

Mobil does not support the position that the commercial domicile can tax more than its apportioned share of dividends related to a unitary business. While the Court refused to speculate on the commercial domicile's constitutional power to tax Mobil's dividends in full, it did hold that the commercial domi-

63. 30 Cal. 2d 472, 183 P.2d 16 (1947).

64. 445 U.S. at 440-41.

65. Nos. 58218, 52828, and 52903 (Ill. Feb. 20, 1981).

cile's power to tax dividends did not foreclose the apportionability of dividends and the power of other states to tax their appropriate share of dividend income. It also stated, "[W]e may assume, for present purposes, that the State of commercial domicile has the authority to lay some tax on appellant's [Mobil's] dividend income as well as on the value of its stock."⁶⁶ Furthermore, the Court noted:

Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained. We find no adequate justification, however, for such a preference. Although a fictionalized situs for intangible property sometimes has been invoked to avoid multiple taxation of ownership, there is nothing talismanic about the concepts of "business situs" or "commercial domicile" that automatically renders those concepts applicable when taxation of income from intangibles is at issue. . . .

The reasons for allocation to a single situs that often apply in the case of property taxation carry little force in the present context.⁶⁷

From the foregoing language, one can only speculate as to whether dividends derived from and utilized in an integrated business can be taxed in full by the domiciliary state. However, in light of recent *ad valorem* property tax cases pertaining to the taxation of movable tangible property,⁶⁸ the Court's historical treatment of intangibles for net worth and property tax purposes,⁶⁹ and the Court's inclination to prevent actual multiple taxation, there is a strong inference that the commercial domicile does not have the constitutional authority to tax such dividends in full.

IV. CONCLUSION

Mobil represents a substantial victory for the principle of full apportionment of the unitary income of a unitary trade or business in accordance with the apportionment standards devel-

66. 445 U.S. at 445.

67. *Id.* at 444-45 (citation omitted).

68. *See, e.g.*, *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979); *Braniff Airways, Inc. v. Nebraska State Bd. of Equalization and Assessment*, 347 U.S. 590 (1954); *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952).

69. *See, e.g.*, *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939); *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185 (1897).

oped by the Supreme Court. Although some of the *Mobil* language employed in resolving the due process issue seems to indicate that dividend income from subsidiary and affiliated corporations is subject to apportionment only if the activities of the payor corporations are in some way integrated with the parent corporation's unitary business, there is nothing in the underlying rationale that detracts from the proposition that all income related to the conduct of a unitary trade or business, irrespective of its nature or source, is subject to fair apportionment among the states. Both the Court's conclusion that the unitary concept is the linchpin of apportionability and the cases the Court relied on specifically support this proposition.

Although *Mobil* raised the question of the reasonableness of an apportionment formula which does not include intangible properties or the payor corporations' underlying activities in the apportionment factors, there is nothing to indicate that the Vermont formula taxed any extraterritorial income of Mobil. The majority in *Mobil*, unlike the dissent, did not find anything invalid per se in the Vermont apportionment formula. This was true even though substantially all of the apportionable income in Mobil's Vermont tax base consisted of so-called "foreign source" dividend income from payor corporations which did not conduct activities in Vermont and which were engaged in a business similar to that of Mobil.

In resolving the multiple taxation issue, the Court reaffirmed the principle of full apportionment of unitary trade or business income. It denied Mobil's claim that the commercial domicile had any special claim, apart from unitary principles, to tax dividend income. In addition, it affirmed the proposition that the boundary of a unitary business can include the business affairs of a group of commonly owned and controlled affiliated corporations; it even suggested that it might be necessary to so define a unitary business to arrive at a constitutional apportionment of the income of a member of an affiliated group conducting a unitary business.

There is nothing in *Mobil* to support the argument that dividends and other income from intangible properties are not apportionable in conformity with unitary principles on the same basis as any other income. The Court recognized that a tax on net income applies to an abstract concept, unlike *ad valorem* property taxes, and that dividends and other receipts forming part of unitary net income cannot be subject to distinct sourcing

rules.

Furthermore, there is nothing in *Mobil* to lighten the burden of proof on a taxpayer attempting to establish the invalidity of an apportionment formula or to dissociate properties and income from the taxpayer's unitary business operations. Given the abstract nature of net income, intangible properties, and apportionment results, the taxpayer's burden is quite heavy.

When the incidents of ownership of intangibles are exercised by the taxpayer in furtherance of its business—which is generally the case in regard to multistate-multinational corporations—income from intangible sources should be distributed “wherever . . . its work is done.”⁷⁰ This is accomplished by application of the standard apportionment formula, which takes into account the location of the taxpayer's property, payroll and sales.

Because the Supreme Court considered the unitary relationship between *Mobil* and its affiliated corporations, because the Court declined to pass on the reasonableness of the Vermont apportionment formula, and because of its reference to combined reporting, *Mobil* would leave serious questions unanswered if the case were viewed apart from prior unitary and apportionment decisions. Fortunately, these issues have been properly dealt with in the Supreme Court's prior decisions.

The only reasonable answer to taxpayer complaints is the insistence upon full apportionment, by rational and uniform apportionment standards, of all income arising in connection with a unitary business. This is the approach adopted in the Uniform Division of Income for Tax Purposes Act, which includes all unitary income within the definition of apportionable business income, including income from intangibles arising in connection with the taxpayer's trade or business operations. Without such certainty, taxpayers would be caught in a web of legal abstractions. While these abstractions may have served their purposes historically, *Mobil* now dictates a different result for the future.

70. *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 223 (1897).