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A. Bruce Clements
Kennesaw State University, aclement@kennesaw.edu

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Clements, Bruce
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SPECIAL REPORT

EDITED BY CHARLES M. STEINES, PHILIP M. TATAROWICZ, AND RICHARD W. TOMEO

Factors to Be Considered in Determining a Corporation's Commercial Domicile

Given the importance of commercial domicile in nexus and apportionment decisions, its determination becomes especially relevant in evaluating sites for corporate activities such as general management, manufacturing, sales, and investment operations.

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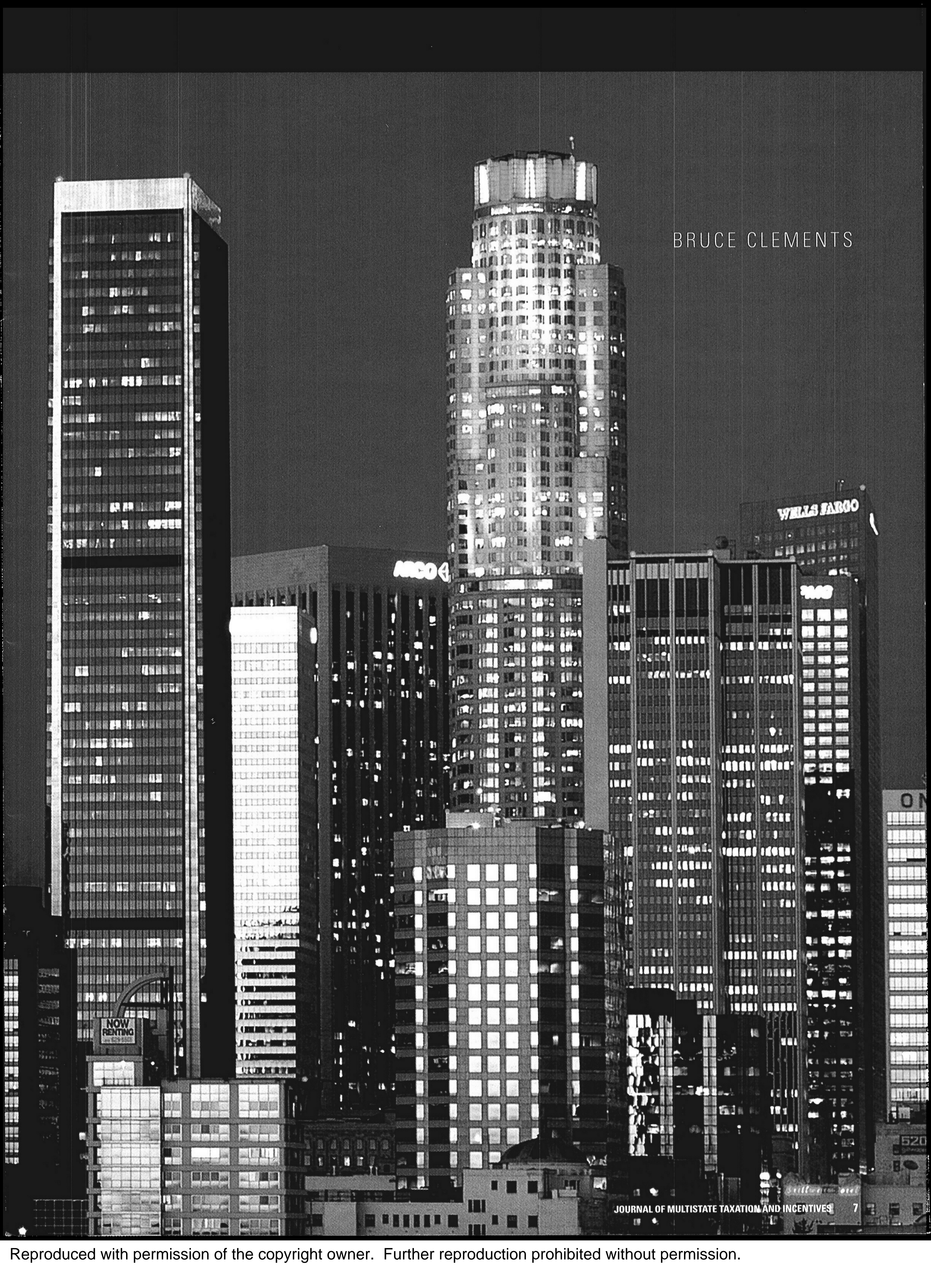

BRUCE CLEMENTS

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In today's commercial environment,

most large and even mid-sized companies conduct business in multiple states. Multistate transactions subject companies to complex sets of tax laws differing by jurisdiction. These laws can vary significantly in taxing multijurisdictional companies depending on a company's degree of corporate presence in the taxing state, the type and source of income earned, and the type of property used or held in the state. Several critical factors can determine a company's tax liability in a state, including the location of the company's commercial domicile.

General constitutional guidelines. A state's ability to tax foreign (i.e., out-of-state) corporations is limited by the U.S. Constitution's Commerce Clause and Due Process Clause and by federal statute, in accordance with the U.S. Supreme Court's interpretations of those laws. The Due Process Clause requires the existence of both a minimum connection (nexus) between the taxpayer and the taxing state and a fair relationship between the tax imposed and the taxpayer's activities in the state. For due process purposes, a company establishes nexus with a taxing state if it purposely directs its activities towards residents of the state and avails itself of the economic benefits of the state.[1]

To satisfy the Commerce Clause, the U.S. Supreme Court articulated a four-part test whereby a state tax will be sustained if the tax:

1. Is applied to an activity with a substantial nexus with the taxing state.[2]
2. Is fairly apportioned.
3. Does not discriminate against interstate commerce.
4. Is fairly related to the services provided by the state.[3]

A role for commercial domicile. The location of a company's commercial domicile potentially impacts determinations of both nexus and apportionment. For example, even after the U.S. Supreme Court's decision in *Quill Corp. v. North Dakota*,[4] which required that the taxpayer have some degree of physical presence in a state before that state could impose a use tax collection liability, exactly what constitutes that "physical presence" still is not clear. As discussed below, courts have identified commercial domicile as one factor in establishing nexus sufficient for taxation of foreign corporations.

Likewise, in apportioning income to states where a company operates or maintains property, commercial domicile may be an important factor. Under the apportionment principles set forth in the Uniform Division of Income for Tax Purposes Act (UDITPA), employed by a majority of the states (and discussed further below), nonbusiness income such as dividends, rents, and capital gains are allocated based on the location of a company's commercial domicile. Because of the importance of commercial domicile in nexus and apportionment decisions, its determination becomes especially relevant in evaluating sites for corporate activities such as general management, manufacturing, sales, and investment operations.

BRUCE CLEMENTS, Ph.D., is an associate professor of accounting and taxation at Kennesaw State University, in Kennesaw, Georgia. He is also a practicing attorney and CPA specializing in business and tax planning issues for businesses and individuals. A member of the Georgia, Florida, and Alabama bars, he has previously written for THE JOURNAL.

Legal vs. Commercial Domicile

In the generic sense, "domicile" refers to the state in which an entity is incorporated or created.[5] In today's modern economy, many companies incorporate in one state but maintain property or their principal business headquarters and other operations in one or more other states. For taxing tangible property, the established legal principle of *mobilia sequuntur personam* held that such property followed the person of the owner. Under this principle, the state of the owner's legal domicile had the sole authority to tax personal property. A subsequent exception permitted the imposition of an ad valorem tax by the state where the property was kept or used. Nevertheless, the property still had only one situs for tax purposes, and only one state had the authority to impose a tax.

Unlike tangible property, for tax purposes intangible property must be assigned a situs. Consistent with its treatment of tangible property, the common law doctrine of *mobilia sequuntur personam* held that the tax situs of intangibles was the owner's legal domicile. Thus, a corporation's state of incorporation—its legal domicile—is generally presumed to be the situs of its intangible property.[6]

During the early years of this nation, each corporation generally maintained its principal place of business and operated almost exclusively in the state in which it was incorporated, and where it benefited primarily from the functions and protection of government, particularly with regard to intangible interests. As noted by the California Court of Appeal in *Southern*

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Pacific Co. v. McColgan,[7] "[t]he rule that ascribed to intangibles a taxable situs at the domicile of the owner developed when corporate operations were less complex than now...." The fact that corporations generally carried on their activities in the state of incorporation, where they also had their principal place of business, led the courts to apply the *mobilia* rule to the taxation of the intangibles owned by such entities.

As these corporations grew in the modern economy, however, they became increasingly involved locally, nationally, and internationally. Their operations became so complex that, in many cases, it became almost impossible to pierce the corporate veil in order to determine where the boundary lines affecting such entities began and ended for state and local tax purposes. In time, courts realized that the locations of a company's legal incorporation and effective control often were divergent, and it was often the case that corporations had no intention of conducting even a small part of their business in the state of incorporation. As a result, courts began to permit taxation of intangibles by the state providing the most benefits in connection with legal services and protection.

This presumed location of domicile presents problems in taxing intangibles. For example, consider the fairness—or lack thereof—of allowing the taxation of a corporation's intangibles, including property and the related income, by the state of incorporation, where the company maintains no offices and conducts no business, while denying tax jurisdiction to the state where the corporation actually operates and is controlled. In recognition of this problem, courts have carved out several exceptions to the rule of sourcing intangibles for tax purposes to the state of legal domicile.

The principle exception concerns a company that has no operations in its state of incorporation—its legal domicile—but maintains its principal business offices in another state where its management activities are directed and controlled. That principal business office location is generally deemed the company's commercial domicile, where its intangible assets may be subject to tax.[8]

The U.S. Supreme Court has acknowledged that although intangibles generally are taxable only at the legal domicile of the owner in order to satisfy due process, an exception applies where the intangibles have acquired a situs at the owner's commercial domicile.[9] In upholding a state's imposition of an ad valorem property tax on the accounts receivable and bank deposits of a foreign corporation, the court affirmed the proposition that "choses in action may acquire a situs for taxation other than at the domicile of their owner if they have become integral parts of some local business."[10] Thus, the concept of commercial domicile permits the taxation of property or activity of a foreign corporation by a state in which the corporation's managerial activities occur in quantity and character sufficient to avoid challenges that the taxing power was exercised outside of due process requirements.

The second major exception involves a company whose intangible assets have acquired a "business situs" in a state other than that of the company's legal domicile. Business situs is based on the assets' being used as an integral part of the company's business activities, which may be conducted in the state of the company's commercial domicile or in another state separate from both the legal and commercial domicile and not necessarily dependent on the location of company management.[11]

In addition to the above noted exceptions to the *mobilia* rule, a state may tax a company's business operations in the state, regardless of asset situs or domicile. Legal distinctions regarding locations of operations, assets, and domicile create additional state tax complexity. For example, Florida imposes an annual tax on intangible personal property based on a "taxable situs" in the state, which is when the property "is owned, managed, or controlled by any person domiciled in [Florida] on January 1 of the tax year ... regardless of where the evidence of the intangible property is kept; or where the intangible is created, approved, or paid; or where business may be conducted from which the intangible arises."[12]

U.S. Supreme Court Sets Forth Commercial Domicile Test

In *Wheeling Steel Corp. v. Fox,*[13] a Delaware-domiciled corporation challenged on due process and equal protection grounds a ruling of the West Virginia Supreme Court of Appeals upholding West Virginia's levying an ad valorem property tax on the Delaware company's accounts receivable and bank deposits. The West Virginia court had found that there had been "such a localization of the corporation's business at Wheeling [West Virginia]," that there was imparted "to its entire intangible property a prima facie situs for taxation at that place."[14]

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Wheeling Steel's general business offices were in Wheeling, West Virginia, where the books and accounting records were kept, and where the chairman of the board, president, treasurer, secretary, and chief counsel resided. The corporation's manufacturing plants were in Ohio and West Virginia, and sales offices were maintained in various states. At least 80% of the monies spent by the corporation in conducting its business (including purchases, payroll, and other operating expenses) were related to operations outside West Virginia,[15] but all funds and expenditures were controlled and directed by the Wheeling office (at the time in question, about 37% of the company's cash deposits were in West Virginia banks). Also, all sales orders generated throughout the U.S. were subject to acceptance or rejection at that office. Both the taxpayer and West Virginia recognized that "the state creating a corporation has the sole right to tax its intangible property" unless the intangible has acquired a "business situs" elsewhere.

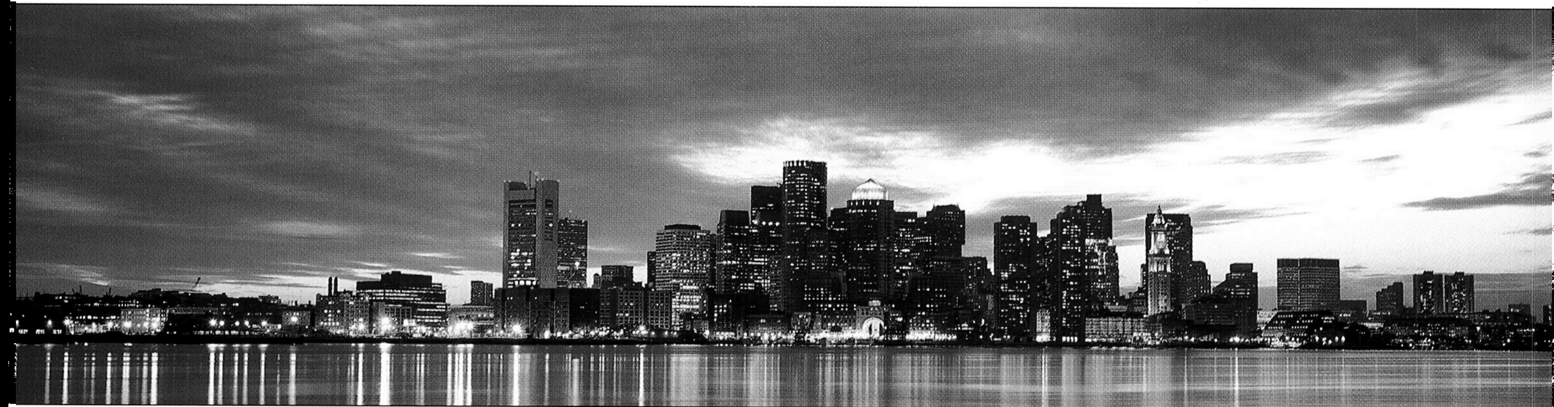
Wheeling Steel argued that the money and accounts receivable West Virginia sought to tax were property derived from business carried on for the most part in Ohio. According to the company, its management activities in West Virginia, particularly the control emphasized by the state court, did not create the intangibles. The majority of the intangibles would not exist without the manufacturing and shipping activities in Ohio. In contrast, West Virginia maintained that Wheeling Steel's accounts receivable and bank deposits "acquired a taxable situs in West Virginia," and they had "no taxable situs in Delaware, where the corporation was chartered."

The U.S. Supreme Court rejected the taxpayer's argument that the only fair result in a case such as this is to allocate intangibles based on the location of the tangible property owned and used in the production of material for sale. Instead, the court held that Wheeling Steel's bank deposits and accounts receivable were taxable by West Virginia. The court found that the company had established a commercial domicile in West Virginia because that was where it (1) maintained its general business offices, (2) kept its accounting records, (3) held meetings of its board of directors, and (4) managed and controlled company operations, including, e.g., approving or rejecting all sales contracts and paying all invoices. In reaching these findings, the court stated: "There, as appellant's counsel well says, 'the management functioned.' The corporation has manufacturing plants and sales offices in other states. But what is done at those plants and offices is determined and controlled from the center of authority at Wheeling. The corporation has made that the actual seat of its corporate government."

State Courts Interpret Commercial Domicile

Subsequent to the U.S. Supreme Court's landmark ruling in *Wheeling Steel*, state courts have interpreted the concept of "commercial domicile" in various ways.

Tennessee looks to source of direction and management. In Tennessee, "commercial domicile" is statutorily defined as "the principal place from which the trade or business of a business entity is directed or managed."[16] This definition is derived from the Uniform Division of Income for Tax Purposes Act (UDITPA), discussed below. In *Associated Partnership I, Inc. v. Huddleston*,[17] the Tennessee Supreme Court interpreted this provision to mean the "actual seat of corporate government." The taxpayer in the case was a Delaware corporation that was set up to hold a partnership interest in a publishing business that operated in Ten-



1 Quill Corp. v. North Dakota, 504 U.S. 298 (1992). See generally Eule and Richman, "Out-of-State Mail-Order Vendors Need Not Collect Use Taxes—Yet!," 2 JMT 163 (Sep/Oct 1992).

2 According to Quill, *supra* note 1, which concerned sales and use tax, this prong requires that the taxpayer have some degree of physical presence in a state before that state can impose its taxing jurisdiction.

3 Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

4 Note 1, *supra*. See also Nolan, "Crossing the Bright Line: Evaluating Physical Presence in *Quill*'s Shadow," 7 JMT 244 (Jan/Feb 1998).

5 See, e.g., Adams Express Co. v. Ohio State Auditor, 166 U.S. 185 (1897) ("a corporation is, for purposes of jurisdiction in the federal courts, conclusively presumed to be a citizen of the state which created it....").

6 See, e.g., Newark Fire Insurance Co. v. State Bd. of Tax App., 307 U.S. 313 (1939).

7 68 Cal. App. 2d 48, 156 P.2d 81 (1st Dist., 1945).

8 See, e.g., Conn. Gen. Stat. § 12-218b(a)(4) (commercial domicile is "the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed").

9 See Wheeling Steel Corp. v. Fox, 298 U.S. 193 (1936), which is discussed in more detail in the text below.

10 Wheeling Steel, *supra* note 9, quoting Farmers' Loan & Trust Co. v. Minnesota, 280 U.S. 204, 8 AFTR 10257 (1930) (internal quotation marks omitted). A "chose in action" is a right to something that may be recovered, e.g., by suit.

11 See, e.g., Bristol v. Washington County, 177 U.S. 133 (1900); State Bd. of Assessors of Parish of Orleans v. Comptoir National D'Escompte de Paris, 191 U.S. 388 (1903); Safe Deposit & Trust Co. of Baltimore, Md. v. Virginia, 280 U.S. 83 (1929).

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nessee. When the corporation sold the partnership interest, Tennessee sought to tax the resulting gain, which for the year in question was found to be non-business income taxable by the state in which the company had its commercial domicile.

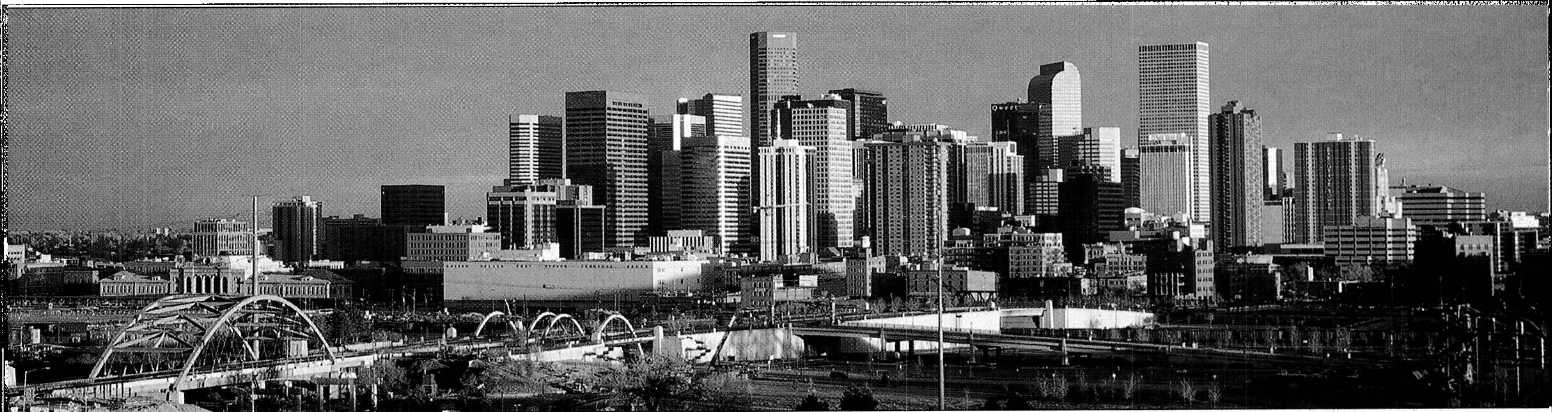
The court noted that all of the taxpayer's management personnel and directors resided outside of Tennessee, and their management meetings were held either in New York or outside the U.S. The directors and managing officers never even traveled to Tennessee during the corporation's existence. The corporation's books and records were maintained in New York, and all the corporation's outside advisors, including lawyers, accountants, and investment bankers, were based in New York or London. The corporation did have one "officer" residing in Tennessee, the "chief accounting officer," who performed bookkeeping functions regarding a corporate bank account in Tennessee that was set up to receive partnership distributions. She had no other duties there and received no compensation from the corporation; she was, in fact, a full-time employee of the partnership. The court "rejected the notion that the assets and activity of a partnership should be attributed to a corporate partner," and found that the corporation's "trade or business was not 'directed or managed' from Tennessee" and, therefore, "Tennessee was not the [corporation's] commercial domicile."

Alabama also relies on location of management and control. In *Anniston Sportswear Corp. v. Alabama,*[18] an Indiana corporation conducted its entire manufacturing operations in Alabama. The administrative functions, however, were carried on at the company's business office in Indiana. The Alabama Supreme Court held that Indiana was the taxpayer's commercial domicile. The court found that all the company's activities other than strictly manufacturing were performed in Indiana, including the formulation of administrative policies; the determination of productive capacity; the setting of prices; the acceptance of orders; the purchasing of all raw materials; the preparation of production orders; the determination of salaries; and the issuance of payroll checks for all officers, as well as for supervisory personnel working at the Alabama facility. Thus, despite that all of the manufacturing operations were conducted in Alabama, the court found that where the business of the plant was managed and directed—i.e., in Indiana—established the commercial domicile.

Similarly, in *Alabama Textile Products Corp. v. Alabama,*[19] the Alabama Supreme Court was dealing with a Delaware corporation that had manufacturing plants in Florida and general business offices in Alabama. The court held that Alabama, the "center of authority" from which the company controlled what it did at those plants, was "the company's location of commercial domicile." In reaching that conclusion, the court noted that the corporation's "trucks ... are based at [Alabama] and are there given their instructions, and [Alabama] is the home base of the airplane." Furthermore, the corporation's books "are kept there and all the goods are sold from the [Alabama] office and all of the accounts receivable come to that office for collection."

Ostensible Legal Control vs. Actual Practical Control

Although the commercial domicile test as discussed in the above cases appears to stress the location of corporate headquarters or other legally controlling body as the major factor in determining a corporation's commercial domicile, this factor has been rejected by courts where it does not coincide with the place of actual management and control.



For example, in *Southern Pacific Co. v. McColgan,*[20] the leading California commercial domicile case, the California Court of Appeal held that the state where "the corporation receives its greatest protection and benefits, that state where the greatest proportion of its control exists," is the commercial domicile. In *Southern Pacific,* the taxpayer was incorporated in Kentucky, but conducted no business there. Its board of directors and executive committee met in New York. The company's railroad transportation business was based in California and six other western states, however, and the vast majority of its employees were in California, along with the staffs of its legal, engineering, and purchasing departments. The company president also was based in California, and the day-to-day business operations were managed there. Based on those facts, the court found California to be the commercial domicile of the corporation.

In making its determination, the California court analyzed several earlier cases, including *Wheeling Steel* (discussed above) and *Smith v. Ajax Pipe Line Co.*[21] In *Ajax Pipe Line,* the Delaware-incorporated taxpayer's general offices were in Missouri but ultimate control rested with the taxpayer's parent company in another state. Nev-

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ertheless, the federal Court of Appeals for the Eighth Circuit found Missouri to be the taxpayer's state of commercial domicile and upheld that state's assessment of an ad valorem intangible property tax on Ajax's bank deposits in New York.

In *Southern Pacific,* the court extended the principle stated in *Wheeling Steel,* and, citing *Ajax Pipe Line,* declared: "That the state where ultimate control is exercised is not necessarily the commercial domicile is implicit in the holding in [the latter case], where the stock of the corporation involved was wholly owned, and therefore the corporation was ultimately controlled, by a holding company located outside the taxing state." The California court went on to state: "When a corporation severs its ties with the state in which it is incorporated and engages in no corporate activities there, but engages in activities elsewhere, the contention that, as a matter of law the only state that can possibly be held to be its commercial domicile is that state where its board of directors meets, is as unrealistic, unsound, and artificial as the concept that the corporation for all tax purposes is domiciled in the state of incorporation. It was to free the law from this last mentioned artificial and fictional concept that the concepts of business situs and commercial domicile were applied by the courts." Therefore, the "true test," according to the California court, "must be to consider all the facts relating to the particular corporation, and all the facts relating to the intangibles in question, and to determine from those facts which state, among all the states involved, gives the greatest protection and benefits to the corporation, which state, among all the states involved, from a factual and realistic standpoint is the domicile of the corporation."

Commercial Domicile and the Commerce Clause

State tax provisions applying the commercial domicile concepts from *Wheeling Steel* nevertheless may conflict with restrictions imposed by the Commerce Clause. In *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia,*[22] the Pennsylvania Supreme Court held that Philadelphia's allocating, for purposes of the city's business privilege tax, 100% of the football club's broadcast royalties to Philadelphia as the team's "commercial domicile" unfairly taxed receipts from the team's out-of-state activities, in violation of the Commerce Clause.

Philadelphia imposes a business privilege tax on the gross receipts of every person engaging in any business in the city. In this case, the Philadelphia Eagles football club—a Delaware corporation that clearly was commercially domiciled in Philadelphia—was subject to the city's tax on royalties the team received from the television networks for weekly broadcasts of the team's football games. Philadelphia sought to apply the tax to royalties earned from the telecasts of all 16 of the Eagles' regular season games, even though the team played eight of those games at stadiums in other cities.

The city relied on a regulation (Phila. Bus. Priv. Tax Reg. 322), which provided that "where a taxpayer, whether a domestic or foreign corporation or any other type of business entity, *maintains its commercial domicile in Philadelphia,* all patent, copyright and trademark royalties received are to be included in the measure of tax *unless attributable to business conducted at a place of business regularly maintained by the taxpayer outside of Philadelphia.*" (Emphasis added.) The football club argued that only 50% of the royalties should have been subject to tax because only half of the Eagles' football games were played in and broadcast from Philadelphia. According to the club, Philadelphia's application of the tax violated the Commerce Clause, which requires that income "must be apportioned to reflect the underlying activity that generated the value."

Commerce Clause takes precedence. The Commonwealth Court found that because income from copyright royalties is properly allocated to the domiciliary situs of the taxpayer, and because the football club was commercially domiciled in Philadelphia, 100% of the royalty receipts were subject to tax by the city. The Pennsylvania Supreme Court reversed, however, based on the "fair apportionment" prong of the U.S. Supreme Court's four-part Commerce Clause test under *Complete Auto Transit, Inc. v. Brady*[23] (noted above). While the Philadelphia tax would pass the "internal consistency" portion of the test (i.e., if every jurisdiction were to impose such a tax, then each would be able to tax the royalties of only those taxpayers commercially domiciled within its boundaries), it failed the "external consistency" test, which is a subjective test that asks whether a state taxes only that portion of the revenue from interstate activity that reasonably reflects the in-state component of the activity

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Practice Note

A corporation's "legal" domicile, of course, is the jurisdiction under whose laws the entity is incorporated or created. In today's economy, however, a business may be active in various states or nations, while maintaining no offices and conducting no business in its state of incorporation. Thus, in determining jurisdiction to tax, especially with regard to intangible property and related income, two factors can become significant:

1. **"Commercial domicile"—generally, the principal place from which a trade or business is directed or managed.**
2. **"Business situs"—where an asset is used as an integral part of a company's business activities, which may be conducted in the state of the company's commercial domicile or in another state separate from both the legal and commercial domicile and not necessarily dependent on the location of company management.**

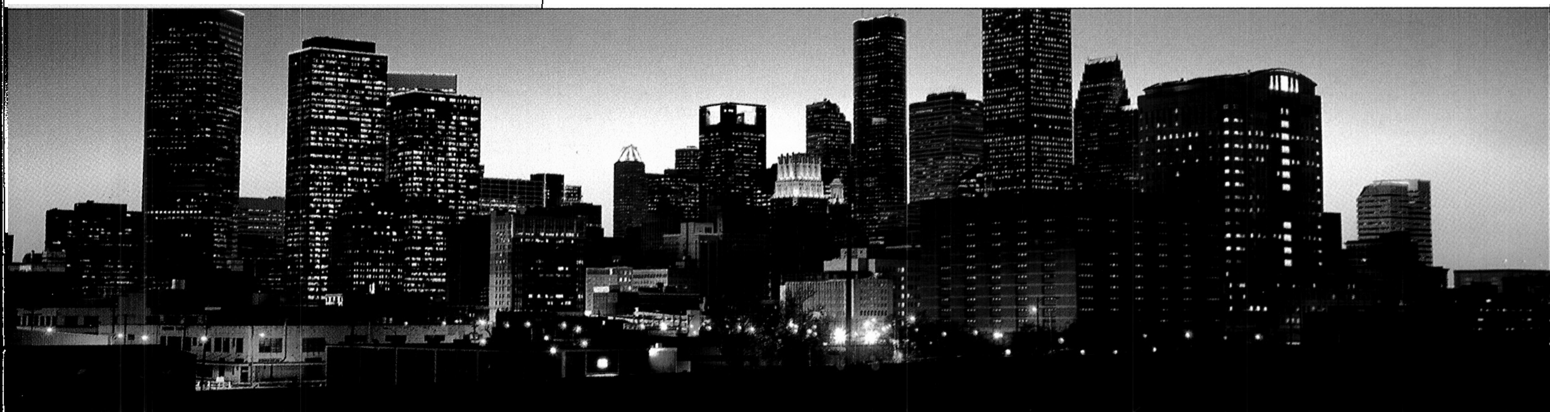
being taxed. Here, the court found that Philadelphia's levy on 100% of the football club's royalties, when half of the Eagles' football games were telecast from venues outside of Philadelphia, was inherently arbitrary and had no rational relationship to the club's business activity that occurred in Philadelphia. Thus, the city's imposition of the tax in the instant case violated the Commerce Clause.

The Pennsylvania Supreme Court found that the Commonwealth Court had erred in concluding that all income from intangible personal property must be allocated to the domicile of the taxpayer. The lower court "apparently mistook the external consistency test as asking whether the City had a justification for taxing *any* of the [royalties], rather than whether the City could fairly lay claim to *all* of the [royalties]." (Emphasis in original.) The state high court concluded that "[a]lthough domicile itself affords a jurisdiction the ability to tax the income of a domiciliary corporation, that jurisdiction may not tax all of that income where another state taxes, or has the authority to tax, an apportioned share of that income."

Thus, in contrast to the U.S. Supreme Court's reasoning in *Wheeling Steel*, in *Philadelphia Eagles Football Club* the Pennsylvania high court held that even though all management functions of the taxpayer were conducted in Philadelphia, the city's taxing scheme imposed an unfair burden on interstate commerce because some primary income-generating activities occurring outside the city were included in the tax base, potentially subjecting the team's revenues to double taxation. Therefore, the commercial domicile test established by the U.S. Supreme Court is not an automatic safe harbor for states and municipalities, even though a taxpayer's entire management activities, including the exercise of actual and ultimate control, are conducted within the taxing jurisdiction.

Commercial Domicile: Not the Only Test

The taxpayer's commercial domicile is not always the overriding criteria in determining the proper taxing state. As the U.S. Supreme Court stated in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*,[24] "[a]lthough 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 *(Continued on page 47)*



[12] Fla. Stat. § 199.175(1). A person domiciled in Florida includes any business organized under Florida law or that has established a commercial domicile in the state. *Id.* § 199.175(1)(a).

[13] Note 9, *supra*.

[14] In re Wheeling Steel Corp. Assessment, 115 W.Va. 553, 177 S.E. 535 (1934). The state's high court reversed the trial court (which had fixed the intangibles subject to tax at those portions of total accounts receivable and the cash in West Virginia banks that were derived from the sale of goods manufactured in West Virginia), but remanded the case for a determination as to whether deductions should be made for any portion of the intangibles subject to taxation in other states.

[15] For example, only about 27% of the assessed value of the company's real and tangible personal property was located in West Virginia, and approximately 24% of the company's shipments originated in that state.

[16] Tenn. Code Ann. § 67-4-2004(3).

[17] 889 S.W.2d 190 (Tenn., 1994).

[18] 275 Ala. 46, 151 So.2d 778 (1963).

[19] 263 Ala. 533, 83 So.2d 42 (1955).

[20] Note 7, *supra*.

[21] 87 F.2d 567 (CA-8, 1937).

[22] 823 A.2d 108 (Pa., 2003), *rev'g in part* 758 A.2d 236 (Pa. Commw. Ct., 2000).

[23] Note 3, *supra*.

[24] 445 U.S. 425 (1980).

[25] Mobil Oil Corp. v. Comm'r of Taxes of Vermont, *supra* note 24, quoting Curry v. McCanless, 307 U.S. 357, 31 AFTR 937 (1939).

[26] 241 La. 564, 129 So.2d 776 (1961).

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(Continued from page 13) renders those concepts applicable when taxation of income from intangibles is at issue." The Court also has recognized that "'the reason for a single place of taxation no longer obtains' when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction."[25]

In *United Gas Corporation v. Fontenot*,[26] the Louisiana Supreme Court refused to read the commercial domicile doctrine into the state's franchise tax law, stating: "Clearly, our franchise tax law contains no language indicating an intent to abrogate the traditional general rule that intangibles owned by a foreign corporation have their situs at the legal domicile of such owner, except insofar as their use in Louisiana operations would give them a business situs in this state. It does not in any manner provide for the allocation of assets to a state in which the corporation has a commercial domicile, as does our income tax law." Subsequently, the Louisiana corporation franchise tax act was amended to include the concept of commercial domicile.[27]

Commercial Domicile and Income Tax

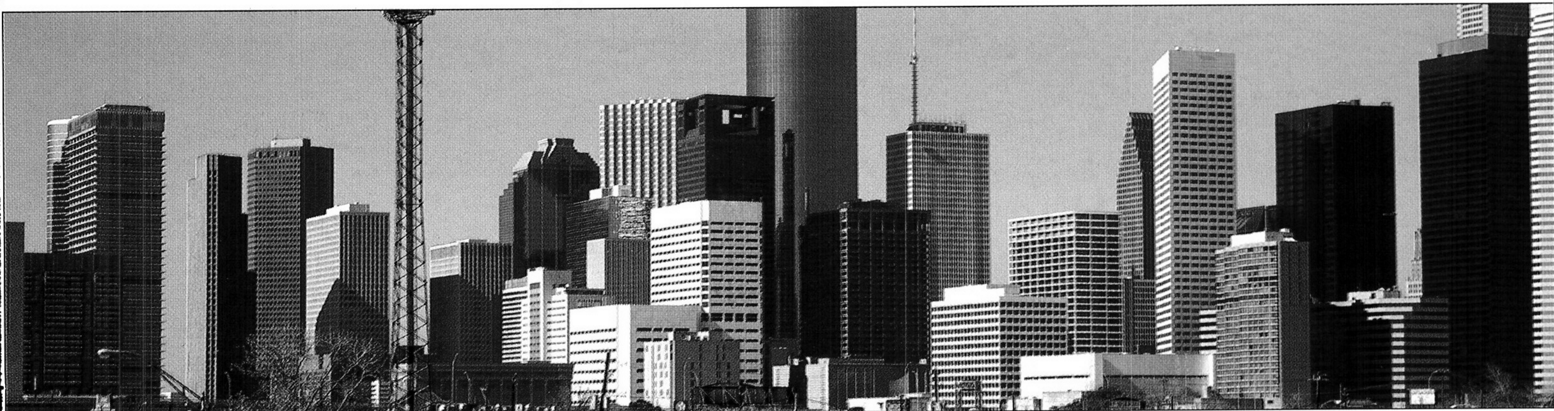
In *Wheeling Steel*, the U.S. Supreme Court considered the assessment of an ad valorem tax. As seen in the discussions above, the location of commercial domicile also can impact a company's income tax liability. In *Memphis Natural Gas Co. v. Beeler*,[28] the U.S. Supreme Court noted that a taxpayer that established a commercial domicile in a state "is subject to taxation there upon its intangibles, unless such taxation infringes the commerce clause." The Court then held that "even if [a] taxpayer's business were wholly interstate commerce, a nondiscriminatory tax by [a state] upon the net income of a foreign corporation having a commercial domicile there ... is not prohibited by the commerce clause."

Subsequent to *Memphis Natural Gas*, states have routinely applied the commercial domicile test in income-tax-related transactions. For example, Indiana imposes an adjusted gross income tax on all corporations deriving income from Indiana sources. Under the state's administrative rules, the income-producing activity is deemed performed "at the situs of real, tangible and intangible personal property...."[29] The rule goes on to provide two methods for determining when intangible property is deemed in Indiana, a "commercial domicile" test that is derived from the principles established in *Wheeling Steel*, and a "business situs" test. According to the rule: "The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a 'business situs' elsewhere," which is "the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property."[30]

Commercial Domicile and UDITPA

In the late 1950s, the National Conference of Commissioners on Uniform State Laws approved the Uniform Division of Income for Tax Purposes Act (UDITPA), which includes a model formula for apportioning income by multistate businesses in states levying taxes on, or measured by, net income. The Multistate Tax Compact, formulated in the mid-1960s by the National Association of Attorneys General and the National Legislative Council, created the Multistate Tax Commission and established for member states a joint audit program for multistate taxpayers.

The Multistate Tax Compact incorporates UDITPA, and the Commission promulgates regulations to interpret the Compact's intent. The Compact has been adopted by 20 states and the District of Columbia; a few other states have adopted specific parts of the Compact.[31] UDITPA generally is



27 See La. Rev. Stat. Ann. § 47:606.

28 315 U.S. 649 (1942).

29 Ind. Admin. Code tit. 45, R. 3.1-1-55.

30 *Id.*

31 The Compact has been adopted by Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Maine, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah, and Washington. For more details, see the Commission's website at http://www.mtc.gov.

32 UDITPA § 2.

33 UDITPA § 1(a).

34 UDITPA § 1(e).

35 UDITPA § § 4 through 8.

36 UDITPA § 1(b).

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EXHIBIT 1
Allocation of Nonbusiness Income Under UDITPA

Income Category	Allocation Rule Under UDITPA
Nonbusiness income from real estate, including rents, royalties, and capital gains.	Allocated to the state in which the property is located.
Nonbusiness rents and royalties from tangible personal property.	Allocated to the state in which the property is used, or if the taxpayer is neither organized under the laws of nor taxable in the state in which the property is used, to the taxpayer's state of commercial domicile.
Nonbusiness capital gains and losses from sales of tangible personal property.	Allocated to the state of business situs at the time of sale. If the taxpayer is not taxable in that state, the gain or loss is allocated to the taxpayer's state of commercial domicile.
Nonbusiness capital gains and losses and interest and dividends from intangible personal property, such as stocks and bonds.	Allocated to the taxpayer's state of commercial domicile.
Nonbusiness royalty income from patents and copyrights.	Allocated to the state in which the patent or copyright is used. If (1) the taxpayer is not taxable in that state, (2) the basis of receipts from the royalties does not permit allocation, or (3) the accounting procedures do not reflect the state of use, the income is allocated to the taxpayer's state of commercial domicile.

intended to apply to the business income of all taxpayers other than individuals, financial organizations, and public utilities.[32]

The location of commercial domicile plays a significant role in income allocation under UDITPA. Most forms of nonbusiness income, including income from intangible assets, are allocated to states based on the location of the taxpayer's commercial domicile. In addition, some states assign certain types of income, such as dividends, to the state of commercial domicile regardless of the income's relation to the taxpayer's regular trade or business. Business income typically is apportioned based on a three-factor (property, payroll, and sales) formula. UDITPA defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."[33] Under UDITPA, nonbusiness income is "all income other than business income."[34]

As indicated in Exhibit 1, UDITPA provides specific allocation rules for five categories of nonbusiness income: (1) rents and royalties from real or tangible personal property, (2) capital gains, (3) interest, (4) dividends, and (5) patent or copyright royalties.[35] These rules with regard to income from intangibles and certain capital gains employ the concept of "commercial domicile." The UDITPA definition of commercial domicile follows the theory adopted by the U.S. Supreme Court in *Wheeling Steel*. Under UDITPA, "commercial domicile" is "the principal place from which the trade or business of the taxpayer is directed or managed."[36]

Conclusion

Clearly, a company's location of commercial domicile has significant tax implications. The U.S. Supreme Court's decision in *Wheeling Steel* regarding commercial domicile is overriding in federal as well as state courts. Accordingly, multistate companies and their tax advisors should consider the location of central management activities when planning to start or expand a business. Other factors contributing to the determination of commercial domicile, as noted in the fairly diverse cases discussed above, also should be reviewed in considering locations for production, administration, and sales functions, in order to minimize the overall tax burden. ■

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