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Abstract

In *Container Corporation of America v. Franchise Tax Board,,1* the Supreme Court for the first time2 approved the application of the unitary method of state taxation3 to the worldwide operations of a multinational business.

KEYWORDS: tax, imports, franchise

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I. Introduction

In *Container Corporation of America v. Franchise Tax Board*,,[1] the Supreme Court for the first time[2] approved the application of the unitary method of state taxation[3] to the worldwide operations of a multinational business. The decision permits states to use a method of taxation different from that used by the federal government and most foreign governments.

Emboldened by the decision in *Container*, the Florida Legislature adopted a tax on multinationals similar to that approved by the Court.[4] This comment presents a background for understanding the *Container* decision, an analysis of that decision, as well as Florida's legislative response, Florida businesses' negative reaction, and federal Executive action. The states have demonstrated a preference for the unitary method when imposing an income tax on multinational businesses. To understand this preference, this comment begins with an examination of state taxation of multijurisdictional businesses.

1. ___ U.S. ___, 103 S. Ct. 2933 (1983).

2. In two cases argued together last term, the Court failed to reach the issue decided in *Container*. In both cases the Court held that the business operations of the domestic corporation and its foreign subsidiaries were not unitary; therefore, it was unnecessary to decide whether the unitary tax method could be applied to the worldwide operations of a multinational business. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982).

See also Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425 (1980), in which the Court held that dividend income received by a nondomiciliary corporation from its subsidiaries could be taxed by a state using the unitary method. *See generally* Comment, *State Taxation of Foreign-Source Income: Mobil Oil Corp. v. Commissioner of Taxes*, 66 CORNELL L. REV. 805 (1980).

3. The unitary method taxes multinationals based on the percentage of their worldwide income attributable to the in-state activities of the business. For a more complete discussion of the unitary tax, *see infra* notes 10-36 and accompanying text.

4. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848 (West) (effective Sept. 9, 1983).

Nova Law Review, Vol. 8, Iss. 3 [1984], Art. 11

II. State Taxation of Multijurisdictional Businesses

A. Development of the Unitary Tax

A domestic corporation whose operations are multistate or multinational may be subject to income tax in more than one jurisdiction. Because a state may not tax income earned outside its borders,[5] the state requires corporations to allocate a portion of their total taxable income to that state. Three methods have evolved for allocating the income of a corporation to a particular state: (1) separate or arms-length accounting; (2) formula apportionment; and (3) specific allocation.

The arms-length method used by the federal government and most foreign governments allocates income on a geographic basis.[6] The income-producing activities of a corporation in one jurisdiction are treated as separate and distinct from those outside the jurisdiction. Often, however, income earned by a corporation may be generated "by a series of multistate transactions beginning with manufacturing profit in one state and ending with sales profit in other States."[7] The income-producing activities of a multijurisdictional corporation may be so interrelated (unitary) that it is a fiction to allocate income among jurisdictions based on artificial geographic boundaries. Indeed, proponents of formula apportionment contend that businesses use the arms-length method to hide income or shift it to jurisdictions where it will be subject to less tax or no tax at all.[8] Income may be shifted to other coun-

5. *See e.g.*, Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77, 80-81 (1983). *See infra* notes 37-42 and accompanying text.

6. P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION 252 (1981). *See also* Keesling & Warren, *The Unitary Concept In the Allocation of Income*, 12 HASTINGS L.J. 42-3 (1960).

7. P. HARTMAN, *supra* note 6, at 522. In one case, for example, all the manufacturing of a multistate business was performed in Connecticut. However, the corporation allocated only three percent of its net income to Connecticut based on separate accounting. The Court, recognizing that the manufacturing process is responsible for a substantial portion of the income earned in other states, approved a one-factor (property) apportionment of income to Connecticut. Since 47% of the company's property was in Connecticut, 47% of its income was apportioned to the state. Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

8. Cappetta, *State Tax Harmonization and the Multistate Tax Commission*, 38TH ANNUAL N.Y.U. INST. § 44.02[3] (1980). The Court acknowledged this contention, noting "that closely related corporations can engage in a transfer of values that is not fully reflected in their formal ledgers." *Container*, __U.S. at __, 103 S. Ct. at

tries as well as other states. "[O]ver one-third of revenues, operating profits and assets of the top 150 [domestic] companies are other than United States revenues, profits and assets."[9]

In order to assure a more accurate division of income, all states which impose a corporate income tax[10] have adopted the formula apportionment method of taxation.[11] The formula method[12] attributes income to a particular state "based on the assumption that the total income of a business enterprise results from certain income-producing factors, such as property, payroll, [and] sales. . . ."[13] The in-state value of each factor is first divided by the total value of that factor for the corporation. The average of the factors is then multiplied by the total corporate income to determine the income taxable by the state.[14] For example, suppose a multinational business has sales of $300, payroll of $25, and property of $100 in State A. The corresponding worldwide figures are $1000, $250, and $500. The standard three-factor formula[15] would be applied as below:

2953.

9. Cappetta, *supra* note 8, at § 44.06[1].

10. Washington, South Dakota, Wyoming, Texas and Nevada are the only states that do not impose a corporate income tax. *See* ST. TAX GUIDE, ALL STATES (2d. ed. CCH), Table of Rates, at 1031.

11. GOV'T ACCOUNTING OFFICE, REPORT BY THE COMPTROLLER GENERAL, KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED RESOLVING 5 (1982) (hereinafter cites as KEY ISSUES).

12. The formula method is described in P. HARTMAN, *supra* note 6, at 523.

13. *Id.* At the federal level, Section 482 of the Internal Revenue Code allows the Internal Revenue Service to intervene between the controlling and controlled interests of a taxpayer to assure proper allocation of income between such interests. "The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer." Treas. Reg. § 1.482-1(b)(1) (1962). In addition, Section 994 of the Code provides rules for inter-company pricing of Domestic International Sales Corporation's (DISC). A DISC is a business which derives most of its gross receipts from exports. *See* I.R.C. § 992 (a)(1) (1983).

14. KEY ISSUES, *supra* note 11, at 3.

15. The standard three-factor formula is based on the UNI. DIV. OF INCOME FOR TAX PURPOSES ACT, 7A U.L.A. 91 (1978).

Primary support for formula apportionment comes from the Multistate Tax Commission, the administrative arm of the Multistate Tax Compact. Cappetta, *supra* note 8, at § 44.01[2].

The Court upheld a one-factor (sales) formula in Moorman Mfg. Co. v. Blair, 437 U.S. 267 (1928), and a one-factor (property) formula in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

$$\frac{\frac{300}{1000} + \frac{25}{250} + \frac{100}{500}}{3} = \frac{.3 + .1 + .2}{3} = \frac{.6}{3} = .2 \text{ or } 20\%$$

Twenty percent of the combined net income of the unitary multinational business would be apportioned to State A and subject to its corporate income tax.

The standard three-factor formula is applied to mercantile or manufacturing enterprises because sales, payroll and property are the prime income-producing factors of such businesses. However, the standard formula may not be appropriate for industries such as banking, insurance, retail sales or transportation. A different mix of factors, such as payroll and receipts for banking, may provide a more accurate picture of a business' in-state activities.[16] Florida imposes a franchise tax on banks and savings associations rather than the unitary tax.[17] Insurance companies may use a one-factor formula based on direct premiums written.[18] Transportation services companies may use a one-factor formula based on revenue miles.[19]

In contrast to the formula method, the arms-length method often results in a lower tax burden[20] on multinationals precisely because it ignores the interrelationship (and profitability) of the worldwide activities of a business. For example, Container paid $72,000[21] less in taxes using the arms-length method for the period 1963-65 than it would have had the three-factor formula method been used.

Specific allocation, the third method of allocating income, assigns certain types of non-operating income to a specific jurisdiction because the source of the income is closely related to a particular location. Included are such items as rent, capital gains and losses, and interest.[22] Specific allocation is often used in conjunction with the apportionment method. First, non-business income is deducted from total corporate in-

16. Levinson, *Interstate Taxation and Apportionment of Bank Income*, 34 NAT'L TAX J. 447 (1981).

17. FLA. STAT. § 220.63 (1981). The franchise tax is a 5% tax on adjusted federal income, as defined in FLA. STAT. § 220.13 (1981).

18. FLA. STAT. § 214.72(1) (1981).

19. FLA. STAT. § 214.72(2) (1981).

20. However, the arms-length method does not always result in a lower tax burden. *See infra* text accompanying note 131.

21. Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, ___, 103 S. Ct. 2933, 2945 n.11-12 (1983).

22. *See* Keesling & Warren, *supra* note 6, at 42. *See also* P. HARTMAN, *supra* note 6, at 524.

come and allocated entirely to the state. The remaining corporate income is then multiplied by an apportionment formula. The state may then impose a tax on the income of the corporation which has been specifically allocated to the state and also on income apportioned to it by means of the apportionment formula.[23]

Initially, apportionment formulas were used only when a business was a single corporation;[24] eventually they were applied by many states to "group[s] of separate corporations performing different functions. . .in different States but engaged in the same unitary business. . . ."[25] The term "unitary tax" now generally refers to the application of formula apportionment to multicorporate entities. Twenty-four states apply the unitary tax to related corporations which operate within the United States.[26] Twelve of those states also apply the unitary tax to related corporations which operate both within and outside the United States.[27] This version of the unitary tax is also known as the worldwide combined reporting method.[28]

The preceding discussion on the theory supporting formula apportionment leads inevitably to the question of when the formula should be applied. Constitutional considerations require a state to determine that the activities of a multicorporate entity are "unitary" before the state may impose its apportionment formula on that entity. "[T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle."[29] However, there is no bright-line test for what constitutes a unitary business.[30] The Court in *Container* provided this

23. KEY ISSUES, *supra* note 11, at 4.

24. *Id.*

25. *Id.*

26. The twenty-four states using the unitary method of taxation are: Alaska, Arizona, California, Colorado, Florida, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah and West Virginia. *Unitary Taxes: Netherlands Says Decision of Supreme Court Threatens Overseas U.S. Investment*, Daily Tax Report, Sept. 9, 1983, at G-6, 7.

27. The twelve states which apply the unitary tax to the worldwide operations of a business are: Alaska, California, Colorado, Florida, Idaho, Indiana, Massachusetts, Montana, New Hampshire, North Dakota, Oregon and Utah. *Id.*

28. *State Taxes: Conable, Mathias Re-Propose Ban on Worldwide Combined Reporting System*, Daily Tax Report, May 6, 1983, at G-1.

29. Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 439 (1980).

30. There is considerable debate over the proper definition of a unitary business. *See* Hellerstein, *The Basic Operations Interdependence Requirement of a Unitary Business: A Reply to Charles E. McLure, Jr.*, 18 TAX NOTES 723 (1983)(WESTLAW,

rather vague definition: "[T]here [must] be some sharing or exchange of value [between related corporations] not capable of precise identification or measurement—beyond mere flow of funds arising out of passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation."[31] Other definitions of a unitary business include the following: (1)"[A]ny business which is carried on partly within and partly without the taxing jurisdiction;"[32] (2) "[E]ither an interstate business which is so integrated as to make separate accounting impossible or as an interstate business in which the in-state activities contribute to the out-of-state business and the out-of-state activities contribute to the in-state business;"[33] and (3) There must a unity of ownership (usually fifty percent ,or more), operations (staff functions), and use (line functions).[34]

Florida defines a unitary business group as follows:

> [A] group of taxpayers related through common ownership whose business activities are integrated with, are dependent upon, or contribute to a flow of value among the members of the group. When direct or indirect ownership or control is 50 percent or more of the outstanding voting stock, the group shall be considered to be a 'unitary business group' unless clearly shown by the facts and circumstances of the individual case to be a non-unitary business group. When direct or indirect ownership or control is less than 50 percent of the outstanding voting stock, all elements of the business activities shall be considered in determining whether the group qualifies as a 'unitary business group.'[35]

Florida's statutory definition presumes a unitary group when there is common ownership of fifty percent or more of the outstanding voting stock. While unity of ownership is an important factor, it is only one of several factors that should be considered in determining whether a bus-

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FTX-TN database)(Professor Jerome Hellerstein's response to an article by Professor Charles McLure which advocated a centralized management test for a unitary business).

31. *Container*, ___ U.S. at ___, 103 S. Ct. at 2940.

32. Keesling & Warren, *supra* note 6, at 46.

33. Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171, 184 (1969).

34. Butler Bros. v. McColgan, 17 Cal. 2d 664, 678, 11 P.2d 334, 341 (1941), *aff'd*, 351 U.S. 501 (1942).

35. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4853, § 220.03(1)(aa)(West).

iness is unitary. Perhaps in recognition of this, the Florida Department of Revenue allows "[the] presumption [to] be overcome by the facts of the specific case which clearly show the business is not unitary."[36] In Florida, as in other states, the determination of whether a business is unitary will have to be made on a case-by-case basis.

States prefer the unitary tax over the arms-length method because the unitary method will more accurately reflect income earned by the in-state activities of a multijurisdictional business. In addition, many states now apply the unitary tax to the worldwide operations of multicorporate entities. The question of whether the operations of a business are in fact unitary is one of constitutional dimension.

B. Constitutional Dimension of the Unitary Tax

The unitary tax is vulnerable to constitutional attack through both the due process clause of the fourteenth amendment[37] and the commerce clause.[38] The restrictions placed upon state taxation of interstate business by the two clauses are similar and are invoked interchangeably by the courts.[39]

Under the due process clause, a state may not impose an income tax on "value earned outside its borders."[40] Thus, before a state may tax extraterritorial business income, there must be "a 'minimal connection' between the interstate activities of the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise."[41] If the commerce clause is relied on, the reviewing court must determine whether the tax is "applied to an activity with a substantial nexus with the taxing state, is fairly appor-

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36. DEP'T OF REVENUE, STATE OF FLORIDA, NO. F-106, INSTRUCTIONS FOR FILING UNDER THE UNITARY METHOD 4 (Aug. 1983); Weissman, *A Primer on Florida's Unitary Method of Corporate Taxation and Capitalizing on its Idiosyncrasies*, FLA. B. J., Jan. 1984, at 42. *See generally* Oppenheimer, *Legislators Hear Unitary Tax System Debated*, The Miami Herald, Oct. 25, 1983, at 5D col. 2 (Arthur England criticizing the presumption).

37. U.S. CONST. amend. XIV, § 1.

38. U.S. CONST. art. I, § 8, cl. 3.

39. P. HARTMAN, *supra* note 6, at 12.

40. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982).

41. Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 436-37 (1980). The due process concept of a "minimal connection" between the in-state and out-of-state values of a business enterprise is analogous to the "minimum contacts" required before a court can invoke long-arm jurisdiction. *See* Inter. Shoe v. Washington, 326 U.S. 310 (1945).

tioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state."[42]

The unitary business concept and formula apportionment of income have been upheld repeatedly by the Supreme Court[43] and have been struck down only as applied to a particular business.[44] In *Container*, the Supreme Court, for the first time, was faced with the question of whether a state could bring the *foreign* subsidiaries of a domestic corporation under the unitary umbrella.

III. The *Container* Decision

A. Facts and Issues Presented

Container Corporation of America (Container), a Delaware corporation headquartered in Chicago,[45] manufactures and distributes paperboard packaging.[46] While Container's operations were "largely domestic,"[47] during the years in question[48] it owned a controlling interest in twenty foreign subsidiary corporations.[49]

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

43. Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207 (1980); *Mobil Oil*, 445 U.S. 425, Moorman Mfg. Co. v. Blair, 437 U.S. 425 (1978); Butler Bros. v. McColgan, 315 U.S. 501 (1942); Bass, Ratcliff & Gretton, Ldt. v. State Tax Comm'n, 266 U.S. 271 (1942); and Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).

44. *ASARCO*, 458 U.S. 307; F.W. Woolworth v. Taxation & Revenue Dep't, 458 U.S. 354 (1982); Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979); and Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931).

45. Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, ___, 103 S. Ct. 2933, 2939, (1983).

46. Brief for Appellant at 2, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part I.

47. *Container*, ___ U.S. at ___, 103 S. Ct. at 2943.

48. The years in question were 1963-1965. *Id.*

49. Brief for Appellant at 2, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1. The percentage ownership of the subsidiaries ranged from 67%-100%. *Container*, ___ U.S. at ___, 103 S. Ct. at 2943. The subsidiaries were located in Colombia, Venezuela, Germany, Italy, Mexico, and Holland. An Austrian subsidiary was inactive. A Panamanian subsidiary was a holding company, with no property, payroll, or sales. Under separate accounting, however, it "was assigned $1.5 million in net income annually. . . ." Brief for Appellee at 7, Container Corp. of Am. v. Franchise Tax Bd.,

Container was subject to California's corporate franchise tax because of its activities within the state.[50] The franchise tax is based on income. Container did not include income from any of its foreign subsidiaries when it calculated its income subject to tax in California.[51] California's Franchise Tax Board (FTB) audited Container's returns for the years in question and determined that Container "should have treated its overseas subsidiaries as part of its unitary business rather than as passive investments."[52] Following the audit, the FTB issued additional assessments against Container.[53] Container paid the assessments and then sued in state court for a refund.[54] The court of appeal upheld a superior court decision denying the refund,[55] and Container appealed to the United States Supreme Court.

In a five-to-three[56] decision, the Supreme Court affirmed. Justice Brennan, writing for the majority, framed the issues as follows:[57] (1) Was it "proper" to characterize Container and its foreign subsidiaries as a unitary business?; (2) If so, was it "fair" to apply the standard three-factor formula to Container?; (3) Alternatively, was California obligated by the foreign commerce clause[58] "to employ the 'arms-length' analysis used by the federal government and most foreign nations in evaluating the tax consequences of inter-corporate relationships?"[59]

___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

50. Container "had approximately $30 million in sales, $10 million in payroll and $15 million in property in California. . . ." Brief for Appellee at 6, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

51. *Container,* ___ U.S. at ___, 103 S. Ct. at 2944. Container also did not include the payroll, sales, or property of the subsidiaries in the apportionment formula. *Id.* at 2945.

52. *Container,* ___ U.S. at ___, 103 S. Ct. at 2945.

53. *Id.* Container's California tax liability increased $72,000. *Id.* at ___, 103 S. Ct. at 2945 nn.11-12.

54. *Container,* ___ U.S. at ___, 103 S. Ct. at 2945.

55. Container Corp. of Am. v. Franchise Tax Bd., 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981).

56. Justice Stevens took no part in the decision. *Container,* ___ U.S. at ___, 103 S. Ct. at 2957.

57. *Container,* ___ U.S. at ___, 103 S. Ct. at 2939.

58. U.S. CONST. art I, § 8, cl. 3.

59. *Container* ___ U.S. at ___, 103 S. Ct. at 2939.

B. The Court's Analysis

1. *Test for Unitary Business: Flow of Goods v. Flow of Value*

The Court first considered Container's challenge to the characterization of its relationship with its foreign subsidiaries as that of a unitary business. For its attack to be successful, Container had the "distinct burden of showing by 'clear and cogent evidence' that [California's apportionment tax] result[ed] in extraterritorial values being taxed."[60] To aid it in meeting this burden, Container urged the Court to adopt a "bright-line" test in making its determination whether Container's business was unitary.[61] Container's suggested test required "a substantial flow of goods"[62] between mercantile or manufacturing enterprises before a business could be characterized as unitary.[63]

Container, not surprisingly, failed to meet the requirements of its own test. Container's sales to its subsidiaries constituted "only about 1% of the subsidiaries' total purchases;"[64] and Container bought no goods from its subsidiaries.[65] Thus, Container argued that its foreign subsidiaries should not be considered as part of a unitary business.

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60. *Id.* at ___, 103 S. Ct. at 2945 (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 221 (1980). Taxation of extraterritorial values would violate the Due Process Clause. *See supra* text accompanying notes 40-1.

61. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947. *See also* Brief for Appellant at 47, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1. Container, based on the Court's decision in F.W. Woolworth v. Taxation & Revenue Dep't, 458 U.S. 354 (1982), also argued that the Court of Appeal had used the wrong legal standard. In *Woolworth*, the Court said that the New Mexico Supreme Court had erred in finding a unitary business based on "the *potentials* of the relationship between Woolworth and its subsidiaries. . .," rather than the *actual* relationship. *Woolworth*, 458 U.S. at 363 (emphasis added). *See also* Brief for Appellant at 43, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in*, BNA's Law Reprints, Vol. 15, No. 8, Part 1. The Court was not persuaded by this argument because, although the lower court alluded to the potential for control by Container, it based its decision on acutal control. *Container*, ___ U.S. at ___, 103 S. Ct. at 2946.

62. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947 (quoting Brief for Appellant at 47, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1).

63. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947.

64. *Id.* at ___, 103 S. Ct. at 2943.

65. Brief for Appellant at 4, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S., ___, 103 S. Ct. 2933 (1983) *reprinted in* BNA's Law Reprints Vol. 15, No. 8, Part 1.

While acknowledging that a substantial flow of goods is a relevant factor, the Court reasoned that it should not be solely determinative.[66] Rather, the Court looked primarily to the "flow of value" between Container and its subsidiaries to establish the "substantial mutual interdependence" necessary to the finding of a unitary business.[67]

The Court then enumerated the factors relied upon by the lower court to find a unitary business.[68] The lower court found that Container was involved with its subsidiaries in the following areas: (1) making and guaranteeing loans, (2) major policy review, (3) obtaining equipment, (4) filling personnel needs, (5) corporate expansion, and (6) technical assistance. The Court considered two of these factors to be particularly significant.[69]

First, Container made substantial loans to its subsidiaries and guaranteed loans made to them by third parties. The annual balance of loans outstanding from Container to its subsidiaries was $7.7 million in 1963, $7.2 million in 1964 and $3.2 million in 1965.[70] The rate of return on these loans ranged from .003% to .018%.[71] Loans guaranteed by Container accounted for approximately one-third of the loans made by third parties to Container's subsidiaries, "or between $2.8 and $3.7 million."[72] While the existence of the loans "and the resulting flow in value"[73] was significant, the fact that Container failed to show that any of the loans were made at market interest rates[74] appeared to be the conclusive factor.

Second, while "a unitary business finding could not be based merely on 'the type of occasional oversight. . .that any parent gives to

66. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947. The Court also noted, however, that one scholar has recommended the flow of goods test and some courts have adopted it as a bright-line test. *Id.* at ___, 103 S. Ct. 2947 n. 17.

67. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947 (quoting F.W. Woolworth v. Taxation & Revenue Dep't, 458 U.S. 354, 371 (1982).

68. *Container*, ___ U.S. at ___, 103 S. Ct. at 2947.

69. *Id.* at ___, 103 S. Ct. 2948 n.19.

70. Brief for Appellant at 2, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

71. Brief for Appellee at 25 n.7, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

72. *Id.* at 25.

73. *Container*, ___ U.S. at ___, 103 S. Ct. at 2948 n.19.

74. *Id.*

an investment in a subsidiary,' "[75] the extent of "the managerial role played by appellant in its subsidiaries' affairs"[76] was considerable. Container took no part in the daily operations of its subsidiaries, however, "major policy decisions of the subsidiaries were subject to review by [Container]."[77] Container had assumed a management position over its subsidiaries that was "grounded in its own operational expertise and its overall operational strategy."[78] The Supreme Court found the combination of these factors sufficient to uphold the finding of the lower court that Container and its foreign subsidiaries constituted a unitary business.[79]

2. *Was the Three-Factor Formula Fairly Applied to Container?*

The Court next considered the question of whether there was a "rational relationship between the income attributed to the State and the intrastate values of the enterprise,"[80] as required by the commerce clause. Container again had the burden of proof, having to establish that such "rational relationship" did not exist.[81] To meet this burden, Container had to prove "that the income apportioned to California under the statute is 'out of all appropriate proportion to the business transacted [sic] in that state.' "[82]

Container argued that the three-factor formula, when applied to a unitary business that included its particular mix of foreign subsidiaries, would allocate more income to California than was properly attributable to its in-state operations.[83] This distortion would occur because wage rates, but not productivity, are lower in the countries in which the subsidiaries are located.[84] Since payroll is a factor in the apportionment

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75. *Id.* (quoting *F.W. Woolworth*, 458 U.S. at 369).
76. *Id.*
77. Container Corp. of Am. v. Franchise Tax Bd., 117 Cal. App. 3d 988, 998, 173, Cal. Rptr. 121, 127, (1981).
78. *Container*, ___ U.S. at ___, 103 S. Ct. at 2948 n.19
79. *Id.* at ___, 103 S. Ct. at 2948.
80. *Id.*
81. *Id.*
82. *Id.* (quoting Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 125 (1931)).
83. Container, ___ U.S. at ___, 103 S. Ct. 2948-9.
84. Brief for Appellant at 15-18, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1. Container also argued that a higher cost of sales contributed to the shift of

formula, including foreign subsidiaries as part of the unitary business would artificially shift income to California.[85] Container supported this argument by showing that formula apportionment allocated an average of $32.1 million of income to the United States, while separate accounting allocated an average of $28.1 million for the same period.[86] Justice Brennan correctly dismissed this showing as "precisely the sort of formal geographic accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place."[87] The Court previously stated this basic proposition: "[W]e need not impeach the integrity of that [separate] accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed."[88] The Court also noted that since Container's business was in fact unitary, it was likely that part of the California payroll was contributing to production by the foreign subsidiaries.[89]

The Court acknowledged that formula apportionment is imperfect, correctly noting that; (1) the one-third weighting of the factors is arbitrary; (2) there are more income-producing factors than just property payroll and sales, and (3) the relationship between the three factors and income is only approximate.[90] However, the Court found that Container had failed to impeach "the basic rationale behind the three factor formula."[91]

3. *Foreign Commerce Clause: Need to Apply Arms-Length Analysis*

Because California's unitary business was international in scope, the Court had to consider two additional factors "beyond those articulated in [the doctrine governing the commerce clause]. . . ."[92] These two factors were derived from *Japan Line, Ltd. v. County of Los Ange-*

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income to California. *Id.* at 18.

85. *Id.* at 16-18. *See infra* notes 123-27 and accompanying text.

86. Brief for Appellant at 17, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

87. *Container*, ___ U.S. at ___, 103 S. Ct. 2948.

88. Butler Bros. v. McColgan, 315 U.S. 501, 507 (1942).

89. *Container*, ___ U.S. at ___, 103 S. Ct. at 2949.

90. *Container*, ___ U.S. at ___, 103 S. Ct. at 2949 n.20.

91. *Id.* at ___, 103 S. Ct. at 2949.

92. *Id.* at ___, 103, S. Ct. at 2951 (quoting Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 446 (1979)).

les.[93] The first factor was "the enhanced risk of [international] multiple taxation."[94] In *Japan Line*, since there was double taxation in fact the Court did not decide "under what circumstances [the] *mere risk* of double taxation would invalidate a State tax. . . ."[95] Second was the "possibility that a state [would] impair federal uniformity in an area where federal uniformity is essential."[96] In order to uphold California's worldwide apportionment tax, the Court had to distinguish *Container* from *Japan Line*.

In *Japan Line*, the Court struck down a California property tax imposed on the shipping containers of a Japanese firm, in part because there was multiple taxation. The Court conceded there was also multiple taxation present in *Container*.[97] The Court noted, however, that the multiple taxation in *Container*, unlike that in *Japan Line*, was not "inevitable." Multiple taxation was inevitable in *Japan Line* because the property taxed in California was subject to tax on its full value in Japan.[98] The multiple taxation in *Container*, on the other hand, was not the inevitable result of applying the worldwide combined reporting method of taxation. Rather, it was "dependent solely on the facts of the individual case"[99] and could have resulted in a lower tax bill.[100].

The Court also found that even if California had adopted the arms-length method there was no guarantee the risk of multiple taxation would be eliminated,[101] because of variations in the way the arms-length method is applied in different countries. Definitions and methods of computing income, deductions and credits are not uniform among countries: "The record shows no such identical tax laws between *any* two countries. . . ."[102]

Finally, the enterprise being taxed in *Japan Line* was foreign

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93. 441 U.S. 434 (1979).

94. *Container*, ___ U.S. at ___, 103 S. Ct. at 2951 (quoting *Japan Line*, 441 U.S. at 446).

95. *Japan Line*, 441 U.S. at 452 n.17 (emphasis added).

96. *Container*, ___ U.S. at ___, 103 S. Ct. at 2951 (quoting *Japan Line*, 441 U.S. at 448).

97. *Container*, ___ U.S. at ___, 103 S. Ct. at 2951.

98. *Id.* at ___, 103 S. Ct. at 2952.

99. *Id.*

100. *Id.* at ___, 103 S. Ct. at 2952 n.25.

101. *Id.* at ___, 103 S. Ct. at 2954.

102. Brief for Appellee at 118, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8 Part 1.

owned, and Container is a domestic corporation. In the *Japan Line* decision, the Court specifically left open the issue of taxation of "domestically owned instrumentalities engaged in foreign commerce."[103]

The Court next considered[104] whether formula apportionment, when imposed on an international business, interferes with federal uniformity in foreign commerce, an area which "is pre-eminently a matter of national concern."[105] This occurs when a state tax: (a) involves matters of foreign policy, or (b) contradicts a mandate of the federal government.[106]

The Court, distinguishing *Container* from *Japan Line*, briefly discussed three reasons why the tax in Container would not implicate matters of foreign policy. First, Container was a domestic corporation, while in *Japan Line* the business was located and organized in a foreign country.[107] Second, the *Japan Line* decision was influenced by the fact that the United States and Japan were signators to a pact that allowed containers from either country to be admitted tax free.[108] Third, because Container was undeniably subject to tax in California, the same result could have achieved simply by raising the tax rates.[109]

The Court also pointed out that the Executive Branch failed to file an *amicus curiae* brief opposing the tax in Container.[110] In *Japan Line* and *Chicago Bridge & Iron Co. v. Caterpillar Tractor* (a case similar to *Container* and argued the same term),[111] the Executive Branch had filed a brief opposing worldwide application of the unitary tax.[112] The majority interpreted the failure to file a brief as evidence that "the

103. *Container*, ___ U.S. at ___, 103 S. Ct. at 2952 (quoting *Japan Line*, 441 U.S. at 444 n.7). In *Container* the Court left open the question of whether a state could tax "domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." *Container*, ___ at ___, 103 S. Ct. at 2952 n.26. On Jan. 9, 1984, however, the Court upheld California's right to apply the unitary tax to a foreign parent corporation with domestic subsidiaries. Alcan Aluminum Ltd. v. Franchise Tax Bd., 52 U.S.L.W. 3505 (U.S. Jan. 10, 1984), *aff'g mem.* 558 F. Supp. 624 (S.D.N.Y. 1983).

104. *Container*, ___ U.S. at ___, 103 S. Ct. at 2955.

105. *Japan Line*, 441 U.S. at 448.

106. *Container*, ___ U.S. at ___, 103 S. Ct. at 2955.

107. *Id.*

108. *Id.* (referring to *Japan Line*, 441 U.S. at 452-53).

109. *Id.* at 2956.

110. *Id.*

111. ___ U.S. ___, 103 S. Ct. 3562 (1983), *dismissing appeal from* the Sup. Ct. of Ill., Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 112, 417 N.E. 2d 1343 (1981).

112. *Container*, ___ U.S. at ___, 103 S. Ct. at 2956.

Executive Branch. . .[is] not seriously threatened"[113] by application of the unitary business concept to a domestically based international business. *Chicago Bridge* was dismissed shortly after the decision in *Container* "for want of a substantial federal question."[114] Container then filed for a rehearing to allow the Executive Branch to file a brief opposing the tax as it had in *Chicago Bridge*,[115] however, the Executive Branch did not support the rehearing and it was dismissed.[116]

Justice Brennan then discussed the lack of a federal mandate requiring the Court to ban California's tax. The United States is a party to many tax treaties with foreign governments that use the "arms-length analysis in taxing the domestic income of multinational enterprises."[117] These treaties, however, are not applicable to the states, and the arms-length method is waived when a government taxes its own corporations.[118] The Court also pointed out that Congress had withdrawn a ban on worldwide apportionment from a tax treaty with the United Kingdom.[119] Finally, the Court noted the lack of Congressional action to ban the states' use of worldwide apportionment.[120]

C. The Dissent

Justice Powell focused his dissent[121] primarily on the issue of multiple taxation. Taking issue with the majority, Powell said that multiple taxation *was* the inevitable result of the worldwide combined reporting method of taxation as used by California in *Container*.[122] He discussed

113. *Id.*

114. *Supreme Court: Illinois Unitary Tax Case Dismissed,* Daily Tax Report, July 6, 1983, at G-6.

115. *State Taxes: Unitary System Threatens Investment in U.S., Japanese Government Warns,* Daily Tax Report, Sept. 14, 1983, at G-5, 7.

116. *Tax Policy: Administration Sets Up Task Force To Study Worldwide Unitary Tax Method on Firms,* Daily Tax Report, Sept. 23, 1983 at G-3.

117. *Container,* ___ U.S. at ___, 103 S. Ct. at 2956.

118. *Id.*

119. *Id.*

120. *Id. See* H.R. 11798, 98th Cong., 2d Sess. (1967); S. 1245, 93rd Cong., 1st Sess. (1973); S. 2080, 94th Cong., 1st Sess. (1975); H.R. 5076, 96th Cong., 1st Sess. (1980); S. 1688, 96th Cong., 1st Sess. (1980) (congressional attempts restricting the use of formula apportionment by the states). *See infra* note 194 for current congressional attempts to restrict formula apportionment.

121. *Container,* ___ U.S. at ___, 103 S. Ct. at 2957 (Chief Justice Burger and Justice O'Connor joined the dissent).

122. *Container,* ___ U.S. at ___, 103 S. Ct. at 2958.

two reasons for his position.

First, he was persuaded by Container's argument that because wage rates, property values and prices for goods sold were higher[123] in California than in the foreign countries where the subsidiaries were located, formula apportionment improperly shifted income away from the foreign countries to California.[124] Formula apportionment is based on the presumption that one dollar of property, payroll, and sales will produce roughly the same amount of profit in each jurisdiction. When variations in wage rates, property values and sales prices are dramatic, income will be shifted to the jurisdiction where the values are highest.[125] Since the foreign countries used the arms-length method, the income which was shifted to California would be taxed both in California and the foreign countries. The resulting multiple taxation, Powell contended, violated the first test of the foreign commerce clause articulated in *Japan Line.*[126] Justice Powell's reliance on this element of Container's case is misplaced. A comparison of the dollar value of payroll, sales and property required to produce one dollar of net income showed the United States ranked second, third and third respectively out of the six countries in which Container operated.[127]

Second, although conceding there could be multiple taxation even if California adopted the arms-length method,[128] Powell was willing to accept this risk of multiple taxation because it was the result of different applications of the same (arms-length) method and thus not "inevitable."[129] On the other hand, Powell felt, multiple taxation *was* inevitable under the worldwide combined reporting method because of the "fundamental inconsistency" between the two different methods of allocating income.[130] As the majority noted, however, application of world-

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123. Brief for Appellant at 15-18, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. at ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

124. *Container,* ___ U.S. at ___, 103 S. Ct. at 2958.

125. J. HELLERSTEIN & W. HELLERSTEIN, STATE AND LOCAL TAXATION 538-539 (4th ed. 1978).

126. *Container,* ___ U.S. at ___, 103 S. Ct. at 2957-2958. *See supra* notes 97-100 and accompanying text.

127. *See* Brief for Appellant at 18, Container Corp. of Am. v. Franchise Tax Bd., ___ U.S. at ___, 103 S. Ct. 2933 (1983), *reprinted in* BNA's Law Reprints, Vol. 15, No. 8, Part 1.

128. *Container,* ___ U.S. at ___, 103 S. Ct. at 2958.

129. *Id.* at ___, 103 S. Ct. at 2959.

130. *Id.*

wide combined reporting can result in reduced taxes.[131] For example, when a parent corporation is making a profit and its out-of-state subsidiaries are losing money (or are merely less profitable), the subsidiaries' operations will reduce the portion of the corporation's total income subject to the apportionment formula.

Justice Powell also addressed the question of whether California's tax prevented the government from speaking with "one voice."[132] He concluded that it did, "because it seriously 'implicates foreign policy issues which must be left to the federal government.' "[133] Powell failed to develop fully the reasons for this conclusion. Instead, he speculated about "sensitive matters of foreign relations"[134] and American investments in foreign countries.[135] He also raised the spectre of foreign reaction were California to apply its tax to a foreign parent corporation.[136] While this is an interesting question, it was not at issue in *Container.* Six months later, however, the Court declined to review a lower court holding that California could impose such a tax on a foreign parent corporation.[137]

Justice Powell also disagreed with the majority over the failure of the Executive Branch to file an *amicus curiae* brief.[138] Powell believed the failure to file a brief did not imply the government had changed its position opposing the worldwide application of formula apportionment. At the time his point was well taken. However, since *Container*, the Executive Branch has decided to study the issues surrounding the tax rather than oppose it.[139]

IV. Impact of Container Decision

A. Florida's Reaction

Two weeks after the decision in *Container*, Florida became one of

131. *Id.* at ___, 103 S. Ct. 2952 n.25.
132. *Id.* at ___, 103 S. Ct. at 2959.
133. *Id.* (quoting the majority at ___, 103 S. Ct. at 2955).
134. *See Id.* (quoting *Japan Line,* 441 U.S. at 456.)
135. *Container,* ___ U.S. at ___, 103 S. Ct. at 2959.
136. *Id.*
137. *See supra* note 103 and accompanying text.
138. *Container,* ___ U.S. at ___, 103 S. Ct. at 2960. *See supra* notes 110-16 and accompanying text.
139. *See infra* notes 198-200 and accompanying text.

twelve states[140] to extend the unitary tax to the worldwide operations of a business.[141] The tax was enacted at special session under the pressure of a school budget clash between Governor Graham and the legislature. The Governor initially vetoed the school budget approved by the legislature because, at $3.6 billion, it was $283 million below his recommendations.[142] Faced with the prospect of a school system unable to pay its bills, an agreement was reached to raise the additional funds sought by the Governor.[143] In addition to modifying the unitary tax, the legislature increased property and alcohol taxes as part of a $233 million package designed to fund the new state education budget.[144] There is a disagreement, however, over how much additional revenue the unitary tax will actually raise. Revenue collections are $30 million less than anticipated after two months under the unitary tax.[145]

The legislature has been criticized for the hasty manner in which the complex unitary tax provisions were adopted.[146] Business had no opportunity to provide input on (or lobby against) a matter which has direct impact on their interests. Responding to negative business reaction to the unitary tax, Florida Secretary of State George Firestone called for a special legislative session to repeal the tax. The Governor's cabinet defeated Firestone by a vote of five-to-one.[147] Lt. Governor

140. *Unitary Tax: Netherlands Says Decision of Supreme Court Threatens Overseas U.S. Investment*, Daily Tax Report, Sept. 9, 1983, at G-6, 7.

141. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848 (West). Governor Graham signed Senate Bill 3C on July 19, 1983. FLORIDA LEGISLATURE, HISTORY OF LEGISLATION, SPECIAL SESSION C, at 1-2.

142. Ollove, *Graham Vetoes Schools Budget: Will Fight for Dramatic Tax Increase*, The Miami Herald, July 1, 1983, at 1A, col. 4.

143. Ollove, *Graham, Leaders Near Pact on New Taxes for Schools*, The Miami Herald, July 7, 1983, at 1A, col. 2. Senate President Curtis Peterson (D., Lakeland) agreed to support the tax increase for education after the governor agreed to restore funding for the Miss Teenage America Beauty Pagent in Lakeland. The governor's aides, however, insisted the timing was just a coincidence. Ollove, *Beauty of a Coincidence Leaves Graham, Peterson Sitting Pretty*, The Miami Herald, July 9, 1983, at 1A, col. 1.

144. Ollove & Doig, *School Taxes Survive Final Battle*, The Miami Herald, July 13, 1983, at 1A, col. 1. This article reports the total tax package at $237 million. Later accounts placed the figure at $233 million. Oppenheimer, *Save-Way Threatens to Leave State*, The Miami Herald, Aug. 5, 1983, at 1E, col. 2.

145. Birger, *Abolishing Unitary Tax to be Business Priority*, The Miami Herald (Business/Monday), Jan. 16, 1984, at 10, col. 1.

146. Sundberg, *State Business Tax Climate Went from Sunny to Bleak*, Ft. Lauderdale News/Sun-Sentinel, Nov. 27, 1983, at 5E, Col. 1.

147. Doig, *4 Cabinet Members Back Governor on Unitary Tax*, The Miami Her-

Wayne Mixson also advocated repeal.[148] To make up for revenue lost by repeal of the tax, Firestone suggested increased fees for drivers license, death certificates, occupational permits and corporate charters.[149] Governor Graham, however, has said he will oppose repeal unless business-related taxes or fees make up for revenue lost by repeal of the unitary tax.[150] Florida Representative John Cosgrove (Coral Gables) has pre-filed a bill for the 1984 legislative session that would effectively repeal the unitary tax.[151] Cosgrove's Coral Gables district has over one hundred multinational businesses.[152] In response to criticism of the new tax and perhaps to quiet those advocating its repeal, the Governor appointed a commission to study the issue.[153] Robert Lanzillotti, Dean of the University of Florida's College of Business Administration, was appointed chairman of the commission.[154] Two months after Lanzillotti's appointment the commission voted to repeal most of the tax because of negative business reaction.[155] However, it is unlikely that Florida's 160 legislators will be able to agree on an alternative source of funding to replace the revenue generated by Florida's version of the worldwide combined reporting method of taxation.[156]

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ald, Oct. 19, 1983, at 8A, col. 1.

148. Prendergast, *Graham, Mixson Butting Heads on Merit of New Tax,* Ft. Lauderdale News/Sun-Sentinel, Oct. 8, 1983, at 1A, col. 2.

149. *Firestone Seeking Review of Tax Laws,* The Miami Herald, Oct. 17, 1983, at 6B, col. 5.

150. Doig, *Graham Issues Warning on Unitary Tax,* The Miami Herald, Jan. 5, 1984, at 9D, col. 2.

151. H.B. 1, Fla. Leg. 1984 (proposed bill for April, 1984 legislative session).

152. Askari, *Battle Begins Over Florida Multinational Tax,* The Miami Herald, July 12, 1983, at 1D, col. 2.

153. Anderson, *Panel to Study Tax on Business,* Ft. Lauderdale News/Sun-Sentinel, Nov.12, 1983, at 1B, col. 5.

154. Bellew, *UF Business Dean Named to Unitary-Tax Panel,* The Miami Herald, Nov. 12, 1983, at 4B, col. 2.

155. Birger, *Governor's Panel Votes to Dump Unitary Tax,* The Miami Herald, Feb. 18, 1984 at 9D, col. 2. The commission recommended retention of that portion of the unitary tax which ended the exemption on overseas sales. *Id.* at col. 3. *See infra* note 160 and accompanying text.

156. Oppenheimer, *Senator Says Unitary Tax Will Stand,* The Miami Herald, Feb. 24, 1984, at 1B, col. 2. Governor Graham has recently indicated he would support the elimination of the worldwide income portion of the tax. If the legislature follows the governor's suggestion, which seems likely, the major objection to the tax of international businesses would be eliminated. The loss of revenue to the state would be approximately $15 million. *Graham Changes Stand on Unitary Tax,* The Miami Herald, Mar. 24, 1984, at 4B, col. 2.

In adopting the worldwide combined reporting method of taxation, the Florida Legislature amended eight existing sections[157] of the tax code and created two new sections.[158] The majority of the tax increase, however, was accomplished by changing only four of the code sections. First, Florida effectively adopted worldwide combined reporting merely by redefining the terms "state" and "everywhere" to include any foreign country.[159] Second, the deduction for income earned on overseas sales was disallowed.[160] Florida had been the only state which excluded all foreign source income for state corporate tax purposes.[161] Third, Florida became the twenty-eighth state[162] to adopt the "throwback" rule.[163] The throwback rule allows taxation of a sale by the origination state (Florida) if the destination state does not tax the sale. Generally, sales of tangible personal property are taxed in the state the property is delivered or shipped to, the destination state. Fourth, non-business income (net rents and royalties, capital gains and losses, interest and div-

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157. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4857-64 (West). Five sections of the tax code were amended in addition to those discussed *infra* notes 159-166 and accompanying text. First, § 220.131 was amended to conform provisions dealing with the adjusted federal income of affiliated groups to the rest of the tax code. Second, § 220.14(3) was amended to permit only one exemption to members of a unitary group. Third, § 220.15 (4) was amended by deleting refund provisions. Fourth, § 220.63(5) was amended by deleting a cross reference which had allowed a deduction from net income for international banks. Fifth, § 220.64 was amended to make certain portions of the new tax applicable to banks.

158. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4858-61 (West). The first new code section, § 220.135, requires all members of a unitary business group to use the unitary method and sets out the procedures which must be employed. The second new code section, § 220.16 relates to the allocation of non-business income.

159. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4853, 4859 (West). The term "state" is defined in § 220.03(1)(t). The term "everywhere" is defined in § 220.15(3). Section 220.15 relates to the apportionment formula and the apportionment of adjusted federal income to Florida.

160. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4856 (West). Parts (a)(b), and (c) of § 220.13(1)(b) were deleted.

161. Fesperman, *New Tax Law Stings Multinational Firms*, The Miami Herald (Business/Monday), Aug. 18, 1983, at 4, col. 1.

162. *See* GOV'T. ACCOUNTING OFFICE, REPORT BY THE COMPTROLLER GENERAL, KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED RESOLVING 165 (1982) (hereinafter cited as KEY ISSUES).

163. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4852, § 214.71(3)(a)(West). The statutory basis of the throwback rule is contained in the UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT, 7A U.L.A. 91 (1978). For a more complete discussion of the throwback rule see Cappetta, *supra* note 8, at § 44.02[1].

idends, and patents and copyrights)[164] is no longer subject to apportionment. Instead, it may be allocated entirely to Florida. Whether a particular item of non-business income is allocable to Florida varies with the nature of the item. For example, interest and dividends are allocable to Florida only if the corporation's commercial domicile in located in Florida.[165] Previously, Florida was one of only eleven states which apportioned all or nearly all of a corporation's income.[166]

The international business community strongly opposes Florida'snew tax.[167] They argue that because of the increase in taxes on multinationals, new businesses will not settle here and existing businesses might leave or at least not expand their operations in Florida.[168] Senator Paula Hawkins' office has released a list of twenty-four companies threatening such action[169] and at least twenty business organizations have joined together to oppose the tax.[170] Because no business wants to pay additional taxes, opposition by multinationals to the new tax is predictable.[171] However, the way the new tax is perceived is also important. Opponents of the tax claim that the perception of Florida as

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164. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4861, § 220.16(West).

165. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4862, § 220.16(3)(West).

166. KEY ISSUES, *supra* note 162, at 65.

167. *See* Doig, *4 Cabinet Members Back Governor on Unitary Tax,* The Miami Herald, Oct. 19, 1983, at 8A, col. 1 (IBM, Motorola, Coca Cola, American Cyanamid, Sony, and the Insurance Exchange of America testify against the new tax at hearing); Birger, *Graham Gets Pressure to Repeal Unitary Tax,* The Miami Herald (Business/ Monday), Oct. 17, 1983, at 3, col. 1 (Windmere Corp. reduces Florida inventory; *Multinational Firms Hire Miami Lawyer to Fight Unitary Tax,* The Miami Herald, Oct. 15, 1983, at 4B, col. 5 (Arthur England, former Justice of the Florida Supreme Court, hired to represent 29 mulitnationals - including Aluminum Co. of America, Gulf Oil, Honeywell, Texaco, TRW and Xerox): *Sony Blasts Florida's Unitary Tax,* The Miami Herald, Oct. 14, 1983, at 1E, col. 2 (Sony reconsiders investments in Florida).

168. *See* Oppenheimer, *Study Fuels Banks' Drive Against New State Tax,* The Miami Herald (Business/Monday), Sept. 19, 1983, at 54, col. 1; Oppenheimer, *International Bankers Fear Unitary Tax,* The Miami Herald, Sept. 15, 1982, at 1C, col. 2; Fesperman, *New Tax Law Stings Multinational Firms,* The Miami Herald (Business/ Monday), Aug. 18, 1983, at 5, col. 1.

169. *Unitary Taxes: Hawkins Bill Would Speed Recommendations of Administration Task Force,* Daily Tax Report, Nov. 1, 1983, at G-2.

170. Oppenheimer, *Groups Banding Together to Seek Repeal of New Tax,* The Miami Herald (Business/Monday), Aug. 1, 1983, at 12, col. 2.

171. *See generally* Cappetta, *supra* note 8, (for a more detailed analysis of corporate opposition ot the unitary tax method).

a state with a favorable business climate has been severely damaged.[172] "What is true for a corporation is not reality, but perception, and the perception of this is bad."[173]

The impact on Florida's business growth resulting from any negative perception (or the reality of a tax increase) is difficult to measure because of conflicting signals. IBM and Pratt & Witney have said they will not move out of the state[174] and reports of new businesses coming to Florida continue despite the unitary tax.[175] For example, Evans Products Company, with annual sales of $1.5 billion, is planning to move its headquarters to Miami.[176] In addition, IBM recently announced plans to double expenditures in 1984 for new construction and equipment for its Boca Raton, Florida-based Entry System Division.[177] On the other hand, IBM also recently announced plans to sell two thousand acres of land near Gainesville, Florida because "the state is an unattractive place to build factories."[178] Furthermore, Save-Way Industries has threatened to leave the state because it estimates its tax bill will increase from $20,000 in 1982 to $180,000 in 1983.[179] These conflicting signals have led to confusion over the impact of the unitary tax.

Confusion over the economic impact of the unitary tax may be illustrated by the response to IBM's recently announced cancellation of

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172. Lawrence, *Unitary Tax Killing Business, C of C Told,* The Miami Herald, Nov. 30, 1983, at 8D, col. 2.

173. Doig, *Corporate, State Officials Square Off on Unitary Tax,* The Miami Herald, Nov. 3, 1983, at 15C, col. 1. A cartoon accompanying a commentary by former Florida Supreme Court Justice Alan Sundberg reflects the purported negative perception: Two workers are putting up a roadside billboard which reads "Keep Out!" On the ground is the sign they have just take down; it reads "Welcome to Florida." Sundberg, *State Business Tax Climate Went From Sunny to Bleak,* Ft. Lauderdale News/ Sun-Sentinel, Nov. 27, 1983, at 5E, col. 1.

174. Fesperman, *supra* note 168, at col. 5.

175. An analysis by the Federal Reserve Bank of Atlanta forcasts a bright economic future for Florida and notes "[h]igh growth, high-technology companies are flocking to the state. . . ." Koch, Whigham & Steinhauser, *Florida Expecting a Boom,* ECONOMIC REV., Feb. 1984, at 20.

176. Russell, *Evans Will Bring its Main Office to Miami,* The Miami Herald, Jan. 20, 1984, at 1E, col. 4.

177. Askari, *IBM Division Plans to Double Spending,* The Miami Herald, Mar. 16, 1984, at 1E, col. 3.

178. Askari, *IBM Blames Unitary Tax for Sale of Land,* The Miami Herald, Feb. 2, 1984, at 5C, col. 2.

179. Oppenheimer, *Save-Way Threatens to Leave State,* The Miami Herald, Aug. 5, 1983, at 1E, col. 1.

further expansion in Boca Raton. Newspaper accounts cited the unitary tax as the primary reason for the cancelled expansion.[180] The unitary tax, however, was not the primary reason for the cancellation: "I can understand someone finding an issue and publicizing it as the reason we did it, and I'm not saying [the unitary tax] isn't a reason, but it is not the only reason."[181] In 1983 IBM experienced substantial growth in the Boca Raton/Delray Beach area. The local workforce increased from 6,300 to 7,800 and its facilities increased by 800,000 square feet to 3.6 million. Anticipating further expansion, builders approached IBM about leasing additional space. A routine management review, however, indicated it would be prudent to curtail expansion for three reasons: (1) The change in Florida's business climate resulting from the unitary tax; (2) Concern that over-expansion of its South Florida operations would have a negative impact on the manageability of those operations; and (3) The impact on community services of further growth in an area where its facilities are already expansive. IBM's decision may cost Florida jobs and property tax revenue. The extent of any loss is difficult to quantify because part of the expansion was designed to relieve existing congestion, however, IBM has no plans to expand its South Florida operations in another state in lieu of Florida.[182] Indeed, two months after the widely publicized cancellation of its expansion plans, IBM announced plans to increase expenditures at its Boca Raton facilities because of the success of the IBM Personal Computer.[183] Whether this confusion is by design or by accident, one point is clear: complex business decisions of this nature are not made soley on the basis of one factor.

While a state's corporate income tax structure is an important consideration in the choice of one state over another, it is by no means the only factor. Even if Florida's tax climate has changed there are several other factors in its favor, including; low labor costs, a sparsely

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180. *IBM Decision Shows Why Florida Should Void Tax*, Ft. Lauderdale News/Sun-Sentinel, Jan. 21, 1984, at 22A, col. 1; Stemle, *Unitary Tax Causes Project Cancellation*, The Monday Paper (Delray Beach), Jan. 16, 1984, at 3A, col. 1; Askari, *IBM Shelves Expansion Plans, Cites Unitary Tax*, The Miami Herald, Jan. 14, 1984, at 4B, col. 2; De George, *IBM Scraps S. Florida Expansion Plans,* Ft. Lauderdale News/ Sun-Sentinel, Jan. 14, 1984, at 1A, col. 1.

181. De George, *supra* note 180, at col. 4 (quoting Dan Scherer, IBM Information Manager in Boca Raton, Florida).

182. Telephone interview with Dan Scherer, IBM Information Manager in Boca Raton, Florida (Jan. 20, 1984).

183. Askari, *supra* note 177.

unionized workforce, easy access to international markets, high population growth rate, and favorable weather conditions. Florida's corporate tax rate of five percent is one of the lowest in the nation[184] and is mandated by the state constitution.[185] Additionally, Florida does not impose a tax on personal income. Indeed, a recent report by the federal Commerce Department ranked Florida forty-ninth out of fifty states in the percentage of personal income taken by state and local taxes.[186] All these factors will continue to make Florida attractive to business.[187]

While the impact of the tax on Florida's economic growth is debatable, the version of the tax adopted by Florida is subject to valid criticism on at least three points. First, instead of using an equally weighted apportionment formula, Florida is one of only four states[188] to assign a weight of fifty percent to sales and twenty-five percent each to payroll and property.[189] Altering the standard formula in this manner distorts the apportionment of income among the states.[190] Second, foreign members of a unitary group are not allowed to deduct net operating losses, net capital losses, or excess contributions.[191] Third, Florida presumes a unitary business group when common ownership is fifty percent or more of outstanding stock.[192] While this presumption may

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184. Only three states have a lower corporate income tax rate than Florida: Michigan - 2.35%, MICH. COMP. LAWS ANN. § 208.31(1)(West Supp. 1982); Oklahoma - 4%, OKLA, STAT. ANN. tit. 68, § 2.355(c); (West Supp. 1983); Utah - 4%, UTAH CODE ANN. § 59-13-3 (Supp. 1983).

185. FLA. CONST. art. VII, § 5(b). The Constitution would have to be amended or revised to change the corporate tax rate.

186. *Tax Burden: State by State,* U.S. News & World Report, Dec. 26, 1983-Jan. 2, 1984, at 18.

187. *See generally* Oppenheimer, *More Foreign-Owned Firms Building Plants in Florida,* The Miami Herald (Business/Monday), July 25, 1983, at 38, col. 1. As evidence of the attractiveness of the state for multinational businesses, "the number of foreign-owned manufacturing plants has almost doubled [to 203] in the past 3 years. . . ." *Id.*

188. KEY ISSUES, *supra* note 162, at 62. Two other states modify the standard apportionment even further: West Virginia employes a two-factor (payroll, property) formula and Iowa uses a one-factor (sales) formula. *Id.*

189. FLA. STAT. § 220.15(4)(1981).

190. *See* Cappetta, *supra* note 8, at § 44.02[1].

191. Taxation-Multi-State Businesses, 1983 FLA. SESS. LAW SERV. 4848, 4856, § 220.13(1)(b)(1)(d)(West). Deductions under Internal Revenue Code §§ 170(d)(2), 172, 1212, and 404 are denied to foreign members of a unitary group.

192. *See supra* notes 35-6 and accompanying text.

be overcome, control alone should not be sufficient to raise it in the first place.[193]

B. National Reaction

Even before the decision in *Container*, legislation was introduced in the Ninety-Eighth Congress to ban states from using the worldwide combined reporting system.[194] The proposed legislation is based on the concern over multiple taxation and opposition to the taxing method by foreign governments.[195]

The Administration is under intense pressure from those who favor the tax and those who oppose it. Multinational businesses and foreign governments want *Container* overturned or legislatively overruled,[196] while the states and proponents of states rights[197] want *Container* left intact. President Reagan responded to the pressure by refusing to seek Supreme Court review of the *Container* decision, an act interpreted as a victory for the states.[198] Instead, the President formed a task force to

193. Weissman, *A Primer on Florida's Unitary Method of Corporate Taxation and Capitalizing on its Idiosyncrasies,* FLA. B. J., Jan. 1984, at 42. *See supra* notes 35-6 and accompanying text.

194. S. 1225, 98th Cong., 1st Sess., 129 Cong. Rec. S. 6145 (1983). H.R. 2918, 98th Cong., 1st Sess., 129 Cong. Rec. H. 2697 (1983). The two bills were introduced in May 1983. *See also State Taxes: Conable, Mathias Re-Propose Ban on Worldwide Combined Reporting System,* Daily Tax Report, May 6, 1983, at G-1.

195. *State Taxes: Conable, Mathias Re-Propose Ban on Worldwide Combined Reporting System*, Daily Tax Report, May 6, 1983, at G-1.

196. *See Unitary Taxes: Netherlands Says Decision of Supreme Court Threatens Overseas U.S. Investment*, Daily Tax Report, Sept. 19, 1983, at G-6 (Netherlands asks United States to strike down worldwide application of the unitary tax); *State Taxes: Unitary System Threatens Investment in U.S., Japanese Government Warns,* Daily Tax Report, Sept. 14, 1983, at G-5 (Japan asks Unites States to abolish the unitary tax); *Tax Policy: Administration Unitary Tax Position Undergoing Close Cabinet Scrutiny*, Daily Tax Report, Aug. 16, 1983, at K-1, 4 (Great Britain asks the United States to join Container's petition for rehearing).

197. House Minority Leader Michel (R-Ill.), in a letter to President Reagan, expressed his opposition to any Administration interference with the *Container* decision. *Tax Policy: Administration Tax Position Undergoing Close Cabinet Scrutiny,* Daily Tax Report, Aug. 16, 1983, at K-1, 3.

198. Lyons, *Reagan Elects Not to Continue Legal Fight Against 'Unitary' Tax,* The Miami Herald, Sept. 24, 1983, at 4B, col. 2; Bacon, *Reagan's Delay on Unitary Tax is Victory For States but May Spark Trade Problems*, Wall St. J., Sept. 26, 1983, at 8, col. 2.

study issues surrounding the worldwide combined reporting method.[199] Major issues to be considered by the task force include the proper definition of a unitary business and how to apply the three factor formula to international businesses.[200] As a result of the President's response, legislative action is unlikely at the next session of Congress[201] and the task force is no longer considering federal legislation as a course of action.[202]

Pressure from international business and foreign governments may eventually lead to some modification of the worldwide combined reporting method. However, because estimates of additional state revenue from the tax range from $600-$900 million annually,[203] a Congressional ban on the tax is unlikely.

V. Conclusion

In *Container*, the Supreme Court upheld the right of states to employ the worldwide combined reporting method of taxation. By dismissing a similar case after reaching its decision in *Container*, the Court sent a clear message that any action against the use of this method of taxation is a matter for Congress and the President, not the Court.

The President has temporarily side-stepped the issue by appointing a task force to study the matter. This move effectively precludes Congressional action, placing the issue on the back burner while adopting a

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199. *Unitary Tax: Reagan to Seek Global Task Force to Solve Problem of State Use of Unitary System*, Daily Tax Report, Sept. 22, 1983, at G-4.

200. *Tax Policy: Administration Sets up Task Force to Study Worldwide Unitary Tax Method on Firms*, Daily Tax Report, Sept. 23, 1983, at G-3, 5. The task force is now known as the Worldwide Unitary Tax Working Group. *Unitary Taxes: Treasury Announces Members of Reagan's Working Group*, Daily Tax Report, Oct. 28, 1983, at G-2.

201. *Tax Policy: Administration Sets Up Task Force to Study Worldwide Unitary Tax Method on Firms*, Daily Tax Report, Sept. 23, 1983, at G-3, 6. A Mathias assistant is quoted as saying "[t]hey've killed our bill. . . ." *Id. See generally supra* note 194.

202. *Unitary Tax: Reagan Panel Hosts First Meeting, Appoints Staff-Level Task Force*, Daily Tax Report, Nov. 2, 1983, at G-5.

203. *Tax Policy: Administration Sets Up Task Force to Study Worldwide Unitary Tax Method on Firms*, Daily Tax Report, Sept. 23, 1983, at G-4. California alone earns $500 million from the tax. *Id.* If additional states adopt the tax, pressure against any Congressional action banning the tax would necessarily increase.

wait-and-see attitude on any foreign retaliation.[204] If none is forthcoming, there is little chance of any federal action banning the use of the tax by the states.

In Florida, the potential for action against the tax is a much closer call. Multinationals may have the political support to attempt repeal of the tax at the next legislative session. If they can substantiate their claims of negative economic impact, and at the same time offer an alternative business source for funding the state education budget, they may succeed in their drive to repeal the tax. Florida would once again be a tax haven for multinationals.

The unitary tax should not be repealed, unless an alternative *business-related* source of funding the education budget can be established. Florida's international business community will directly benefit from a better educated workforce from which to draw employees and thus should assume more of the burden of educating that workforce.

Even if the unitary tax is not repealed the legislature should address the three primary criticisms of Florida's version of the tax.[205] First, Florida should employ an equally weighted apportionment formula rather than the current sales-weighted formula. Second, Florida should permit foreign members of a unitary group to deduct certain losses currently disallowed. Finally, a unitary business group should not be presumed solely on the basis of fifty percent or more common ownership of outstanding stock.

Scot Simpson

204. An analysis by the Advisory Committee on Intergovernmental Relations (ACIR) of 12 states using the unitary method showed "no noticeable retaliations from foreign governments or a drop in foreign investment." *State Taxes: Bipartisan Commission Opposes Ban on Worldwide Combined Reporting System*, Daily Tax Report, May 31, 1983, at G-4, 5. *But see Tax Policy: Administration Sets Up Task Force to Study Worldwide Unitary Tax Method On Firms*, Daily Tax Report, Sept. 23, 1983, at G-3 ("several investment projects. . .cancelled").

205. *See supra* notes 188-193 and accompanying text.