Chapter 10: Intro to Corp.

Apportionment Formula

Microsoft v. FTB

39 Cal. 4th 750 (2006) (California)

- **Facts:** Microsoft engaged in business in California and operated its treasury department in Washington (no income tax). The treasury department made many sales and redemptions of securities, producing a huge amount of gross income but little net income. By including those gross receipts in the sales factor of the California apportionment formula, Microsoft diluted its California sales factor from 11% to 3%, cutting its California taxable income in half.
- **Issue:** Can California exclude the securities gross receipts from the sales factor or, in the alternative, use a different formula, as allowed by UDITPA in abuse cases?
- **Holding:** The security redemptions must be included in the sales factor but California has sustained its burden of proof to use an alternative formula.

Chapter 11: Corporate Tax

The Leading Cases

Wisconsin v. Wrigley Co.

505 U.S. 214 (1992), p. 11-1

- **Facts:** Tp, and Illinois company, sells gum in Wisconsin but claims to be exempt from tax in that state under PL 86-272, which prevents a state from imposing an income tax if the tp's only contact is soliciting sales. Tp also does other stuff, including replacing stale gum and selling small quantities to fill a display case.
- **Issue:** Is the Tp protected by Pl-86-272?
- **Holding:** No. The test is whether the stuff done is ancillary to soliciting, and selling gum crosses the line.

Hans Rees' Sons v. N.C.

283 U.S. 123 (1931), p. 11-27

- **Facts:** Tp ran a tanning business in North Carolina and sold the tanned hides in New York. By its accounts, only 17% of its income related to NC, whereas the single-factor property formula allocated around 80%. The lower court refused to allow the "distortion" evidence.
- **Issue:** Should the court have admitted the evidence?
- **Holding:** Yes, the assessment based on the formula was unreasonable under assumed facts.

Butler Brothers

315 U.S. 501 (1942) (California), p. 11-30

- **Facts:** Tp, an Illinois company, has a wholesale dry goods and general manufacturing business with several distribution houses, including one in San Francisco. It had SF sales of around $5 million and overall sales of around $66 million. It showed a SF loss of $82,851 on its books, but the 3-factor formula allocated $93,552 to SF. The business was unitary, and the Tp had discounts for bulk purchases.
- **Issue:** Can the tp defeat the formula?
- **Holding:** No, the result is reasonable.

Moorman Mfg Co.

437 U.S. 267 (1978) (Iowa), p. 11-38

- **Facts:** Tp is an Illinois company manufacturing and selling animal feed. It manufactures in Illinois and sells in many states, including Iowa, and has a large sales force in Iowa. Iowa computes the Moorman's income using a single-factor sales formula.
- **Issue:** Is the single-factor formula acceptable, despite causing more income to be attributed to Iowa than the widespread 3-factor formula?
- **Holding:** Yes, the Supremes will not pick the formula, which is up to the states.

Mobil Oil Corp.

445 U.S. 425 (1980) (Vermont), p. 11-52

- **Facts:** Mobil, domiciled in new York, operates a worldwide unitary petroleum business. It has gas stations in Vermont generating gross sales of around $9 million. Vermont taxes it on an apportioned share of its worldwide income ($76,419), including dividends from its foreign affiliates. The factors for the affiliates were not included in the apportionment.
- **Issue:** Should the foreign dividends be including in apportionable income?
- **Holding:** Yes.

Container Corp. v. FTB

463 U.S. 159 (1983) (California), p. 11-99

- **Facts:** Tp manufactures custom-ordered paperboard packaging, with 20 foreign subsidiaries in the same business. California taxed an apportioned part of the total income of the enterprise, which it claimed (and the court found) was unitary.
- **Issue:** Is it okay to include the income of the foreign subsidiaries in the apportionment amount, given alleged differences in profit margins?
- **Holding:** Yes. Apportionment is a different method, not to be judged by an separate accounting.

Barclays Bank v. FTB

512 U.S. 298 (1994), p. 119

- **Facts:** Barclays, a UK banking corporation, had a branch and a subsidiary operating in California. It was taxed on a fraction of its worldwide income, using the 3-factor apportionment formula, with some practical accommodations to reduce compliance costs.
- **Issue:** Does the California scheme violate the discrimination prong of Complete Auto (heavier administrative burden) and the special prongs of speaking with one voice and causing double taxation?
- **Holding:** No, taxing scheme upheld.

Allied-Signal, Inc.

504 U.S. 768 (1992) (New Jersey), p. 11-191

- **Facts:** The tp (Bendix) operated an aerospace business in New Jersey. It also owned around 20% of ASARCO, which dealt with nonferrous metals. The parties stipulated that ASARCO and the tp were unrelated business enterprises. The tp sold is ASARCO stock for a gain of $211.5 million. NJ taxed the gain, asserting that the tp was in the business of buying and selling companies.
- **Issue:** Is that gain taxable by New Jersey?
- **Holding:** No. It is nonbusiness income.

Hunt-Wesson v. FTB

528 U.S. 458 (2000), p. 11-210

- **Facts:** Tp operated a business in California and also had nonbusiness dividends allocable to Illinois (its domiciliary state). It has outstanding debt, on which it paid interest. Under California law, the interest was attributed to the nonbusiness dividend and interest income, to the extent thereof.
- **Issue:** Can California use a "direct allocation" of interest to the nonbusiness income, or must it use a pro rata allocation rule.
- **Holding:** The California tax fails; pro rata is required.

Geoffrey, Inc. v. S.C.

437 S.E.2d 13 (1993), p. 11-215

- **Facts:** Geoffrey is a Delaware holding company and affiliate of Toys R Us. It owns and licenses valuable trademarks and trade names to an affiliate in South Carolina. It also provides business know-how. The affiliate paid a royalty fee to Geoffrey and deducted it in computing its S.C. income tax. S.C. imposed its tax on Geoffrey's royalty income.
- **Issue:** Does the tax on the royalty income violate the Due Process and Commerce Clauses?
- **Holding:** No. Physical presence is not required.

Lanco v. Director (N.J.)

379 N.J. Super. 562 (2005), supp. p. 74, p. 11-224

- **Facts:** Lanco licenses trademarks, trade names, etc., to Lane Bryant, a clothing retailer. It has no physical presence in New Jersey. N.J. imposes its income tax on the royalty payments make by Lane Bryant to the tp.
- **Issue:** Can Lanco be taxed on the royalties despite not having a physical presence in N.J.?
- **Holding:** Yes, the commerce Clause does not require physical presence for a state to impose an income tax. Lower court decision (p. 11-224) overturned.

WVa v. MBNA America Bank

640 S.E.2d 226 (2006), Supp. p. 82

- **Facts:** MBNA manages VISA and MasterCard credit cards in West Virginia but has no physical presence in the state. It had gross receipts in the relevant years over $18 million. It paid an income tax and sued for refund, asserting no nexus to tax.
- **Issue:** Can WVa tax MBNA on its credit card profits under the Commerce Clause when the tp has no physical presence in the state but is engaged in business in the state?
- **Holding:** Yes, "substantial nexus" is enough.

Sherwin-Williams v. MA

438 Mass. 71 (2002), p. 11-229

- **Facts:** The tp, in the paint business, organized a Delaware holding company that managed its trademarks. Part of the reason was to minimize taxes, and part business. The tp paid fees to the holding company for the use of the marks it formerly owned.
- **Issue:** Is the holding company a sham?
- **Holding:** Not a sham because the holding co. was formed for a substantial business purpose or engaged in substantial business activity.

Sherwin-Williams v. N.Y.

784 N.Y.S.2d 178 (2004)

- **Facts:** Basically same as in the Massachusetts case. But the law is different. In NY, the Department can require consolidation to clearly reflect income in the state. That rule seems to be narrowly construed to present issues similar to those in the MA case.
- **Issue:** Was the lower court clearly wrong in holding that consolidation was required and the deal was mostly about tax avoidance?
- **Holding:** No, lower court's decision upheld. Double presumption, by statute and lower court.

J. C. Penney Nat'l Bank

19 S.W.3d 831 (1999) (Tennessee), p. 11-244

- **Facts:** Tp is a federal bank organized in Delaware and earning money in Tennessee from its credit card business. It has no offices (physical presence) in Tennessee, but it does retain ownership of the credit cards, which are physically present in the state. TN taxed it on an apportioned share of its income as a financial institution.
- **Issue:** Does Tp have substantial nexus with TN?
- **Holding:** No. Quill controls.

America Online

2002 Tenn. App. LEXIS 555 (2002), p. 11-252

- **Facts:** America Online has many customers in Tennessee that access the Internet through AOL's leased equipment and through actions of third parties and affiliates located in TN. AOL also ships multiple CDs into the state to attract business.
- **Issue:** Was the lower court correct in granting summary judgment to AOL?
- **Holding:** No, the question of whether AOL has substantial nexus is an open question needing more facts.

Dillard National Bank

96-545-III, Chancery Court, 2004 (Tennessee)

- **Facts:** DNB has a credit-card business in Tennessee. Its parent also runs stores in the state, and the stores help promote the credit-card business. On 3 or 4 occasions, it had employees in the state signing up credit-card customers. Plus some other in-state activities, not themselves enough for substantial nexus.
- **Issue:** Does substantial nexus exist?
- **Holding:** Yes. Fact question.