[J-172-2002]
IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

UNISYS CORPORATION, Appellee v. COMMONWEALTH OF PENNSYLVANIA, BOARD OF FINANCE & REVENUE, Appellant CROSS APPEAL OF UNISYS CORP. AT NO. 76 MAP 1999	:	No. 73 MAP 1999 Appeal from the Order of the Commonwealth Court entered on 3/8/99 at 151 F.R. 1991 reversing the Order dated 3/29/91 and remanding to the Department of Finance and Revenue
UNISYS CORPORATION, Appellee v. COMMONWEALTH OF PENNSYLVANIA, BOARD OF FINANCE & REVENUE, Appellant CROSS APPEAL OF UNISYS CORP. AT NO. 77 MAP 1999	:	No. 74 MAP 1999 Appeal from the Order of the Commonwealth Court entered on 3/8/99 at 201 F.R. 1993 reversing the Order dated 3/29/91 and remanding to the Department of Finance and Revenue
UNISYS CORPORATION, Appellee	:	No. 75 MAP 1999 Appeal from the Order of the Commonwealth Court entered on 3/8/99 at 202 F.R. 1993 reversing the Order

v.	:	dated 3/29/91 and remanding to the
	:	Department of Finance and Revenue
COMMONWEALTH OF PENNSYLVANIA,	:	
BOARD OF FINANCE & REVENUE,	:	
	:	
Appellant	:	
	:	
CROSS APPEAL OF UNISYS CORP. AT	:	
NO. 78 MAP 1999	:	
	:	
	:	
	:	
UNISYS CORPORATION,	:	No. 77 MAP 1999
	:	
Appellant	:	Appeal from the Order of the
	:	Commonwealth Court entered on 3/8/99
	:	at 201 F.R. 1993 reversing the Order
v.	:	dated 3/29/91 and remanding to the
	:	Department of Finance and Revenue
COMMONWEALTH OF PENNSYLVANIA,	:	
BOARD OF FINANCE & REVENUE,	:	
	:	
Appellee	:	
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	:	
	:	
UNISYS CORPORATION,	:	No. 78 MAP 1999
	:	
Appellant	:	Appeal from the Order of the
	:	Commonwealth Court entered on 3/8/99
	:	at 202 F.R. 1993 reversing the Order
v.	:	dated 3/29/91 and remanding to the
	:	Department of Finance and Revenue
COMMONWEALTH OF PENNSYLVANIA,	:	
BOARD OF FINANCE & REVENUE,	:	
	:	
Appellee	:	Re-submitted: August 22, 2002

DISSENTING OPINION

MADAME JUSTICE NEWMAN **Decided: October 25, 2002**

I respectfully dissent. The taxing scheme employed by the Department of Revenue (Department) is unconstitutional as applied to multi-state business enterprises with subsidiaries, such as Unisys Corporation (Unisys), because there is no rational relationship between the income attributable to this Commonwealth for tax purposes and the activities giving rise to that income within the Commonwealth.

The United States Constitution limits the authority of states to tax businesses that operate both within and without their confines. "Under both the Due Process and the Commerce Clauses . . . a state may not, when imposing an income-based tax, tax value earned outside its borders." Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 164 (1983) (internal quotation omitted). The Constitution does not "allow a State to tax income arising out of interstate activities--even on a proportional basis--unless there is a minimal connection or nexus between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." Id. at 165-166 (internal quotations omitted).

I recognize that it is not possible to construct a formula that exactly computes the portion of a business conducted within a specific jurisdiction. International Harvester Co. v. Evatt, 329 U.S. 416, 421 (1947). "[T]he States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income

attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State,' or has 'led to a grossly distorted result.'" Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274 (1978) (quoting Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 135 (1931) and Norfolk & Western Ry. Co. v. Missouri State Tax Commission, 390 U.S. 317, 326 (1968)).

Nevertheless, a state seeking to apportion the income of a multi-jurisdictional business must do so fairly, which necessitates that the tax be both internally and externally consistent. Container Corp., 463 U.S. 159. Internal consistency requires that "the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." Id. at 169. "This test asks nothing about the degree of economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995). "A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax." Id.

External consistency requires that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." Container Corp., 463 U.S. at 169. "External consistency . . . looks not to the logical consequences of cloning [the internal consistency test], but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax

reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." Oklahoma Tax Commission, 514 U.S. at 185. To demonstrate external inconsistency, the taxpayer must demonstrate that the income attributed to the State is disproportionate to the business transacted in the State or has led to a grossly distorted result. See Moorman Mfg., supra.

In the case at bar, pursuant to Section 602(b) of the Pennsylvania Tax Reform Code of 1971,[1] the Commonwealth imposes a Franchise Tax on out-of-state corporations to the extent that they do business within Pennsylvania. The formula for computing the tax is comprised of two components: (1) Actual Value; and (2) an Apportionment Factor. Actual value for the years at issue here was calculated by averaging the capitalized five year average net income with seventy-five percent (75%) of the net worth and subtracting from that figure a one-hundred thousand dollar ($100,000.00) deductible. Net worth of a parent company such as Unisys includes the value of any common stock the corporation owns in other entities, such as subsidiaries, and dividends received from its stock ownership of those subsidiaries. 61 Pa. Code § 115.27(a) and (b). The Apportionment Factor is determined by calculating the percentages of the corporation's property, payroll, and sales in the Commonwealth. The value of the corporation's property within the Commonwealth is divided by the value of the corporation's property everywhere to ascertain the percentage of property within the Commonwealth. 72 P.S. § 7602(b)(1). The same method is employed to determine the percentages of payroll and sales within the Commonwealth. The Apportionment Factor is equal to the average of these three percentages. The Department then

[1] Act of March 4, 1971, P.L. 6, as amended, 72 P.S. § 7602(b).

multiplies Actual Value by the Apportionment Factor, and that number by 10 mills to arrive at the Franchise Tax due.

The Department calculates the Apportionment Factor using only the property, payroll, and sales of the parent taxpayer corporation, in this case, Unisys itself, and not of the parent taxpayer corporation's subsidiaries. However, the Department computes Actual Value using the net worth and dividends not only of the parent taxpayer corporation, but also of its subsidiaries. Thus, while the net worth of the parent taxpayer corporation's holdings in a subsidiary and any dividends paid to the parent taxpayer corporation by the subsidiary are included in Actual Value, the property, payroll, and sales of those subsidiaries are not included in the calculation to determine the Apportionment Factor. As the majority recognizes, "[u]nlike the methodology utilized to determine the tax base . . . the apportionment formula prescribed by the taxing statute, as interpreted by the Department, does not take into account factors representing out-of-state value generated by taxpayer subsidiaries." Majority Opinion, slip op. at 3.

I agree that the taxing scheme at issue here is internally consistent. It is well settled that a three-factor apportionment method, such as the one employed here, is constitutionally acceptable. See Container Corp, 463 U.S. at 165; Butler Bros. v. McColgan, 315 U.S. 501, 505 (1942) ("We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. [T]hese factors may properly be deemed to reflect the relative contribution of the activities in the various states to the production of the total unitary income, so as to allocate to [one state] its just proportion of the profits earned by [taxpayer] from [the] unitary business"). If each jurisdiction calculated Actual Value and the apportionment factor in the same manner as

does the Department, the aggregate apportionment factor would equal one hundred percent (100%) as each item of property, payroll, and sales must, by definition, be attributed to one and only one jurisdiction. Thus, all jurisdictions, *in toto*, would tax no more nor no less than one hundred percent (100%) of the Actual Value of Unisys and its subsidiaries. See E.I. DuPont de Nemours & Co. v. State Tax Assessor, 675 A.2d 82, 89 (Me. 1996), overruling Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039 (Me. 1991) (Tambrands held that a taxing scheme analogous to the one at issue here failed the internal consistency test, but DuPont rejected that analysis. DuPont held that the Tambrands scheme was internally consistent but that the taxing body's failure to adjust the "apportionment factors to reflect the taxpayer's activities both within and without the state . . . may result in the taxation of extra-territorial value and, therefore, may run afoul of the fairness principles of the Due Process Clause").

While the taxing scheme employed by the Department in the case *sub judice* is internally consistent, it is nonetheless constitutionally infirm because it is not externally consistent. In Mobil Oil Corporation v. Commission of Taxes of Vermont, 445 U.S. 425 (1980), the United States Supreme Court was faced with a taxing scheme that did not include in the calculation of the apportionment factor the property, payroll, and sales of Mobil Oil's subsidiaries, even though the tax was imposed on the value of Mobil Oil and dividends it received from its subsidiaries. A majority of the justices of the United States Supreme Court deemed the issue with which we are presently faced waived and, accordingly, refused to address it. Justice Stevens filed a separate dissenting opinion, in which he concluded that "[u]nless the sales, payroll, and property values connected with the production of income by the payor corporations are added to the denominator of the apportionment formula, the inclusion of earnings attributable to those corporations

in the . . . tax base will inevitably cause Mobil's Vermont income to be overstated." Id. at 461 (Stevens, J., dissenting). Justice Stevens reasoned that "[e]ither Mobil's worldwide petroleum enterprise is all part of one unitary business, or it is not; if it is, Vermont must evaluate the entire enterprise in a consistent manner. As it is, it has indefensibly used its apportionment methodology to multiply its share of Mobil's 1970 taxable income." Id.

The same concerns are implcated here. The Commonwealth of Pennsylvania has the constitutional prerogative to tax Unisys for its income fairly attributable to its in-state activities. This extends to income derived from subsidiaries. However, when determining the percentage of business that the taxpayer corporation conducts in Pennsylvania, fairness and external consistency mandate that the same entities used to determine Actual Value are used to calculate apportionment. Assume, *arguendo*, that the Actual Value of Unisys is $100 and the actual combined value of Unisys' subsidiaries attributable to the Actual Value of Unisys pursuant to the taxing scheme is $400. Now assume that Unisys conducts 80% of its business within the Commonwealth and that the subsidiaries conduct 10% of their business within the Commonwealth. Pursuant to the Pennsylvania taxing scheme, the Actual Value of the taxable corporation would be $500 and the apportionment factor would be 80% (percentage of business Unisys itself conducts in-state). Thus, Unisys would be liable for tax on $400, even though only $120 of its business is attributable to Pennsylvania (80% of $100 + 10% of $400). In fact, this taxing scheme is only externally consistent when the average percentage of property, payroll, and sales in-state for the parent taxpayer corporation is equal to the average percentage of property, payroll, and sales in-state for the combined subsidiaries.

Therefore, I would hold that the taxing scheme is unconstitutional as applied to multi-state business enterprises with subsidiaries because it has the potential to tax extra-territorial income. Whether or not the tax base is purely unitary or a hybrid is of no moment; the tax base is comprised of the parent corporation and at least some aspects of the subsidiaries. The entity or entities used to determine that tax base should be the same entity or entities used to determine proper apportionment. Had the denominator of the apportionment formula included a part of the subsidiaries property, payroll, and sales reasonably designed to balance out the inclusion of subsidiary factors in the tax base, that would be a different question. In this case, however, the Department makes no such attempt at fair apportionment.

I further disagree with the majority that Unisys has failed to demonstrate by clear and cogent evidence that the Commonwealth is taxing income earned extra-territorially. The majority would put the burden on the taxpayer to devise a reasonable apportionment formula and show how that formula differs from the one actually utilized by the Department. I believe that the burden on the taxpayer is to show: (1) that the current scheme has the potential to impose a tax that is not in reasonable proportion to the business activities conducted by the taxpayer in the Commonwealth; and (2) that the tax imposed in this case is unfair.

Unisys has clearly and cogently established both that the current scheme has the potential to impose a tax that is not in reasonable proportion to its in-state business activities and that the tax imposed on Unisys is unfair. Thus, the taxing scheme is constitutionally infirm as applied to multi-jurisdictional businesses with subsidiaries. The

inclusion of aspects of the earnings of the subsidiaries in the actual value of the parent taxpayer corporation without an attendant inclusion of aspects of the property, payroll, and sales of the subsidiaries in the calculation of the apportionment factor renders the relationship between the tax base and the parent taxpayer corporation's business activities conducted within the state unreasonable.

Mr. Justice Castille joins in this dissenting opinion.