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

UNISYS CORPORATION,	:	No. 73 MAP 1999
	:	
Appellee	:	Appeal from the Order of the
	:	Commonwealth Court entered on 3/8/99
	:	at 151 F.R. 1991 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. 76 MAP 1999	:	
	:	
UNISYS CORPORATION,	:	No. 74 MAP 1999
	:	
Appellee	:	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,	:	
	:	
Appellant	:	
	:	
CROSS APPEAL OF UNISYS CORP. AT	:	
NO. 77 MAP 1999	:	
	:	
UNISYS CORPORATION,	:	No. 75 MAP 1999
	:	
Appellee	:	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. 76 MAP 1999
	:	
Appellant	:	Appeal from the Order of the
	:	Commonwealth Court entered on 3/8/99
	:	at 151 F.R. 1991 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	:	
	:	
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	:	
	:	
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

OPINION

MR. JUSTICE SAYLOR **Decided: October 25, 2002**

These consolidated appeals concern constitutional and statutory challenges to the methodology employed by the Department of Revenue to calculate Pennsylvania franchise tax obligations of an out-of-state corporation conducting business activities in the Commonwealth.

Corollary to the capital stock tax imposed on domestic (Pennsylvania) corporations, the Commonwealth imposes a franchise tax upon foreign (out-of-state) corporations authorized to do business within its borders. In conformance with federal constitutional requirements, the tax is ostensibly designed to reach only value attributable to the conduct of in-state business activity. Nevertheless, the initial tax base is quite broad in that it subsumes measures of value generated by the taxpayer and its subsidiary corporations, both in and out of state. In attempting to adjust this broad tax base to isolate in-state value prior to application of the tax rate, the taxing statute incorporates principles of formulary apportionment. Unlike the methodology utilized to determine the tax base, however, the apportionment formula prescribed by the taxing statute, as interpreted by the Department, does not take into account factors representing in- and out-of-state value generated by taxpayer subsidiaries. Unisys's present challenges are centered upon the absence of factor representation in single-entity, franchise value apportionment.

Unisys is a Delaware corporation with its principal offices in Blue Bell, Pennsylvania, conducting business in all states of the United States; it was formerly

named Burroughs Corporation and is the successor by merger to Sperry Corporation.[1] Throughout the tax years in question, Unisys owned, directly or indirectly, the stock of more than one hundred domestic and foreign affiliates doing business in more than one hundred countries. Despite such ownership (and plain requirements of the taxing statute), in its franchise tax returns, Unisys calculated its tax base without reference to value attributable to its subsidiaries. In settling Unisys's franchise tax for the applicable years, however, the Department increased the tax base to include certain measures of out-of-state value. Nevertheless, in adjusting the tax base to arrive at a taxable value, the Department did not incorporate into the apportionment formula any indices of value pertaining to the out-of-state subsidiaries, which, according to Unisys, had the effect of distorting its tax liability (or, more specifically, increasing the taxable value by some forty-five percent). Unisys filed resettlement petitions with the Department, which were denied, then with the Pennsylvania Board of Finance and Revenue (the "Board"). The Board also denied Unisys's petitions, and the company lodged appeals in the Commonwealth Court sitting effectively as a trial court, see Pa.R.A.P. 1571, with the present appeals concerning the tax years ending March 31, 1985, and 1986 (Sperry Corporation returns), and December 31, 1986 (Unisys returns). At all stages of the litigation, Unisys contended that the apportionment formula applied by the Department violated the Commerce and Due Process Clauses of the United States Constitution, U.S. CONST. art. I, §8, cl. 3;[2] U.S. CONST. amend XIV, §1, as well as statutory fair

[1] Further references to Unisys include Sperry and Burroughs for the applicable tax years.

[2] Although the Commerce Clause does not expressly restrict the states' authority in the area of income/value taxation, the Supreme Court has long relied upon its negative implications as imposing the relevant constraints. See, e.g., Oklahoma Tax Comm'n v. (continued…)

apportionment provisions set forth in Section 401 of the Tax Reform Code of 1971,[3] 72 P.S. §7401(3)2.(a)(18).

Pursuant to the procedure for review of Board determinations, see Pa.R.A.P. 1571, the Commonwealth Court considered the appeal on a stipulation submitted by the parties. A divided, en banc court determined that the franchise tax imposed was consistent with constitutional precepts, but that Unisys was nevertheless entitled to statutory relief. See Unisys Corp. v. Commonwealth, 726 A.2d 1096, 1103, 1105 (Pa. Cmwlth. 1999). The majority opened its opinion with a detailed overview of the mechanics of the taxing statute applicable to foreign corporations doing business in Pennsylvania. Under Section 601 of the Tax Code, 72 P.S. §7601, the tax base, termed the "capital stock value" of the corporation, is first determined by a statutory formula based upon the corporation's net worth ("the sum of the entity's issued and outstanding capital stock, surplus and undivided profits as per books . . .," 72 P.S. §7601(a)), and average net income ("[t]he sum of the net income or loss for each of the current and immediately preceding four years, divided by five," 72 P.S. §7601(a)). For such purposes, the taxpayer's net worth includes net worth of subsidiaries, see 72 P.S. §7601(a) ("In the case of any entity which has investments in other corporations, the net worth shall be the consolidated net worth of such entity[.]").[4] Net income, however, is

---

(…continued)
Jefferson Lines, Inc., 514 U.S. 175, 179-80, 115 S. Ct. 1331, 1335-36 (1995) (discussing dormant Commerce Clause jurisprudence generally).

[3] Act of March 4, 1971, P.L. 6 (as amended, 72 P.S. §§7101-10004) (the "Tax Code").

[4] The scope of this statutory definition is tempered by several doctrines, including those of multiformity and unrelated assets, see generally Commonwealth v. ACF Indus., Inc., 441 Pa. 129, 134-35, 271 A.2d 273, 276 (1970), which have been crafted to accommodate the salient constitutional principles discussed below.

assessed on a separate-company, unconsolidated basis (exclusive of the net income or loss of subsidiary corporations), although it includes dividends received from subsidiaries. See 72 P.S. §7601(a); 61 PA. CODE §155.26(a), (b); see also Philadelphia Suburban Corp. v. Commonwealth, 535 Pa. 298, 303-05, 635 A.2d 116, 119-20 (1993). See generally Unisys, 726 A.2d at 1098-99. The statute defines capital stock value as the average of seventy-five percent of net worth and capitalized average net income, subject to a fixed deduction.[5]

Following calculation of the tax base, one of two elective methods of apportionment is employed to arrive at a taxable value, again, in deference to the constitutional proscription against state taxation of value earned outside the state's borders. The method applicable to foreign corporations per the terms of the Tax Code is known as three-factor apportionment, see 72 P.S. §§7602(b), 7401(3)2.(a)(9)(B), 7603.[6] This method compares certain in-state business activities of a taxpayer with all

---

[5] Specifically, the taxing statute defines "capital stock value" as:

> The amount computed pursuant to the following formula: the product of one-half times the sum of the average net income capitalized at the rate of nine and one-half per cent plus seventy-five per cent of net worth, from which product shall be subtracted one hundred twenty-five thousand dollars ($125,000), the algebraic equivalent of which is
>
> $$(.5 \times (\text{average net income}/.095 + (.75)$$
>
> $$(\text{net worth}))) - \$125{,}000$$

72 P.S. §7601(a). For tax years 1985 and 1986, the final adjustment was to subtract $100,000, rather than the present $125,000. See 72 P.S. §7601(a) (superseded).

[6] Per the noted provisions, the three-factor formula is reposited in the corporate net income taxation statute and incorporated by reference into the franchise tax provisions.

such of its activities, regardless of the location. Specifically, the formula calculates the mathematical average of three ratios: intrastate property to property everywhere; intrastate payroll to payroll everywhere; and intrastate sales to sales everywhere. Therefore, the apportionment fraction equals:

$$\frac{\text{Property in PA}}{\text{Property everywhere}} + \frac{\text{Payroll in PA}}{\text{Payroll everywhere}} + \frac{\text{Sales in PA}}{\text{Sales everywhere}} \div 3 = \text{Apportionment factor}$$

Unisys, 726 A.2d at 1099 (citing 72 P.S. §7602(b)(1)). In the application of this formula, the Commonwealth Court majority emphasized that:

> As consistently interpreted and applied by the Department, the property, payroll and sales figures that comprise the three fractions represent only the property, payroll and sales of the taxpayer itself, and not of the taxpayer's subsidiaries. Thus, under this method, while the net worth of and dividends paid by certain subsidiaries of a corporation are included in the corporation's actual value, the property, payroll and sales of those subsidiaries are not considered in the apportionment formula.

Unisys, 726 A.2d at 1099 (emphasis added). After apportionment, the tax due is then computed by applying the millage rate to the taxable value.[7]

---

[7] Thus, for a year in which the tax rate is ten mills, the tax due is represented mathematically by:

$$\text{actual value} \times \text{apportionment fraction} \times .01$$

Foreign corporations are also afforded the option of calculating capital stock value according to the single-factor formula. The single-factor formula is authorized by the Act of June 22, 1931, P.L. 685, No. 250 (as amended 72 P.S. §1896), and may be employed by foreign corporations pursuant to this Court's decision in Gilbert Assocs., Inc. v. Commonwealth, 498 Pa. 514, 516, 447 A.2d 944, 945 (1982). Under that method, the apportionment fraction is based upon the percentage of the corporation's real and tangible personal property located in-state. See 72 P.S. §§1894, 1896; 61 PA. CODE §155.10.

Having reviewed the relevant provisions of the Tax Code, the Unisys majority proceeded to consider the pertinent constitutional precepts as developed in seminal decisions of the United States Supreme Court, principally, Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 103 S. Ct. 2933 (1983), Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 100 S. Ct. 1223 (1980), Moorman Mfg. Co. v. Bair, 437 U.S. 267, 98 S. Ct. 2340 (1978), Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 88 S. Ct. 995 (1968), and Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 51 S. Ct. 385 (1931).[8] The starting point of these decisions, again, was the limitation arising under the Commerce Clause upon taxation by states of corporate income or value generated beyond their borders. See Unisys, 726 A.2d at 1100. See generally Container Corp., 463 U.S. at 164, 103 S. Ct. at 2939; Goldberg v. Sweet, 488 U.S. 252, 260-61, 109 S. Ct. 582, 588 (1989). Upon consideration of the difficulties attendant to the delineation of in-state income or value via geographic or transactional accounting,[9] the Supreme Court has concluded that the Commerce and Due Process Clauses afford the states latitude to include multijurisdictional income/value within a corporation's tax base, provided that certain governing conditions are satisfied. See Container Corp., 463 U.S. at 164-65, 103 S. Ct. at 2940, cited in Unisys, 726 A.2d at 1100-01. As recognized by the Commonwealth

[8] While many of the United States Supreme Court decisions in this area concern corporate income tax, the first instances of application of the relevant, unitary business principles occurred in the value tax context. See Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 779, 112 S. Ct. 2251, 2258 (1992); Jefferson Lines, 514 U.S. at 181-83, 115 S. Ct. at 1336-37.

[9] See Container Corp., 463 U.S. at 164-65, 103 S. Ct. at 2940 ("The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.").

Court, the requirement primarily here at issue is fair apportionment of a unitary business enterprise. See id.[10]

This requirement is comprised of two interrelated concepts. First, in order for a state to assess multijurisdictional income/value (including that which is attributable to subsidiary corporations), the Supreme Court has determined that the taxpayer must be part of a unitary business enterprise, assessed primarily according to the degree of functional integration, centralization of management, and economies of scale arising from its inter-entity dynamics. See Unisys, 726 A.2d at 1100 (describing a unitary business enterprise as "an enterprise which carries out distinct multijurisdictional activities resulting in ultimate profit or value derived from the entire business operation" (citing Container Corp., 463 U.S. at 165, 103 S. Ct. at 2940)).[11] Second, while a state

---

[10] The full criteria presently governing the imposition of state taxes on the instrumentalities of interstate commerce are set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S. Ct. 1076 (1977), and permit such taxation when:

> the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state.

Id. at 279, 97 S. Ct. at 1079; see also Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 219-20, 100 S. Ct. 2109, 2117-18 (1980) (quoting Mobil Oil, 445 U.S. at 436-37, 100 S. Ct. at 1231).

[11] See also Allied-Signal, 504 U.S. at 783, 112 S. Ct. at 2260 (stating that "the constitutional test focuses on functional integration, centralization of management, and economies of scale"); Container Corp., 463 U.S. at 166, 103 S. Ct. at 2941 (recognizing breadth of unitary business principle and that it could apply "not only to vertically integrated enterprises, but also to a series of similar enterprises operating separately in various jurisdictions but linked by common managerial or operational resources that produced economies of scale and transfers of value"). As noted, the parties here agree that Unisys and its subsidiaries function as a unitary business enterprise.

may therefore take interstate income or value into account in evaluating the tax liability of a unitary business enterprise, it must nevertheless make a sufficient attempt to identify the portion of the total which is fairly attributable to in-state business activity, or, in other words, to apportion the income/value prior to taxation. See Unisys, 726 A.2d at 1100-01 ("The functional meaning of [the unitary business enterprise] requirement is that there be some sharing or exchange of value not capable of precise identification or measurement . . . which renders formula apportionment a reasonable method of taxation." (quoting Container Corp., 463 U.S. at 166, 103 S. Ct. at 2933)).[12]

The Unisys majority proceeded to discuss the substantial difficulty in apportionment with respect to a corporation conducting business through subsidiaries and in multiple jurisdictions. See id. at 1100 (citing Container Corp., 463 U.S. at 164, 103 S. Ct. at 2939 (observing that "in the case of a more-or-less integrated business enterprise operating in more than one State, . . . arriving at precise territorial allocations of 'value' is often an elusive goal")); cf. id. at 192, 103 S. Ct. at 2954 ("[a]llocating income among various taxing jurisdictions bears some resemblance . . . to slicing a

---

[12] As elaborated by the Supreme Court in Container Corp.:

> The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.

Container Corp., 463 U.S. at 164-65, 103 S. Ct. at 2940; see also Allied-Signal, 504 U.S. at 783, 112 S. Ct. at 2260; Mobil Oil, 445 U.S. at 438, 100 S. Ct. at 1232.

shadow"); International Harvester Co. v. Evatt, 329 U.S. 416, 422, 67 S. Ct. 444, 447 (1947) ("this Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of appellant"). Therefore, the Supreme Court has determined that a "'rough approximation rather than precision' is sufficient" to satisfy constitutional demands, so long as the formula used for apportionment appears designed to tax only the value of intrastate business activities. See id. at 422, 67 S. Ct. at 447 (quoting Illinois Central Ry. Co. v. Minnesota, 309 U.S. 157, 161, 60 S. Ct. 419, 422 (1940)). See generally Unisys, 726 A.2d at 1100 (observing that "states must often resort to the use of formulas based upon more readily ascertainable measures of the corporation's activities within and without the state in order to apportion the taxes"). The Commonwealth Court majority thus recognized that, pursuant to Supreme Court precedent, the authority of states to devise various methodologies for assessing intrastate value or income is broad. See Allied-Signal, 504 U.S. at 784, 112 S. Ct. at 2261 (explaining that "our cases give States wide latitude to fashion formulae designed to approximate the in-state portion of value produced by a corporation's truly multistate activity"); Norfolk & W. Ry., 390 U.S. at 327, 88 S. Ct. at 1002 (noting that "broad tolerance [is] permitted").

In consideration of the constitutional requirement of fairness in apportionment, the Unisys majority noted that the Supreme Court had repeatedly upheld the constitutionality of a three-factor apportionment formula, going so far as to describe it as "something of a benchmark against which other apportionment formulas are judged." Unisys, 726 A.2d at 1101 (quoting Container Corp., 463 U.S. at 170, 103 S. Ct. at 2943). The majority distinguished Unisys's arguments, however, as attacking, not the formula itself, but rather, the Department's use in the calculation of payroll, property, and sales data of only the parent corporation. See Unisys, 726 A.2d at 1101 ("The

essence of Unisys' argument on appeal is that it is fundamentally unfair for the Department to include as income the dividends Unisys received from its subsidiaries and as net worth the value of its investments in the subsidiaries when calculating the actual value of the corporation, but not to include its subsidiaries' property, payroll and sales in the apportionment formula."). In this respect, the Unisys majority credited the sound logic underlying factor representation. See Unisys, 726 A.2d at 1101 ("Since the purpose of the formula is to apportion the value of the unitary business enterprise among different jurisdictions, it can hardly be subject to dispute that an apportionment formula which includes data from the entire enterprise will yield a more accurate result than a formula based solely upon the parent corporation's operations."). It recognized, nonetheless, that the General Assembly is not necessarily required to implement the most consistent, accurate, or preferred formula, but rather, the question before the court was whether factor representation was constitutionally required. See id. The majority acknowledged the position taken by Justice Stevens in his dissent in Mobil Oil to the effect that factor representation is in fact mandated by constitutional principles;[13] however, it also noted that the reasoning applied in a number of state court decisions

[13] The majority quoted Justice Stevens as follows:

> Either 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 the apportionment methodology artificially to multiply its share of Mobil's 1970 taxable income.

Mobil Oil, 445 U.S. at 461, 100 S. Ct. at 1234 (Stevens, J., dissenting), cited in Unisys, 726 A.2d at 1101.

would support a contrary result, at least insofar as they have rejected a per se or bright line test in the traditional due process analysis. See Unisys, 726 A.2d at 1101.[14]

The Unisys majority then narrowed its inquiry, focusing upon the two-part test crafted by the United States Supreme Court for determining whether an apportionment formula comports with constitutional fairness precepts -- in this regard, the Court has indicated that an apportionment scheme will be sustained if it is internally and externally consistent. See Unisys, 726 A.2d at 1101-02 (citing Container Corp., 463 U.S. at 169, 103 S. Ct. at 2942). The internal consistency assessment seeks to determine whether, on its face, the apportionment formula is reasonably calculated to reach only the profits earned within the state, or, in other words, that the formula is not inherently arbitrary. See id. The Commonwealth Court described external consistency as looking to the practical effect of the formula. See Unisys, 726 A.2d at 1102. Under this branch of the analysis, a reviewing court will disallow application of an apportionment scheme if the taxpayer shows that the taxable value 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."'" Container Corp., 463 U.S. at 170, 103 S. Ct. at 2942 (quoting Moorman, 437 U.S. at 274, 98 S. Ct. at 2345, in turn quoting Hans Rees', 283 U.S. at 135, 51 S. Ct. at 389, and Norfolk & W. Ry., 390 U.S. at 326, 88 S. Ct. at 1001); see also Exxon, 447 U.S. at 223, 100 S. Ct. at 2118.

The Commonwealth Court majority then characterized Unisys's appeal as predicated upon external consistency and reviewed a series of United States Supreme Court cases concerning that precept. It began by noting that, in Hans Rees', the

[14] The Commonwealth Court cited E.I. Du Pont de Nemours & Co. v. State Tax Assessor, 675 A.2d 82, 88-91 (Me. 1996), NCR Corp. v. Commissioner of Revenue, 438 N.W.2d 86, 93 (Minn. 1989), and American Tel. and Tel. Co. v. Department of Revenue, 422 N.W.2d 629, 636-37 (Wis. Ct. App. 1988).

Supreme Court disapproved taxation under a single-factor method where the foreign corporation demonstrated that, while approximately eighty percent of its income was allocated to North Carolina under the apportionment formula, less than twenty-two percent of the corporation's income actually had its source in the corporation's operations within North Carolina. See Unisys, 726 A.2d at 1102 ("Thus, a more than 250% difference between an assessment calculated under a state's apportionment formula and the amount of income actually attributable to a corporation's operations carried on within a state is outside the allowable margin of error, and therefore offends due process." (citing Hans Rees', 283 U.S. at 135-36, 51 S. Ct. at 389-90)). Similarly, the court reviewed the disposition in Norfolk & W. Ry., 390 U.S. at 317, 88 S. Ct. at 995, also observing that a one-hundred sixty-six percent difference in tax due under a state's apportionment formula and under a formula using actual values is also outside the permissible margin of error. See Unisys, 726 A.2d at 1102-03. The majority contrasted two decisions of the Supreme Court in which fourteen and forty-eight percent discrepancies asserted by taxpayers were deemed to be constitutionally acceptable. See id. at 1103 (citing Container Corp., 463 U.S. at 183-84, 103 S. Ct. at 1949-50; Moorman, 437 U.S. at 280-81, 98 S. Ct. at 2348). Against this background, the Unisys majority reasoned as follows:

> Applying the principles of these cases, we conclude that Unisys has not demonstrated a due process violation. Unisys can claim only that were the total property, payroll and sales of the unitary business enterprise included in the fractions of the three-factor formula, its tax due would be approximately 44.5% less than the figure arrived at by the Board in its calculation under the three-factor formula set forth in the Tax Code. We do not believe that a 44.5% disparity between calculations lies outside of the constitutional margin of error delineated by the Supreme Court. A 44.5% disparity is not even remotely close to the 266% and 300% disparities cited by the Court as unconstitutional in Norfolk & Western Railway and Hans

> Rees' Sons, and is somewhat less than the variance upheld in Moorman.

Unisys, 726 A.2d at 1103.

Having thus concluded its constitutional analysis favorably to the Board, the majority moved to Unisys's contention that it was entitled to statutory equitable relief pursuant to the special apportionment provision set forth in Section 401(3)2.(a)(18) of the Tax Code, 72 P.S. §7401(3)2.(a)(18), which the court described as affording the Department "broad discretion to make appropriate adjustments where any substantial inaccuracy results from application of the allocation and apportionment provisions." Unisys, 726 A.2d at 1104. Distinguishing constitutional from statutory unfairness, the majority had little difficulty determining the forty-four and one-half percent variance asserted by Unisys required a remedy under the special apportionment provision. See id. ("Even giving due deference to the Department's interpretation of the statute, we simply cannot say that an allocation so far at variance 'fairly represents the extent of [Unisys's] business activity in this State.'"). In this regard, as it did in its constitutional inquiry, the majority again accepted the benchmark figures supplied by Unisys as its reference and the fact and amount of the percent disparity.[15] In view of the above, the Commonwealth Court remanded to the Board for implementation of statutory relief.

---

[15] The majority took care to emphasize that it was not requiring the inclusion of subsidiaries' data in three-factor formula apportionment in all cases. See Unisys, 726 A.2d at 1105 ("The statute gives broad discretion to the Department to use any method which will produce a fair and equitable result, and we will not here limit the method the Department may use[;] [w]e hold only that some form of Subsection (18) relief must be accorded.").

In dissent, Judge Pellegrini expressed his view that, in order for relief to be required under the statutory fair apportionment provisions, there must be an unfair and unconstitutional allocation and apportionment of the foreign corporation's income that does not fairly represent its actual business activity in the State. See Unisys, 726 A.2d at 1108 (Pellegrini, J., dissenting). Since Judge Pellegrini agreed with the majority's (continued…)

Direct cross-appeals to this Court followed, which raise primarily legal questions, open to this Court's plenary consideration.

Presently, Unisys maintains its argument that, in settling its franchise tax liability for the years in question, the Department ascribed to it a unitary tax base. Unisys does not dispute its status as a unitary business enterprise, or contest Pennsylvania's ability to measure the value of its franchise as such in the first instance. Rather, it rejects the apportionment of an asserted unitary tax base according to factors attributable to the parent corporation only. In this regard, Unisys emphasizes that the justification provided in Container Corp. and its progeny for permitting states to aggregate interstate value for purposes of taxation depends integrally upon the out-of-state portion being reasonably "apportioned away" prior to arriving at a taxable value, such that the taxing state can ultimately be said to be fairly reaching only value reasonably attributable to business activities within its borders. Where a tax base is determined on a unitary basis, in Unisys's estimation, constitutional fairness principles require that the apportionment fraction must be unitary as well, and therefore, rationally related to, and consistent with, the tax base that it seeks to divide. According to Unisys, a structural "mismatch" between valuation and apportionment methodologies is not only irrational but also produces an inherent and impermissible distortion in segregating value. Unisys asserts that the methodology resulted in an overstatement of the value attributable to its Pennsylvania business activities on the order of some forty-five percent and maintains that the distortion is inimical to the salient constitutional fairness principles regardless of the degree of numerical disparity in tax liability produced. In

---

(…continued)
conclusion that Unisys had failed to establish a constitutional violation, by his reasoning it followed that no statutory relief was due. Judge Doyle also dissented, but without opinion.

support of its primary argument, Unisys cites to decisions of the appellate courts in Maine, Wisconsin, and New York. See Du Pont, 675 A.2d at 89 (citing Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039, 1044-45 (Me. 1991), overruled in part, DuPont, 675 A.2d at 88-89); American Tel. & Tel. Co. v. Wisconsin Dep't of Revenue, 422 N.W.2d 629, 634-36 (Wis. Ct. App. 1988); People v. Knapp, 129 N.E. 202, 206 (N.Y. 1920). Further, Unisys claims that the statutory fair apportionment provision requires an identical result, again, consistent with the decisions of other state appellate courts. See, e.g., Homart Dev. Co. v. Norberg, 529 A.2d 115, 121 (R.I. 1987); NCR Corp. v. Comptroller of Treasury, 544 A.2d 764, 781 (Md. 1988).

The Board disagrees fundamentally with Unisys's position that the franchise tax base assessment is unitary in character. To the contrary, it contends, the aspects of the formula that capture consolidated worth are included merely as a "valuation device" used to measure taxpayers' in-state business activities. In this regard, the Board emphasizes that the average net income component of the tax base assessment is calculated on an unconsolidated basis, with dividends from subsidiaries included only as an appropriate item of income to the taxpayer. Thus, in the first instance, the Board advances its view that factor representation in apportionment is not required in the Pennsylvania scheme even assuming the correctness of Unisys's core argument that consolidated valuation would require it in theory. The Board emphasizes its position that the Department's settlements concerning Unisys's franchise tax liability are consistent with application of the internal and external consistency tests fashioned by the United States Supreme Court, and that Unisys has failed to meet its burden of establishing that the apportionment fractions ascribed do not fairly reflect the extent of Unisys's business activities in the Commonwealth. The Board also posits that the availability of an alternate, elective method for calculating franchise tax liability

ameliorates any unfairness that might otherwise be attributed to apportionment via the three-factor method. Finally, the Board maintains that statutory relief is not warranted because the only evidence of "unfairness" in the record stems from Unisys's alternative apportionment formula, which is neither mandated by the statute nor grounded in sound theory. According to the Board, the statutory fair apportionment provision is to be used only in extraordinary circumstances and to avoid constitutional infractions, neither of which is present here.

In considering whether factor representation is required in Pennsylvania franchise tax apportionment, we begin with the question of legislative interpretation, namely, whether the Department's practice of apportioning solely with reference to the parent company's property, payroll, and sales factors is a reasonable interpretation of the taxing statute. As noted, the Tax Code requires apportionment of the franchise tax base according to factors attributable to the "taxpayer." See 72 P.S. §7401(3)2.(a)(10), (12), (13). While the term "taxpayer" is not specifically defined by the statute, its use in context favors the Department's interpretation that it does not include subsidiary corporations. For example, Section 601 of the Tax Code defines "subsidiary corporation" in terms of majority ownership by "the taxpayer corporation." See 72 P.S. §7601. The Department's interpretation is also supported by the weight of authority from other jurisdictions considering similar provisions. See, e.g., NCR Corp. v. Taxation and Revenue Dep't, 856 P.2d 982, 985 (N.M. Ct. App. 1993)(concluding that "[i]n this case the 'taxpayer' is NCR, not its foreign subsidiaries"); NCR Corp. v. South Carolina Tax Comm'n, 402 S.E.2d 666, 669 (S.C. 1991) (same); NCR Corp. v. Commissioner of Revenue, 438 N.W.2d 86, 89-90 (Minn. 1989); NCR Corp. v. Comptroller, 544 A.2d 764, 777 (Md. 1988). But see American Tel. & Tel., 422 N.W.2d at 632; Kellogg Co. v. Herrington, 343 N.W.2d 326, 332 (Neb. 1984). Given the reasonableness of the

Department's administrative interpretation, and in keeping with the deference owed it in this regard, see Jay R. Reynolds, Inc. v. Department of Labor and Indus., Prevailing Wage Appeals Bd., 661 A.2d 494, 497 (Pa. Cmwlth. 1995), we will not disturb such interpretation in the absence of sufficient proof of a constitutional violation.

Concerning the constitutional questions presented by Unisys, the Commonwealth Court majority provided a detailed and correct overview of the unitary business enterprise concept and the corresponding requirement of fair apportionment, as summarized above. It is noteworthy, however, that the United States Supreme Court has not fully developed the contours of permissible apportionment as concerns multi-jurisdictional, affiliated corporations. Moreover, the Supreme Court's overall treatment of the guiding principles has been described as lacking concreteness by commentators, as well as by the Court itself.[16] Of particular relevance here, the Supreme Court has

---

[16] See, e.g., Quill Corp. v. North Dakota, 504 U.S. 298, 315, 112 S. Ct. 1904, 1915 (1992) (stating that "our law in this area is something of a 'quagmire,'" in describing Supreme Court jurisprudence regarding constitutional limitations upon state taxation); Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457-58, 79 S. Ct. 357, 362 (1959) ("application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation"); Ferdinand P. Schoettle, Big Bucks, Cloudy Thinking: Constitutional Challenges to State Taxes – Illumination from the GATT, 19 VA. TAX. REV. 277, 281-82 (Fall 1999) (summarizing the relevant critical commentary). Justices have opined that legislative action may be necessary in order to implement a wholly adequate solution. See Moorman, 487 U.S. at 279-80, 98 S. Ct. at 2347-48; see also ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 352-53, 102 S. Ct. 3103, 3127-28 (1982) (O'Connor, J., dissenting). In this regard, commentators have advocated the use of uniform tax bases and apportionment rules, see, e.g., Kathryn L. Moore, State and Local Taxation of Interstate and Foreign Commerce: The Second Best Solution, 42 WAYNE L. REV. 1425, 1467-68 (Spr. 1996), as well as the use of combined accounting procedures. See generally Oliver Oldman and Richard D. Pomp, State Corporate Taxes, 491 PLI/TAX 291, 323-26 (Mar.-Apr. 2001).

expressly left open questions concerning the necessity of factor representation in apportionment. See Mobil Oil, 445 U.S. at 441 n.15, 100 S. Ct. at 1233 n.15.

The United States Supreme Court, nevertheless, has channeled the inquiry through the application of its internal and external consistency tests. See Jefferson Lines, 514 U.S. at 185, 115 S. Ct. at 1338 ("For over a decade now, we have assessed any threat of malapportionment by asking whether the tax is 'internally consistent' and, if so, whether it is 'externally consistent' as well" (citations omitted)); Goldberg, 488 U.S. at 261, 109 S. Ct. at 589 ("we determine whether a tax is fairly apportioned by examining whether it is internally and externally consistent"). As recognized by the Commonwealth Court, an apportionment method is considered internally consistent if, in a hypothetical application by all taxing jurisdictions, no more than one hundred percent of the unitary business's income or value is taxed. See Container Corp., 463 U.S. at 169, 103 S. Ct. at 2942 (recognizing that the internal consistency standard is satisfied where the formula, "if applied by every jurisdiction . . . would result in no more than all of the unitary business's income being taxed"). Presently, however, Unisys has not attempted to demonstrate that exclusion of the subsidiaries' income-producing activities in the denominator of Pennsylvania's apportionment formula would result in more than all of its income being taxed.[17] Moreover, the Pennsylvania formula as applied by the

[17] Rather, as concerns internal consistency, Unisys asserts primarily that the Pennsylvania franchise tax statute, viewed in tandem with the taxing schemes of other jurisdictions, results in multiple taxation. See Unisys brief at 39 ("The net worth of all subsidiaries is taxed once as part of the capital stock of the parent and a second time as a part of the capital stock value of those subsidiaries taxable in Pennsylvania or another state."). The internal consistency test, however, is a narrow one focused solely upon the structure of the taxing scheme in question. See Goldberg, 488 U.S. at 261, 109 S. Ct. at 589 ("If we were to determine the internal consistency of one State's tax by comparing it with slightly different taxes imposed by other States, the validity of state taxes would turn solely on 'the shifting complexities of the tax codes of 49 other States[;]' [i]n any event, to the extent that other States have passed tax statutes which (continued…)

Department plainly meets the internal consistency test, since if every taxing jurisdiction applied the formula, no more than all of the value of the unitary business would be taxed, as each item of property, payroll, and sales of the parent corporation represented in the numerator of the apportionment fraction can be attributable to only one jurisdiction. Accord Du Pont, 675 A.2d at 89.

As frequently emphasized in the commentary, the internal consistency test constitutes a minimal check on theoretical weaknesses of apportionment schemes. See, e.g., Moore, State and Local Taxation, 42 WAYNE L. REV. at 1453 ("The internal consistency test, in the fair apportionment context, is unexceptional and does little more than serve as a check against blatant multiple taxation in theory." (citation omitted)). The degree to which the Supreme Court intends for external consistency to serve as an additional gauge for theory, as opposed to merely a final check on application of apportionment formulae, is unclear. Certainly, in various instances of its descriptions touching upon the test, the Court has sometimes spoken in terms of theory.[18] The

---

(…continued)
create a risk of multiple taxation, we reach that issue under the external consistency test[.]" (citation omitted)). See generally Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185, 115 S. Ct. 1331, 1338 (1995)("This [internal consistency] 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.").

[18] See, e.g., Container Corp., 463 U.S. at 169, 103 S. Ct. at 2942 (indicating that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated"); General Motors Corp. v. District of Columbia, 380 U.S. 553, 561, 85 S. Ct. 1156, 1161 (1965) (observing that the Court "has sought to ensure that the methods [of apportionment] used display a modicum of reasonable relation to corporate activities within the State"); Norfolk & W. Ry., 390 U.S. at 325, 88 S. Ct. at 1001 ("Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing state." (citation omitted)).

Court has also recognized, however, that "[e]very method of allocation devised involves some degree of arbitrariness." Barclays Bank PLC v. Franchise Tax Bd., 512 U.S. 298, 303, 114 S. Ct. 2268, 2272 (1994).[19] Indeed, in application, the Court's focus in determining external consistency has fairly regularly been upon result, namely, the degree of disparity between taxation under the state's apportionment scheme versus the outcome pursuant to some more "neutral" measure or baseline. See, e.g., Container Corp., 463 U.S. at 182-84, 103 S. Ct. at 2949-50; Moorman, 437 U.S. at 272-75, 98 S. Ct. at 2344-45. Further, the Supreme Court has also employed definitive terms to indicate that the external consistency test is an outcome-based assessment. See, e.g., Goldberg, 488 U.S. at 264, 109 S. Ct. at 590 ("It should not be overlooked . . . that the external consistency test is essentially a practical inquiry."); Container Corp., 463 U.S. at 170, 103 S. Ct. at 2942 (couching the relevant inquiry in terms of taxable value which "'is in fact out of all appropriate proportion to the business transacted . . . in that state,' or has 'led to a grossly distorted result'" (citations omitted)); International Harvester, 329 U.S. at 422-23, 67 S. Ct. at 447 ("Unless a palpably disproportionate result comes from an apportionment, a result which makes it patent that the tax is levied upon interstate commerce rather than upon an intrastate privilege, this Court has not been willing to nullify honest state efforts to make apportionments."). See generally Moorman, 437 U.S. at 273, 98 S. Ct. at 2344 ("despite . . . imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula"). Notably, the Commonwealth Court majority's percentage-oriented

[19] Accord Daniel N. Shaviro, State and Local Taxation: The Current Judicial Outlook, 22 CAP. U. L. REV. 279, 287 (Spr. 1993) ("[I]t is impossible, from an economic standpoint, to ascribe a definite location to income or value.").

assessment of external consistency, see Unisys, 726 A.2d at 1102-03, represents a fairly typical application.

The challenge facing the Supreme Court has clearly been to allow the states sufficient latitude to surmount the complexities involved in the taxation of multijurisdictional entities while at the same time safeguarding against overreaching by any individual state.[20] We conclude that the balance struck by the Court restricts the impact of theoretical attacks upon all but the most arbitrary of formulae by generally limiting the inquiry to the relatively minimal test for internal consistency, while preserving the opportunity for taxpayers to more meaningfully challenge apportionment applications by demonstrating a substantial disparity between the tax burden imposed upon them and some reasonable baseline measure. Accord Container Corp., 463 U.S. at 182-83, 103 S. Ct. at 2949 (observing that "[s]ome methods of formula apportionment are particularly problematic because they focus on only a small part of the spectrum of activities by which value is generated" but noting that "we have generally upheld the use of such formulas" in the absence of "distortive effect[s]" that were "so outrageous . . . as to require reversal").[21]

---

[20] In this regard, we are cognizant of the particular difficulty facing the Commonwealth as concerns a value-oriented tax. Many of the cases cited by the parties concern the taxation of corporate income, in which instance the income-based tax base is more readily quantifiable than the value of capital. See Norfolk & W. Ry., 390 U.S. at 324, 88 S. Ct. at 1000 ("Going-concern value, of course, is an elusive concept not susceptible of exact measurement."). In the case of a value tax, therefore, the heightened complexities span both valuation and apportionment. Indeed, to the extent that the Container Corp. Court's likening of apportionment of income to slicing a shadow is accurate, see Container Corp., 463 U.S. at 164, 103 S. Ct. at 2939, the apportionment of value might be fairly analogized to slicing vapor.

[21] We acknowledge that some courts would appear to have moved beyond review for internal and external consistency as interpreted above, applying more exacting review (continued…)

In order to provide a predicate for assessment of external consistency, therefore, a taxpayer must establish a proper baseline. In the complex field of constitutional restraints on state taxation of multijurisdictional commerce, the dollar figures presented by the parties for comparison have not been predicated upon any uniform set of parameters from which percentage-based comparisons can be easily drawn across cases. The large discrepancies at issue in Hans Rees' Sons and Norfolk & W. Ry., for example, involved the difference between the tax due and that which would have been

---

(…continued)
of the theoretical underpinnings of apportionment formulae. See, e.g., Tambrands, 595 A.2d at 1044.

In dissent, Mr. Justice Nigro appears to adopt such an approach, and, as one indication that the apportionment formula is constitutionally infirm he posits that a corporation's tax liability could, in a hypothetical case, increase even as its in-state factors decrease. See Dissenting Opinion, slip op. at 10 (Nigro, J.). To support his conclusion of facial unconstitutionality, moreover, he cites to PPG Industries, Inc. v. Board of Finance and Revenue, 567 Pa. 580, 790 A.2d 261 (2001) ("PPG II"), in which the Court found that the manufacturing exemption's headquarters subfactor facially discriminated against interstate commerce. See Dissenting Opinion, slip op. at 11-12 (Nigro, J.). It should be noted, however, that, pursuant to the headquarters formula, PPG's tax liability would always increase if PPG were to move or expand operations out-of-state. See PPG Industries, Inc., v. Board of Finance and Revenue, 567 Pa. 565, 575-76, 790 A.2d 252, 258 (1999) ("PPG I"). Thus, the scheme provided a positive incentive for PPG to conduct business within the Commonwealth and penalized the company for expanding such activities out-of-state, thereby running afoul of the prohibition on discrimination against interstate commerce under Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 97 S. Ct. 599 (1977), and its progeny. See PPG I, 567 Pa. at 575-76, 790 A.2d at 258. See generally PPG II, 567 Pa. at 600, 790 A.2d at 273 (Saylor, J., dissenting). Here, by contrast, there is no similar incentive to shift operations either in-state or out-of-state, and hence, no facial discrimination against interstate commerce. Given the imprecision inherent in virtually any attempt to tax the in-state value of a multi-jurisdictional enterprise, the mere fact that one can propose a hypothetical scenario in which the taxpayer's liability increases while its in-state activities diminish, with no causal connection between the two, is an insufficient basis for a finding of facial unconstitutionality.

owed had the taxing authority taken into account the underlying economic realities specific to the unique circumstances of the aggrieved taxpayer. In Container Corp., on the other hand, the relatively small discrepancy at issue arose when the taxpayer chose to compute its tax liability based upon an alternate method that did not reflect the unitary nature of its business. And in Moorman, the forty-eight percent discrepancy represented the difference between two admittedly reasonable apportionment schemes tied to different economic indicators. Although it is therefore clear that different measures may be employed, it is appropriate in all cases as a threshold matter to consider the reasonableness of the method or methods presented by the taxpayer to arrive at a baseline measure.

Here, Unisys has presented a single approach which treats its tax base as wholly unitary and reflects full factor representation in apportionment -- in other words, Unisys has added the full property, payroll, and sales figures of its subsidiary corporations to the denominator of the apportionment fraction. Further, it has presented raw data coupled with bottom-line figures that are detached from the data by the admonition that unquantified adjustments have been made to account for undisclosed exemptions/exclusions.[22] In order to determine the reasonableness of Unisys's approach, it is therefore necessary to consider whether Unisys is correct that the tax base is wholly unitary, such that full factor representation in apportionment will produce an appropriate measure of in-state value. In this regard, the Department argues that such a baseline is unreasonable, since the tax base is not a unitary or consolidated one.

[22] This manner of presentation, as well as the absence of additional descriptive data such as the net average income/profits of subsidiary corporations, see infra, substantially constrains a reviewing tribunal in terms of its ability to assess fairness in application of the taxing statute other than strictly on the terms dictated by the taxpayer.

Contrary to the Department's argument, it is apparent that there are unitary aspects to the tax base, as, for example, capital stock value takes into account consolidated net worth. See 72 P.S. §7601(a). It is important to observe too, however, as the Department also emphasizes, that the average net income component of value is assessed on an unconsolidated basis prior to capitalization. See id.[23] While dividends from subsidiaries are included in taxpayer average net income, and this may be viewed as one measure of consolidated value, the more common and broader measure of value attributable to subsidiaries, namely, the net income or profits of subsidiaries, is not assessed under the statute. Considering similar circumstances, other jurisdictions have made adjustments to the denominator of the apportionment fraction to ensure that the value imputation due to dividends from subsidiaries is not overstated. For example, the "Detroit formula," applied in some jurisdictions, includes in the denominator only a portion of subsidiary factors based on the ratio of dividends received from subsidiary corporations to the subsidiaries' total net income or profits.[24] As explained by several courts in evaluating a similar paradigm:

---

[23] Although Pennsylvania thus hybridizes consolidated and unconsolidated factors in determining the franchise tax base, such approach is not wholly aberrant. See Container Corp., 463 U.S. at 168 n.5, 103 S. Ct. at 2942 n.5 (recognizing that "[s]ome States, it should be noted, have adopted a hybrid approach").

[24] See 14A FLETCHER CYCLOPEDIA OF PRIVATE CORP. § 6970 (2000) ("the 'Detroit formula' . . . operates to reduce state's apportioned share of multijurisdictional taxpayer's taxable income base by adding a portion of property, payroll, and sales of dividend-producing foreign subsidiaries, determined by dividing net dividends that parent corporation receives from foreign subsidiaries by those subsidiaries' total net profit, into the denominators of the portions of parent corporation's property, payroll, and sales attributable to in-state value under the Uniform Division of Income for Tax Purposes Act, thus lowering the UDITPA fractional multiplier used against taxpayer's total income and thereby its state taxable income base.").

> [i]t may not be unreasonable to suggest that inclusion of subsidiaries' dividends in the apportionable income [of NCR] should be balanced by some change in the formula denominator. But the balancing should not be done by including the total property, sales, and payroll values . . .. Instead, the denominators should be modified by including only those percentages of the foreign subsidiaries' property, payroll, and sales that generated the foreign subsidiary dividend income taxed by Maryland.

NCR Corp. v. South Carolina Tax Comm'n, 402 S.E.2d 666, 673-74 (S.C. 1991) (quoting NCR Corp. v. Comptroller of the Treasury, 544 A.2d 764, 781 (Md. 1988)).[25] Indeed, in some cases, in their attempts to establish a baseline by which to adjudge external consistency, taxpayers have acknowledged the inherent reasonableness of adjusting the apportionment formula to account for retained income or profits of subsidiaries. See Tambrands, 595 A.2d at 1042 n.4 ("Tambrands' position is that included in the denominators of the apportionment formula factors should be the same percentage of property, sales and payroll of each Foreign Affiliate as the percentage of net income that each Foreign Affiliate paid in dividends to Tambrands.").[26]

---

[25] While the tax at issue in NCR Corp. was a corporate income tax, similar overstatement of the contribution of subsidiaries to the parent company may occur in the value tax context due to the inclusion of full subsidiary property, payroll, and sales factors in apportionment in circumstances in which the capitalized dividends taken into account in determining the tax base represent merely a portion of the net income or profits of subsidiaries, some of which is retained.

[26] Accord Container Corp., 463 U.S. at 169 n.7, 103 S. Ct. at 2942 n.7 (recognizing as a substantial factor that "the State in that case included dividends from the subsidiaries to the parent in its calculation of the parent's apportionable taxable income, but did not include the underlying income of the subsidiaries themselves"); Walter Hellerstein, State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond, 48 TAX. L. REV. 739, 832 (Fall 1993) ("inclusion of 100% of the subsidiary's factors in the parent's apportionment formula would overstate the subsidiary's contribution to the parent's income if each dollar of payroll, property, and sales was presumed to bear the same relationship to the apportionable income it produced"); id. ("there are complicated issues bearing on the proper adjustment of the parent's factors to reflect fairly the subsidiary's (continued…)

It is also noteworthy that, in the Pennsylvania formula for calculation of the tax base, net worth of the unitary enterprise is reduced by twenty-five percent (which reduction subsumes a reduction of worth attributable to both parent and subsidiary corporations), see supra note 5, thus adding substantially to the "margin of error" for purposes of the constitutional assessment. See Container Corp., 463 U.S. at 184, 103 S. Ct. at 2950. Unisys's numbers proffered reflecting full factor representation also fail to take this adjustment into account.[27] Some additional latitude is also due in favor of the Commonwealth in Unisys's particular circumstance, since it maintains its headquarters in Pennsylvania, thereby demonstrating considerable Pennsylvania activity in the management and production of value. Accord Maxland Dev. Corp. v. Director of Revenue, 960 S.W.2d 503, 506 (Mo. 1998) ("Income arises partly from transactions in this state when the 'brains' -- that plan, design, and direct a specialized operation in other states -- are in Missouri." (citation omitted)).

While the inherent rationality of factor representation in apportionment cannot be disputed, neither can the need for a taxpayer, addressing a tax base that incorporates unitary aspects but is substantially hybridized and adjusted, to account for the methodology by which the tax base is calculated in establishing a baseline for purposes of external consistency assessment.

(…continued)
contribution to the apportionable tax base that tend to be overlooked in the broad endorsements of the principle of factor representation").

[27] Indeed, in tax years in which Unisys subsidiaries experienced negative average net income, the statutory adjustment and averaging process required as the means for computing capital stock value resulted in Unisys's pre-apportionment tax base being established at thirty-seven and one-half percent of net worth. (Seventy-five percent of net worth plus zero average net income divided by two equals thirty-seven and one-half percent of net worth).

We also consider the Pennsylvania franchise taxation provisions that incorporate fair apportionment principles relevant to the constitutional inquiry. See 72 P.S. §7401(3)2.(a)(18). Such provisions establish a statutory mechanism for equitable adjustment to the extent a taxpayer is able to demonstrate that the application of the tax is unconstitutionally (or perhaps otherwise) unfair, thus ameliorating due process concerns within the confines of the taxing scheme itself.[28] Further, regardless of whether statutory fair apportionment precepts sweep beyond the boundaries of constitutional fairness, we conclude that the General Assembly intended for it to be assessed, like external consistency, according to some meaningful reference point established by the taxpayer. Since we find that Unisys has failed to demonstrate the appropriateness of its proffered baseline figures, we also conclude that it has not demonstrated entitlement to relief under Section 401(3)2.(a)(18) of the Tax Code.[29]

---

[28] Accord S.M.Z. Corp. v. Director, Div. of Taxation, 473 A.2d 982, 990 (N.J. Super. 1984) (explaining, with respect to New Jersey's analog to Pennsylvania's statutory fair apportionment provisions, "[i]t is undeniably clear that our Legislature enacted Section 8 to serve as a 'safety valve' in cases where the 'allocation factor' determined under Section 6 may produce an unconstitutional result"); cf. Moorman, 437 U.S. at 275, 98 S. Ct. at 2345 ("The Iowa statute afforded appellant the opportunity to demonstrate that the single-factor formula produced an arbitrary result[;] [b]ut the record contains no such showing and therefore the [d]irector's assessment is not subject to challenge under the Due Process Clause.").

[29] Mr. Justice Nigro faults the above reasoning for allegedly shifting to the taxpayer the burden to prove the unconstitutionality of the present taxing scheme by comparison with demonstrably reasonable baseline figures for the tax base. See Dissenting Opinion, slip op. at 13 (Nigro, J.). As noted even by the dissent, however, the burden has always been on the taxpayer to demonstrate unconstitutionality by "clear and cogent evidence." See id. at 5. In this regard, we are merely following the U.S. Supreme Court's lead in requiring, as a practical measure, that the taxpayer present the court with a valid and meaningful set of reference calculations against which to measure the alleged distortionate effects of the challenged taxing statute, once it is determined that the apportionment formula passes the internal consistency test. Compare Container Corp., 463 U.S. at 181, 103 S. Ct. at 2948 (rejecting a claim of alleged unconstitutional (continued…)

In summary, Pennsylvania's scheme for taxation of foreign business franchises may be less than ideal and, absent statutory fairness adjustment, unconstitutional in some applications. Nevertheless, a taxpayer alleging Commerce and Due Process Clause violations bears a substantial burden to demonstrate by clear and cogent evidence that the state is taxing income earned outside its jurisdiction. See Container Corp., 463 U.S. at 169-70, 103 S. Ct. at 2942-43. Here, Unisys has presented baseline figures predicated solely upon full factor representation of subsidiaries, while failing to establish an adequate correlation between the hybrid, adjusted tax base ascribed to it and factor representation on such terms. Pursuant to the standards crafted by the United States Supreme Court, we conclude, therefore, that Unisys has failed to carry its heavy burden.[30] For much the same reasons, we reach the same result on consideration of the statutory fair apportionment provisions.

(…continued)
distortion where the taxpayer's baseline figures were founded upon an accounting method suffering from "basic theoretical weaknesses") and Moorman, 437 U.S. at 272, 276, 98 S. Ct. at 2344, 2346 (denying relief in part because taxpayer failed to proffer figures representing the actual profitability of in-state sales subject to the challenged tax) with Hans Rees', 283 U.S. at 134-36, 51 S. Ct. at 389 (providing relief where, although the apportioning methodology was facially sound, the taxpayer adduced convincing reference figures indicating that its income attributable to in-state activities was well below that yielded by the taxing formula) and Norfolk & W. Ry., 390 U.S. at 328, 88 S. Ct. at 1002 (same).

[30] Other courts have reached similar conclusions predicated upon the adequacy of the taxpayers' presentations. For example, one court framed the conclusion as follows:

> [W]e are unable to determine [from the record], in any meaningful way, the extent to which a reasonably structured formula . . . might differ in its results from a formula which excludes that portion of the foreign subsidiary property, payroll, and sales which generated the dividend income. As a further consequence, we cannot tell whether

(continued…)

Accordingly, we reverse the Commonwealth Court's order and remand for reinstatement of the settlements as approved by the Board. Jurisdiction is relinquished.

Mr. Justice Nigro files a dissenting opinion.

Madame Justice Newman files a dissenting opinion in which Mr. Justice Castille joins.

(…continued)

> disproportionality [a grossly distorted result] of constitutional proportions is present here.

NCR Corp., 402 S.E.2d at 674 (quoting NCR Corp., 544 A.2d at 781).