Recent Developments in State Taxation

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I. Increasing Importance of State and Local Taxes

A. Increasing State Tax Burden

1. With increasing cutbacks at the federal level and the cost of more programs being mandated to local government, the revenue needs of state and local governments are increasing rapidly. State tax revenues increased $15 billion in fiscal 1992, the largest state tax increase ever, and a total of $24 billion in the last two years. Coopers & Lybrand, State and Local Taxes: The Burden Grows (1992) (Report on C&L's 1992 Business Survey: citing the National Governors Association and the Association of State Budget Officers).

2. State and local tax issues are often the "deal breaker" when federal tax issues are closely negotiated. Even in relatively low tax states in the Southeast, the aggregation of income taxes, sales and use taxes, license taxes, recordation and other privilege taxes can represent a swing of 13% or more in the total value of a deal.

3. State and local tax collectors are becoming increasingly aggressive. Audits are more frequent. Audit positions are more aggressive.

B. Active Supreme Court Term

1. The United States Supreme Court's 1991--92 Term was one of the most active in recent years in terms of state and local taxes. For one of the first times in modern history, state tax developments may have overshadowed developments at the federal level.

2. In the month before this outline was prepared, the United States Supreme Court handed down six major state tax decisions. Not only do these cases decide important particular issues, the Court's
analysis provides important insights into the resolution of on-going issues, particularly in the income tax area.

II. Background: The Judicial Revolution

A. Formalism in Taxing Interstate Commerce

1. Prior to 1977, the case law concerning taxation of interstate commerce was confusing, at best. The Court's "negative" or "dormant" Commerce Clause analysis had evolved substantially over 200 years from a complete prohibition against taxing interstate commerce in any form, to permitting "indirect" but not "direct" taxes on interstate commerce, to an analysis of whether taxes imposed "multiple tax burdens." See Quill Corporation v. North Dakota, 112 S. Ct. 1904, 60 U.S.L.W. 4423 (1992) (summarizing history of Court's analysis under both Due Process and Commerce Clauses).

2. The Court focused on whether a tax was on the "privilege" of doing interstate business; the result often turned on how a tax was named and not on its economic effects. "Magic words or labels" were critical. Railway Express Agency, Inc. v. Virginia, 358 U.S. 434, 441 (1959).

B. Interstate Commerce: Complete Auto Transit, Inc. v. Brady

1. The Court retreated from a formalistic analysis of interstate commerce tax issues in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). There, the taxpayer was engaged in the purely interstate business of transporting motor vehicles from out-of-state manufacturers to dealers in Mississippi. A similar tax had been held unconstitutional in Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951) because it was imposed on "the privilege of doing interstate business."

2. In upholding Mississippi's fairly apportioned tax on this interstate transportation business, the Court announced its now famous four part test. A tax will be sustained against Commerce Clause challenge so long as:

[T]he tax [1] is applied to an activity with a substantial nexus with the taxing
State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State. 430 U.S. at 279. This test substitutes a more pragmatic, substantive approach for the formalistic standards previously applied by the Court. Spector was overruled. 430 U.S. at 282.

C. Foreign Commerce: Japan Line v. County of Los Angeles

1. Two years after Complete Auto, the United States Supreme Court announced a similar analysis under the Foreign Commerce Clause. In Japan Line, Limited v. County of Los Angeles, 441 U.S. 434 (1979), the Court considered the constitutionality of a fairly apportioned property tax on foreign owned container vessels used exclusively in foreign commerce.

2. In Japan Line the Court held that "[w]hen construing Congress' power to 'regulate commerce with foreign Nations,' a more extensive constitutional inquiry is required." 441 U.S. at 446. To the four tests announced in Complete Auto for analyzing issues under the Commerce Clause, the Court added two new considerations for Foreign Commerce Clause cases:

In addition to answering the nexus, apportionment and nondiscrimination questions posed in Complete Auto, a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." 441 U.S. at 451 (italics supplied). Although Los Angeles' apportioned property tax passed muster under Commerce Clause analysis, it fell short under the Foreign Commerce Clause because the cargo containers were subject to multiple international taxation under various treaties between Japan and the United States.
III. Nexus to Tax: Who Must Pay

A. Sales and Use Taxes: Quill Corp. v. North Dakota

1. Most states' sales and use tax laws follow a similar pattern. Retail transactions are subjected to a "sales tax" which the retail merchant is required to collect and remit to the state. To prevent circumvention of the tax, there is a "compensating use tax" generally applicable whenever the sales tax is not imposed. Except for large businesses, use tax audits are not a practical enforcement tool. Thus, collection of this major revenue source is heavily dependent upon cooperation of the retail merchant, the state's tax collection agent.

2. Supreme Court decisions generally required some sort of physical presence in the taxing state before the retail merchant could be required to act as the state's collection agent.
   b. National Bellas Hess, Inc. v. Department of Revenue of Illinois, 386 U.S. 753 (1967), overturning state's attempt to require mail-order house to collect use tax on goods purchased by customers in-state. Mail-order house had no stores or sales representatives in the taxing state. A "seller whose only connection with customers in the State is by common carrier or the United States mail" cannot be required to collect the state's tax under both the Commerce Clause and Due Process Clause. Id. at 758.
   d. D.H. Holmes Co. Ltd. v. McNamara, 486 U.S. 24 (1988), upholding Louisiana use tax on value of catalogues distributed by mail to customers in state where retailer had numerous stores, employees, etc. in Louisiana.
3. With the more pragmatic, substantive approach signaled by Complete Auto, states saw the opportunity to eliminate the ever expanding mail order "loophole." Anticipating reversal of the "no physical presence" test in Bellas Hess, many state statutes were expanded to increase tax collection responsibilities for out-of-state sellers. For example:

   a. Virginia Code § 58.1-613 was amended to treat the following activities as creating taxable nexus:
      (i) Advertise through materials distributed in Virginia other than by U.S. mail.
      (ii) Solicit business systematically in Virginia by advertising broadcast or relayed from a transmitter located in Virginia.
      (iii) Solicit business through mail with the benefit of any banking, financing, or marketing activities in Virginia (e.g., credit cards).

   b. Georgia Code Annotated § 48-8-2(H) was amended to include with the term "Dealer" responsible for collecting the sales tax, one who:
      (H) Solicits business by representatives or engages in the regular or systematic solicitation of a consumer market in this state by the distribution of catalogs, periodicals, advertising fliers, or other advertising, or by means of print, radio, or television media, by telegraphy, telephone, computer data base, cable optic, microwave or other communication system.

4. This particular constitutional issue made for peculiar bedfellows. On the one hand, the mail-order industry fought hard to preserve its competitive advantage and to avoid what it perceived as the nightmare of attempting to collect sales and use taxes in thousands of separate jurisdictions throughout the United States. It was often joined, for example, by small manufacturing and other businesses selling by catalogue or otherwise through interstate deliveries. Frequently aligned with the states were national retailers and established local businesses who were losing sales to the "tax free" mail-order industry. The cases were divided:
a. SFA Folio Collections, Inc. v. Bannon, 585 A.2d 666 (Conn. 1991) (mail-order subsidiary of Saks Fifth Avenue could not be required to collect Connecticut's tax even though affiliated corporations were doing business in state).

b. Bloomingdale's By Mail, Ltd. v. Huddleston, Tenn. Chanc. Ct. (March 8, 1991), assessments against mail order business upheld, citing changes in nature of business since Bellas Hess, advent of computers to ease collection efforts, and trash disposal burdens on government from catalogs.

c. North Dakota v. Quill Corporation, 470 N.W.2d 203 (N.D. 1991), citing "wholesale changes" in the economy and the law since the U.S. Supreme Court decision in Bellas Hess, 470 N.W.2d at 213, mail-order catalogue business, which was sixth largest vendor of office supplies in North Dakota, required to collect a use tax from its customers.

5. The longstanding dispute was finally resolved by the U.S. Supreme Court in Quill Corporation v. North Dakota, 112 S. Ct. 1904, 60 U.S.L.W. 4423 (1992). Quill sold office equipment and supplies to over 3,000 customers in North Dakota. It solicited business through catalogues, flyers, advertisements in national periodicals and direct telephone solicitation. It had annual sales of approximately $1 million in that state. Although all merchandise was delivered to North Dakota customers by mail or common carrier from out of state, the North Dakota statute had been amended in 1987 to define a "retailer" responsible for collecting the tax as "every person who engages in the regular or systematic solicitation of a consumer market in this state." Relying on "changes in the legal landscape" since Complete Auto the North Dakota Supreme Court concluded that National Bellas Hess was no longer binding precedent and affirmed the validity of its tax on the mail-order merchant. 470 N.W.2d 203 (1991).

a. The United States Supreme Court agreed with the North Dakota Supreme Court's analysis of the case under the Due Process Clause. It held that there was no question that Quill's purposeful direction of marketing activities in North Dakota was sufficient under the Court's modern case authority to satisfy due process considerations of "fair play and
substantial justice." 112 S. Ct. at 1910, 1911, 60 U.S.L.W. at 4425.

b. The United States Supreme Court reversed the North Dakota Court based on the Commerce Clause. Contrasting the purposes of the two constitutional provisions, the Supreme Court held that the Commerce Clause was concerned with "structural concerns about the effects of state regulation on the national economy." 112 S. Ct. at 1919, 60 U.S.L.W. at 4426. Thus, the Court explained that the "substantial nexus" requirement of Complete Auto is "a means for limiting state burdens on interstate commerce." Id. It further held that the "physical presence" test of Bellas Hess provided a "bright-line" test from which it did not wish to retreat. 112 S. Ct. at 1914. The artificiality of that test "is more than offset by the benefits of a clear rule." 112 S. Ct. at 1915.

c. There are two important keys to the Supreme Court's opinion. First, the Court noted that its decision, grounded on the Commerce Clause, could be overruled by Congressional legislation while a decision grounded on the Due Process Clause could not be. Thus, the Court seems convinced that a national legislative solution makes the most sense. Second, as the opinion filed by the three concurring justices makes clear, this Court finds increasingly important the principal of stare decisis as a way to protect legitimate reliance interest of government and business.

We have recently told lower courts that "[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions" ... It is strangely incompatible with this to demand that private parties anticipate our overrulings. 112 S. Ct. at 1924, 60 U.S.L.W. at 4432 (citations omitted). In short, the concurring opinion takes an interesting shot at state legislatures' rush to amend their
6. Because of the very broad nexus provisions in many states' sales and use tax laws, especially the recently expanded ones, the Supreme Court's holding in Quill has a significant practical effect on day to day practice. The basic rule, reaffirmed in Quill, is that the seller must have some physical presence in the taxing state for that state to be able to require the seller to collect its sales and use tax. Even if all goods are shipped from out of state, nexus for sales and use tax purposes might be established, for example, by an office, salesmen visiting the state, or company trucks making regular deliveries in the state. Depending upon local practice and interpretation, nexus might also be established by participation in a local trade show.


1. In Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), the Supreme Court upheld an apportioned tax on an Iowa corporation's net income where the taxpayer's activities in the state consisted of the solicitation of orders, which were filled and delivered from its plant in Iowa, and related activities (leased sales office). That holding, which permitted taxation based on what industry considered to be a minimal physical presence, led to the enactment of Public Law 86-272 (1959), codified as 15 U.S.C. § 381. The statute provides, in pertinent part:

   (a) No State, or political subdivision thereof, shall have power to impose ... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

   (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are
filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customers to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

2. The statutory protection generally applies only in these situations:
   a. Net income taxes. It does not apply, for example, to taxes measured by gross receipts.
   b. Sales of tangible personal property. The statute does not apply, for example, to sales of services.
   c. Local activities must be limited to the solicitation of orders which are approved or rejected outside the taxing state.
   d. The orders must be filled by shipment or delivery from outside the taxing state.

3. Wisconsin Dept. of Rev. v. William Wrigley, Jr., Co., 112 S. Ct. 2447, 60 U.S.L.W. 4622 (1992). Wrigley had an extensive sales force operating in Wisconsin, but it had no offices there. Its salesmen and district manager typically operated out of their homes or occasionally had meetings in hotels or motels. Each salesman was provided with a company car, about $1,000 worth of gum, a supply of display racks and promotional materials. In addition to soliciting orders which were filled by shipments from out of state, salesmen provided free display racks to customers, occasionally sold and delivered gum to be displayed in these racks, and replaced stale gum at no cost to retailers. In this factual context, the Supreme Court considered two questions which it felt had been a source of confusion in interpreting Public Law 86-272:

   The primary sources of confusion, in this case as in others, have been two questions: (1) what is the scope of the crucial term "solicitation of orders"; and (2) whether there is a de minimis exception to the activity (beyond
"solicitation of orders") that forfeits § 381 immunity.
112 S. Ct. at _____, 60 U.S.L.W. at 4624.

4. The Supreme Court analyzed the term "solicitation" as follows:
   a. The term includes not only "explicit verbal requests for orders, but also any speech or conduct that implicitly invites an order." 112 S. Ct. at _____, 60 U.S.L.W. at 4624. It also covers activities that neither explicitly nor implicitly propose a sale.
   b. The Court rejected the state's position to construe "solicitation" narrowly to include only acts "essential" to requesting an order. Id.
   c. The Supreme Court also rejected Wrigley's position that "solicitation" should include any "ordinary and necessary 'business activities' accompanying the solicitation process" or other activities that are "routinely associated with deploying a sales force". 112 S. Ct. at _____, 60 U.S.L.W. at 4625.
   d. Rejected the state's argument that all "post sale" activities be excluded from "solicitation." This hard line position appeared unworkable in the context of a continuing relationship involving regular sales.
   e. The test adopted by the Court turns on whether activities serve an independent business function apart from the solicitation of orders.

"[T]he next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in any way but chooses to allocate to its in-state sales force."
112 S. Ct. at _____, 60 U.S.L.W. at 4626.

5. The Supreme Court confirmed that there is a de minimis exception applicable under Public Law 86-
272. The test is whether the additional connection is "trivial": Accordingly, whether in-state activity other than "solicitation of orders" is sufficiently de minimis to avoid loss of the tax immunity conferred by § 381 depends upon whether that activity establishes a non-trivial additional connection with the taxing State. 112 S. Ct. at ____, 60 U.S.L.W. at 4627.

6. Perhaps the most helpful part of the Supreme Court's opinion is its identification of particular activities that do and do not result in loss of tax immunity under the statute.
   a. According to a majority of the Court, the following activities were not "ancillary" to the solicitation of orders by Wrigley and therefore were not protected under the statute:
      i. Replacement of stale gum, an activity that serves a business purpose independent of soliciting new orders.
      ii. Supplying gum, for a fee, to be used in display cases. The fact that the gum was sold showed that there was a purpose for providing it to customers independent from soliciting new orders.
      iii. Storing in Wisconsin the gum that was used to "swap" for stale gum and sell for display racks.
      iv. Employing salesmen to repair or service the company's products.
   b. The Court expressly noted that the following activities by Wrigley were protected under the statute:
      i. Recruiting, training and evaluating sales representatives.
      ii. Using hotels and homes for sales related meetings.
      iii. Resolving credit disputes between customers and the "home office."
      iv. Providing cars to sales personnel.
      v. Driving within the state and spending nights in hotel rooms.
      vi. Displaying product samples.
   c. The Court makes clear that maintaining an office in state, without more, will subject the taxpayer to income taxation:
      Even if engaged in exclusively to facilitate requests or purchases,
the maintenance of an office within the State, by the company or on its behalf, would go beyond the "solicitation of orders." We would not make any more generalized exception to our immunity standard on the basis of the "office" provision. It seemingly represents a judgment that a company office within a State is such a significant manifestation of company "presence" that, absent a specific exemption, income taxation should always be allowed.

112 S. Ct. at ___, 60 U.S.L.W. at 4626. Note, however, that this per se rule does not apply if the office is maintained by independent contractors. See 15 U.S.C. § 381(c).

7. The Court's conclusion that Wrigley's activities did not come within the de minimis exception to the statute makes questionable the viability of this argument in future cases. The amount of gum provided by Wrigley salesmen amounted to only 0.00007% of its sales in Wisconsin. However, the Court, declined to view any of these non-immune activities in isolation. Instead, viewing them in toto, it concluded that they were not a "non-trivial additional connection with the state."

112 S. Ct. at ___, 60 U.S.L.W. at 4628. We need not decide whether any of the non-immune activities were de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constitute a non-trivial additional connection with the State.

112 S. Ct. at ___, 60 U.S.L.W. at 4628.
8. Although less than the complete victory sought by industry, the Supreme Court's decision in Wrigley should put an end to the narrow interpretation of Public Law 86-272 applied by many states. In addition, it establishes a number of bright lines as to what a taxpayer should and should not do if it wishes to take advantage of the statutory immunity. Definite "do not dos" are: maintain an office or store goods in the taxing state or provide follow-up "repair and servicing" to customers.

IV. Apportionment of Unitary Business Income

A. Formulary Apportionment

1. There are two ways commonly used to determine the amount of income earned in a particular state: "transactional" or "geographical" accounting and "formulary apportionment."

   a. Under the transactional accounting method, income and expenses are determined based on geographic origin, with arm's-length pricing standards used to adjust for intercompany transactions. Although the apparent accounting standard of business and industry, tax collectors see this system as subject to abuse.

One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or inadequately captures the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.


[T]he Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.

Butler Bros. v. McColgan, 315 U.S.
at 508-509. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source." Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 438 (1988).

b. Because of the uncertainties inherent in geographical accounting, particularly when dealing with complex multi-state and international corporate structures, most states utilize so-called "formulary apportionment" under which the total income of the corporate entity is apportioned among the states where it does business based on a formula. The most common formula uses three factors derived from property, payroll and sales. See Uniform Division of Income for Tax Purposes Act, 7A U.L.A. 331 (1985).

2. Formulary apportionment rests on the premise that all the various elements of a "unitary business" contribute to the profits of the whole. In simplest terms, whether there is a unitary business depends upon an analysis of three "factors of profitability":
   a. Functional integration.
   b. Centralized management.
   c. Economies of scale.

3. The key to formulary apportionment, the unitary business concept is found in a number of different contexts:
   a. Treating the separate, unitary divisions of a single corporation as an entity for purposes of determining income subject to taxation by apportionment. E.g., Commonwealth of Virginia v. Lucky Stores, 225 S.E.2d 870 (Va. 1976).
   b. Taxing members of an affiliated group of unitary corporations in a single, combined return. E.g., Container Corp. of America v.


4. Among the states that require unitary affiliates to file a "combined" return, there are two different approaches: "world-wide combination" and the "waters edge" approach. Under "world-wide combination" the state determines taxable income based on formulary apportionment as applied to the world-wide income of all members of the corporate group engaged in a unitary business. The "waters edge" excludes from the combined return foreign corporations that are members of the corporate group but that do no business in the United States. Because of the extraordinary accounting and compliance burdens world-wide combination places on businesses, this form of taxation has been particularly controversial.

a. California's world-wide combination approach was approved in Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) when applied to a group the parent of which was a domestic corporation. In finding the requisite "unitary business," the United States Supreme Court noted the deference generally paid to state courts' determinations, and that the burden of disproving the existence of a unitary relationship is on the taxpayer. 463 U.S. at 175. The court also adopted an analysis focusing on the "flow of value" between members of a multicorporate group to determine the existence of a unitary business. 463 U.S. at 178.

b. Following the decision in Container Corp., the open question was whether the Foreign Commerce Clause would produce a different result in the case of a corporate group the parent of which was not a U.S. corporation.

i. In Franchise Tax Board v. Alcan Aluminum, Limited, 493 U.S. 331 (1990), rehearing denied, 494 U.S. 1012 (1990), the United States Supreme Court struck down the attempt of a foreign corporation whose domestic subsidiary
did business in California to challenge that state's world-wide combination methodology in federal court. As a general proposition, the "Tax Injunction Act", 28 U.S.C. § 1341, generally bars resolution of state tax issues in federal court so long as there is an adequate state remedy available. Such cases also raise questions of "comity" and federal state relations.


iii. For an interesting discussion of world-wide unitary taxation, see Hellerstein, Are Days of World-Wide Unitary Taxation by States Limited?, 72 J.Tax 172 (March 1990). Notwithstanding the recent litigation reverses of taxpayers in California courts, Professor Hellerstein notes in his article:

   Indeed, the real war over world-wide unitary combination, whether involving domestic or foreign parents, was effectively waged and won by the multi-nationals in state legislatures across the country following the CONTAINER decision. Between 1983 and 1989, Arizona, California, Colorado, Florida, Idaho, Indiana, Montana, New Hampshire, North Dakota, Oregon, and Utah endorsed a waters edge approach to the unitary business principle, and only Alaska apparently still adheres to a policy of world-wide unitary combination.

72, J. Tax at 176.
V. Limits on Apportionability: The Discrete Business Enterprise

A. Unitary Business -- The Linchpin of Apportionability

1. Where the unitary business concept has provided the basis for taxation by formulary apportionment and combined returns, it has also provided a limitation on states' taxing powers. In upholding Vermont's apportioned tax on income including dividends from foreign unitary subsidiaries, the Supreme Court made the now famous statement "the linchpin of apportionability in the field of state income taxation is the unitary business principle." Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 439 (1980). Focusing, however, on the requirement of the Due Process Clause that there be a "minimal connection" between the interstate activities and the taxing state, the Court went on to state:

Where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability, because there would be no underlying unitary business.

445 U.S. at 442. The issue is whether the income derive[s] from "unrelated business activity" id. at 442, which constitutes a "discrete business enterprise." Id. at 439. See also, Exxon Corp. v. Wisconsin Dept. of Rev., 447 U.S. 209, 224 (1980) (Exxon's marketing and other departments part of unitary business and not "discrete business enterprises"). The form of investment (e.g., corporation, division, partnership) or form of income is not controlling. Id. at 440-41.

One must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability.

Id. at 440.

B. ASARCO

1. Following through with its warnings in Mobil Oil, the Supreme Court overturned Idaho's attempt to include in ASARCO's apportionable income certain dividend, interest and capital gain income it received from investments in five foreign
corporations. ASARCO, Inc. v. Idaho State Tax Comm'n, 459 U.S. 961 (1982). Although Asarco and the five corporations were all engaged in various aspects of the same industry (mining), the Court concluded that they were not engaged in a unitary business because various agreements limited ASARCO's control over the "affiliates" and required transactions to be conducted on an arm's length standard. Since there was no unitary relationship, the court concluded that the five investments were "discrete business enterprises" within the meaning of Mobil Oil and Exxon.

2. Notwithstanding a strong dissenting opinion by Justice O'Connor, a majority of the Court, speaking through Justice Powell, rejected Idaho's position that income from intangibles was unitary if the intangibles contribute to or relate in any way to furtherance of the taxpayer's trade or business. According to Justice Powell, such a reading of the unitary business principle would destroy the concept.

This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently all of its operations, including any investments made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business" when pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. 458 U.S. at 326.

3. Following the Supreme Court's decision in ASARCO, state courts reached conflicting results as taxing authorities tried to avoid imposing the unitary business concept as a limit on full apportionability.

a. ASARCO was applied literally in the following cases:
   i. James v. Int'l Tel. & Tel. Corp., 654 S.W.2d 865 (Mo. 1983).
   iii. Corning Glass Works v. Virginia Department of Taxation, 402 S.E.2d 35
(1991). Because Corning Glass Works was prohibited by terms of antitrust consent decree from exercising any control over or influencing management of its 50% investment in Owens Corning Fiberglass, there was no unitary relationship between payor and payee. Accordingly, state's attempt to tax a portion of the capital gain recognized upon sale of stock in subsidiary invalid.

b. ASARCO was distinguished in the following cases:


ii. Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983). Short-term loans to parent corporation, with principal and interest used to meet short-term business needs.

iii. Silent Hoist & Crane Co., Inc. v. Director, Div. of Taxation, 494 A.2d 775 (N.J. 1985), cert. denied, 474 U.S. 995 (1985). Single corporation operating in divisions had income from manufacturing and from investments. Fact that there was one chief executive officer who directed all company activities, one set of accounting records and one bank account showed unitary nature of business.

iv. Comptroller v. Armco, Inc., 521 A.2d 785 (Md. App. 1987). Reasoning that ASARCO must be limited to its precise facts, court determined that taxation can be supported if income is earned as part of the unitary business of the payee conducted in-state. Case returned to Tax Court to determine if interest received was unrelated to Armco's Maryland business operations.

v. Comptroller v. NCR Corp., 524 A.2d 93 (Md. App. 1987). Surplus funds invested in short-term investments issued by nonunitary payers. Following Armco, income held to be taxable by apportionment since income derived from unitary business operations and were
available to support unitary business operations in Maryland.

4. Various commentators found a literal application of the requirement that there be a unitary relationship between the payor and payee to be unworkable in certain situations. For example:
   a. When the payee corporation is, for example, an investment firm whose income derives from its investments in other corporations. Cf. Corn Products Refining Co. v. Commissioner, 350 U.S. 46 (1955).
   b. Interest received from bank accounts or other investments providing short-term operating capital for the business.

C. ASARCO Means What It Says: Allied-Signal Inc. v. Director

1. The dispute as to the meaning of ASARCO was resolved in Allied-Signal, Inc. v. Director, Div. of Taxation, 112 S. Ct. 2251, 60 U.S.L.W. 4554 (June 15, 1992). Bendix Corporation, the predecessor in interest to Allied-Signal, held 20.6% of the stock in ASARCO. Bendix was engaged primarily in manufacturing while ASARCO was a mining company. When Bendix sold its stock back to ASARCO, New Jersey asserted its right to tax, by full apportionment, part of the $211.5 million gain recognized by Bendix. The parties, however, had stipulated as follows in the trial court:
   a. Bendix and ASARCO were unrelated business enterprises each of whose activities had nothing to do with the other. 112 S. Ct. at 2256, 60 U.S.L.W. at 4555.
   b. None of the business activities of ASARCO were involved with those of Bendix, and none of the business activities of Bendix were involved with those of ASARCO. Id.
   c. None of the many factors traditionally related to a "unitary business" existed. For example, Bendix and ASARCO had no common management, did not lend money to each other, did not lend employees to each other, and did not sell product to each other. 112 S. Ct. at 2256-57.

2. The New Jersey Supreme Court had affirmed the taxation of the gain recognized by Bendix by focusing on the use to which Bendix put those funds. Bendix Corp. v. Director, Div. of
Taxation, 592 A.2d 536 (N.J. 1991). It noted that Bendix had a long time company policy of corporate acquisitions and divestitures. It further noted that the proceeds from the sale of ASARCO stock were intended to be used in an unsuccessful bid to acquire another member of the aerospace industry whose activity would likely have been unitary with those of Bendix' aerospace/electronics businesses. 112 S. Ct. at 2257, 60 U.S.L.W. at 4556.

3. After requesting the parties to brief specially various questions, including whether the unitary business theory remained an appropriate device for determining whether a state "has transgressed its constitutional limitations", the United States Supreme Court reaffirmed its previous decision in ASARCO. Justice Kennedy stated:

   New Jersey's basic theory is that multi-state corporations like Bendix regard all their holdings as pools of assets, used for maximum long-term profitability, and that any distinction between operational and investment assets is artificial. We may assume, arguendo, that the managers of Bendix cared most about the profits entry on a financial statement, but that state of mind sheds little light on the question whether in pursuing maximum profits they treated particular intangible assets as serving, on the one hand, an investment function, or, on the other, an operational function.... That is the relevant unitary business inquiry, one which focuses on the objective characteristics of the asset's use and its relation to the taxpayer and the activities within the taxing state.

112 S. Ct. at 2261-62, 60 U.S.L.W. at 4558. The Court rejected the reading of ASARCO that one must show a unitary relationship between payor and payee as a prerequisite to taxation by apportionment. The test offered by Justice Kennedy was summarized, a second time, as follows:

   What is required instead is that the capital transaction serve an operational rather than an investment function.

112 S. Ct. at 2263, 60 U.S.L.W. at 4558.

4. Under the Court's opinion, the following situations will support taxation by apportionment:
a. A unitary relationship between payee and payor "is one justification for apportionment, but not the only one." Id.
b. Interest earned on short-term deposits if that income forms part of the working capital of the unitary business.
c. Although not addressed in the Court's opinion, investments which provide the payee corporation a source of supply or other market advantages would seemingly satisfy Justice Kennedy's test of serving an "operational rather than an investment function."

5. Based on the stipulation of the parties, the Supreme Court held that New Jersey had illegally subjected to tax the capital gain recognized by Bendix upon its sale of ASARCO stock. Based on the stipulations, there was no unitary relationship between Bendix and ASARCO. Moreover, there was nothing in the facts to suggest that Bendix' investment was analogous to short-term working capital. The fact that the investment served a business function, such as making a profit, was irrelevant. Moreover, the intended use of the proceeds from the sale of stock provided no relevant indication that the stock served an operational function and not an investment one.

6. Note that the ASARCO and Allied Signal principle applies to virtually any type of investment income: dividends, interest, capital gains, and royalties. Even in a UDITPA state, the classification of any of these items as "business income" does not necessarily satisfy the Due Process concerns. That argument was rejected both in ASARCO and Allied Signal. Thus, the two-part analysis indicated in Justice Kennedy's opinion should be applied to any type of investment income to determine taxability by a corporation's nondomiciliary state. That two-part test is:

a. Is there a unitary relationship between the payor and payee corporations?
b. Even if there is not a unitary relationship, does the investment serve an operational function?
VI. Fair Apportionment and Factor Relief

A. The Tests of Fair Apportionment

1. There are two tests to determine whether a state's apportionment formula is constitutionally fair. See Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 169 (1983).

   a. The first test is the "internal consistency" test.
      "[T]he formula must be such that, is applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed."  
      Id.

   b. The second test is the external consistency test. Under this test "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated."  
      Id.

B. Justice Stevens' Dissent in Mobil

1. To be ideally fair, an apportionment formula must reflect the income being taxed. For this obvious reason, formulas which apportion to a particular state a part of a corporation's income relate in-state activities (e.g., property, payroll and sales) to the corporation's total activities. Problems can arise when there is no such correlation.

2. Justice Stevens' dissent in Mobil provided a road map for fair apportionment litigation during the next decade. Although a majority of the Court affirmed Vermont's inclusion of dividends from foreign subsidiaries in Mobil's apportionable tax base, Justice Stevens' dissent notes that Vermont's apportionment formula did not make the correlative adjustments necessary to produce a fair result.

   But of greatest importance, the record contains no information about the payrolls, sales or property values of any of those corporations, and Vermont has made no attempt to incorporate them into the apportionment formula computations. Unless 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 apportionable tax base will inevitably cause Mobil's Vermont income to be overstated.

Either Mobil's world-wide "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. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 460-61 (J. Stevens, dissenting).

C. Fair Apportionment Cases

1. American Tel. & Tel. v. Wisconsin Dept. of Rev., 422 N.W.2d 629 (Wis. App. 1988). State's formula apportioned income from AT&T's subsidiaries based solely on factors of the entity doing business in Wisconsin. That entity's Wisconsin factors were much larger than the Wisconsin factors of the entire corporate group. The resulting tax failed the external consistency test. "[T]he taxes which Wisconsin exacts from AT&T are grossly disproportionate to the benefits conferred." Id. 422 N.W.2d at 636.

2. NCR Corporation, a manufacturer, conducts its business outside the United States through foreign branches and subsidiaries. It receives dividends, interest and royalties from these unitary subsidiaries. Although taxes are paid by the subsidiaries to foreign governments, many states include income from the subsidiaries in NCR's apportionable income without providing any correlative adjustments to the apportionment formula. There are three NCR "factor relief" cases:
   a. NCR Corp. v. Comptroller, 544 A.2d 764 (Md. 1988). With respect to dividends, the Maryland Court of Appeals determined that "NCR is correct in asserting that the formula, as applied to it, does not produce ideally fair results." 544 A.2d at 780. The case was remanded to Tax Court to determine if "the existing distortion is so grossly disproportionate that it is unconstitutional." Id. at 780.
b. **NCR Corp. v. Commissioner of Revenue**, 438 N.W.2d 86 (Minn. 1989). Minnesota's apportionment formula upheld on the grounds that the result was not so grossly disproportionate as to rise to level of constitutional significance.

c. **NCR Corp. v. South Carolina Tax Commn.**, 402 S.E.2d 666 (S.C. 1991). Following the Maryland Court of Appeals' analysis, the Supreme Court of South Carolina agreed that there were potential problems with the apportionment formula. The case was remanded to determine if the problems rose to a level of constitutional significance:

> [W]e remand this case to the lower court for a re-factoring of the formula, considering in the formula denominator the proportionate measure[s] ... of the foreign subsidiaries' property, payroll, and sales which generated the NCR income. Once this is done, the new tax amount should be figured and compared with the tax amount presently assessed against NCR by the Tax Commission. If the trial court finds there is a gross disparity between the two amounts of constitutional proportions, it shall order the new tax amount to be assessed and refund granted. If no gross distortion exists upon a comparison of the tax amounts, the original tax assessed against NCR shall stand and NCR shall not be entitled to any refund. 402 S.E.2d at 674.

3. **Tambrands, Inc. v. State Tax Assessor**, 595 A.2d 1039 (Me. 1991). Dividends received from foreign affiliates were included in apportionable income without making any correlative adjustment to the three factor apportionment formula. The Supreme Court of Maine held that the assessment was constitutionally flawed because it lacked internal consistency. If Maine was to include in Tambrands' apportionable tax base income from affiliates operating abroad, it could not apportion that income by factors reflecting only Tambrands' domestic operations. 595 A.2d at 1044. Case remanded to assessor "to include additional
factors in the apportionment formula that will 'fairly represent' Tambrands' business activity" in Maine. Id. at 1045.

VII. Discrimination Against Interstate Commerce

A. Discriminatory Taxes Prohibited

1. Under Complete Auto a tax will not survive Commerce Clause challenge if it discriminates against interstate commerce. The discrimination is invalid if it either provides a benefit to in-state business that is not provided to others or if it produces a burden on out-of-state business that is not borne by in-state businesses.

2. The following recent decisions illustrate this rule against discriminatory taxation of interstate commerce:
   a. Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977). New York law was struck down because it imposed a higher tax on transfers of stock occurring outside that state than on transfers involving sales within that state.
   b. Armco v. Hardesty, 467 U.S. 638 (1984). West Virginia's gross receipts tax on wholesale merchants was invalidated as applied to an Ohio manufacturer. West Virginia manufacturers, who paid a tax on manufacturing receipts, were exempt from the tax on wholesalers; but the same exemption was not available to the Ohio manufacturer. Actual proof of discriminatory impact was not required because, viewed together, the taxes on manufacturing and wholesaling failed the internal consistency test of Container Corp..
   c. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984). Hawaii's excise tax on wholesales of liquor held invalid because two locally produced products were exempted from the tax. Neither the twenty-first amendment nor legislative purpose to help a new, struggling industry could justify the illegal discrimination.
B. Kraft General Foods v. Iowa Department of Revenue

1. Kraft General Foods v. Iowa Dept. of Rev., 112 S. Ct. 2365, 60 U.S.L.W. 4582 (1992) reviewed discrimination resulting from the fact that Iowa's corporate income tax basically followed the federal definition of "net income". As a result, Iowa's definition of taxable income excluded dividends received from domestic subsidiaries but not dividends received from foreign subsidiaries. Unlike the federal tax laws, Iowa provided no credit for taxes paid to foreign countries.

2. The United States Supreme Court held that Iowa's taxing scheme violated the Foreign Commerce Clause, even though Iowa's tax in no way favored local commerce. Iowa's subsidiaries were not more favorably treated than subsidiaries located elsewhere. When dealing with foreign commerce, such local preference or benefit is not necessary. So here, we think that a State's preference for domestic commerce over foreign commerce is inconsistent with the Commerce Clause even if the State's own economy is not a direct beneficiary of the discrimination. As the absence of local benefit does not eliminate the international implications of the discrimination, it cannot exempt such discrimination from commerce clause prohibitions.

112 S. Ct. at ___, 60 U.S.L.W. at 4584-4585.

3. According to Ernst & Young, ten other states have laws which suffer the same defect as Iowa's taxing scheme:

Ten other states discriminate against foreign-source dividends in a manner similar to Iowa. New Mexico, Vermont, and Pennsylvania have enacted tax schemes identical to Iowa's. Colorado, Kansas, Maine, Missouri, Oklahoma, Rhode Island, and South Carolina have adopted similar schemes, but with modification. Alabama and the District of Columbia do not follow the federal scheme, but nevertheless discriminate against foreign-source dividends. Taxpayers in these states should consider filing refund claims.
C. Chemical Waste Management v. Hunt

1. In Chemical Waste Management v. Hunt, 112 S. Ct. 2009, 60 U.S.L.W. 4433 (1992), the United States Supreme Court dealt with one of the current hot political potatoes of state and local government -- the disposal of solid waste material, especially hazardous waste material. Alabama adopted a two-tier tax structure affecting operators of hazardous waste landfills. A "base fee" of $25.60 per ton applied to all hazardous waste, and an "additional fee" of $72 per ton applied to hazardous waste "generated outside of Alabama and disposed of ... in Alabama." 112 S. Ct. at 2012, 60 U.S.L.W. at 4434. The Alabama Supreme Court upheld the validity of this facially discriminatory fee arguing that it advanced legitimate local purposes relating to the health and safety of the state's citizens.

2. The United States Supreme Court reversed. A statute which produces "facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives." 112 S. Ct. at 2014. The flaw in the Alabama scheme was that the hazardous waste produced outside Alabama was no more dangerous than hazardous waste produced inside the state. Thus, the statute discriminated based solely on the interstate origin of the waste. Moreover, the United States Supreme Court found that there were less discriminatory alternatives to the State such as a higher per ton fee applicable to all hazardous waste material or a per-mile tax on vehicles transporting hazardous waste materials across Alabama roads. So viewed, the Court found the additional fee to be "'an obvious effort to settle those outside the state' with most of the burden of slowing the flow of waste into the [Alabama] facility." 112 S. Ct. at 2016.

3. The Court did not consider arguments that the "additional fee" makes out-of-state generators pay their "fair share" of costs incurred by the state or that the additional fee was justified as a "compensatory tax." 112 S. Ct. at 2016, n. 9.
D. Florida's Intangibles Tax

1. The United States Supreme Court, without opinion, has let stand the decision of the Florida District Court of Appeal upholding the validity of that state's intangibles tax against challenges under the Commerce Clause. See Ford Motor Credit Company v. Department of Rev., 111 S. Ct. 2049 (1991). There was no opinion of the United States Supreme Court. Its order indicates that the judgment below was "affirmed by an equally divided Court." Justice O'Connor took no part in the decision.

2. Ford Motor Credit Company (FMCC) attacked the Florida intangibles tax arguing that it failed the internal consistency test of Container Corp.. The Florida statute treats as taxable any intangibles either (i) "arising out of, or issued in connection with, the sale, leasing or servicing of real or personal property in the state" or (ii) intangibles owned by a domiciliary corporation. If all states apply this dual nexus standard, then FMCC and other interstate businesses will be subject to double taxation: once in the states where its loans originate and once in the state of its corporate domicile. The Florida Court of Appeal, however, held that the internal consistency test had been applied by the United States Supreme Court only in income and franchise tax cases and never in a property tax case. It also held that the Florida taxing scheme did not discriminate against interstate commerce by affording an undue advantage to local business. Ford Motor Credit Co. v. Department of Rev., 537 So.2d 1011 (Fla. App. 1 Dist. 1988).

VIII. Cost Based Property Taxes

A. Allegheny Pittsburgh Coal Co. v. Webster County

1. For more than ten years, one West Virginia locality valued property based on "the declared consideration at which the property last sold." 488 U.S. at 338. Only minor adjustments to this value were made in subsequent years. Under this system, owners of newly acquired property were assessed at substantially higher values than were owners of substantially identical properties which had not transferred recently. The plaintiff coal companies were assessed at 8 - 35 times higher
than comparable properties in the county. The Supreme Court of Appeals of West Virginia held that the assessor's actions did not constitute "intentional and systematic" discrimination and, even if they did, the plaintiffs' remedy was to have the values of other property owners increased. 488 U.S. at 342.

2. The United States Supreme Court reversed, holding that the assessments on the coal companies' property violated the Equal Protection Clause of the Fourteenth Amendment which protects individuals from being subjected to taxes not imposed on others in the same class. Allegheny Pittsburgh Coal Co. v. Webster County, 488 U.S. 336 (1989). The assessments in question could not be defended on a rational classification basis because the West Virginia Constitution requires all taxes to be uniformly assessed at fair market value. Thus, no classification argument was available to the assessor as a matter of state law.

B. Proposition 13

1. The holding in Allegheny Pittsburgh Coal immediately drew into question the validity of the property taxing system employed following California's adoption of Proposition 13. Nordlinger v. Hahn, 112 S. Ct. 2326, 60 U.S.L.W. 4563 (1992). Under that system, property is appraised at its "full cash value," defined as its assessed value in 1975 or its value in any year thereafter when the real property is purchased, newly constructed, or has a change in ownership. Annual increases in value over the "full cash value" are limited to the lesser of inflation or two percent. The California Court of Appeals upheld the validity of the "acquisition value" system imposed by Proposition 13 arguing that it was supported by at least two rational bases. Nordlinger v. Lynch, 275 Cal. Rptr. 684, 691-692 (1990).

2. The United States Supreme Court affirmed, upholding the validity of California's acquisition value assessment system. Unlike West Virginia, the California Constitution does not require uniform assessments based on current market values. This fact opened the way for the taxing authorities to assert that there were legitimate
state interests supporting its assessment system; for example, protecting property owners from being driven out of their homes by increased taxes and preserving local neighborhoods.

C. Welcome Stranger Taxes After Nordlinger

1. The fate of California's Proposition 13 may not yet have been finally decided. Because the plaintiff in Nordlinger was an individual, she could not raise certain constitutional objections available to corporations. For example, a case originally filed by R.H. Macy & Co. but dropped in favor of letting Nordlinger proceed raised the question of validity under the Commerce Clause. The argument there is that an acquisition value system discriminates against interstate commerce because it subjects out-of-state corporations locating in California to higher property taxes than are assessed against existing corporations.

2. It is not unusual to find an acquisition value system employed to assess tangible personal property, machinery, equipment, etc. In a state with constitutional standards requiring assessments to be uniform and at fair market value, is an "original cost" assessment system valid under Nordlinger? What if the "original cost" is changed whenever the property is sold? For example, in an asset acquisition, one owner may buy personal property from another for the express purpose of obtaining a higher cost basis for federal income tax purposes. The property will be used thereafter in the same business. If the locality assesses that property at the new federal tax cost basis, it will be assessing the identical property owned by substantially identical taxpayers at substantially different values.

IX. Availability of Retroactive Refunds

A. Previous Retroactivity Cases

1. The United States Supreme Court in Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107 (1971) set forth a three part inquiry for determining whether a decision of the United States Supreme Court will be given effect only prospectively.
   a. Does the decision establish a new principle of law, either by overruling clear past
precedent or by deciding an issue of first impression whose resolution was not clearly foreshadowed.

b. Will applying the new rule retroactively further or retard the operation of the rule in question?

c. Will retroactive application of the new rule produce substantial inequitable results?

2. Various states seized upon the three part Chevron test to deny refunds to parties which had successfully contested the validity of unconstitutional taxes. Since some of the circumstances in which refunds were denied were questionable, at best, the issue of retroactive refunds became a source of great tension between taxpayers and state taxing authorities.

a. American Trucking Ass'ns v. Smith, 496 U.S. 167 (1990). Four justices of the United States Supreme Court, with Justice Scalia concurring on other grounds, ruled that the taxpayers were not entitled to refunds of taxes collected prior to the date of an earlier case which effected a "change of law." The four justices relied on the Chevron test to support not making retroactive refunds.

b. McKesson v. Florida Alcohol & Tobacco Div., 496 U.S. 18 (1990). Notwithstanding the United States Supreme Court decision in Bacchus declaring a substantially identical Hawaii tax invalid, Florida enacted a tax on wholesale liquor distributors providing rate reductions for certain local products. Citing certain "equitable considerations", the Florida Supreme Court declined to grant retroactive refunds. The United States Supreme Court reversed. In a unanimous opinion, the Court held that:

When a State penalizes taxpayers for failure to remit their taxes in timely fashion, thus requiring them to pay first before obtaining review of the tax's validity, federal due process principles long recognized by our cases require the state's postdeprivation procedure to provide a "clear and certain remedy" ... for the deprivation of tax monies in an unconstitutional manner.
496 U.S. at 51. The case was remanded to the Florida courts to determine the exact form of relief to be provided, so long as that relief was meaningful and satisfied minimum federal requirements.

B. *James B. Beam Distilling Co. v. Georgia*

1. The retroactivity issue left open by the United States Supreme Court's decisions in *McKesson* and *American Trucking* seemed to come to a conclusion in yet another case involving retroactive refunds based on *Bacchus*. *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). Once again, however, no five justices were able to agree on a single opinion.
   a. Justice Souter, joined by Justice Stevens, concluded that refunds must be retroactively granted because they had been granted to the litigants in *Bacchus*. "When the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." 111 S. Ct. at 2448.
   b. Justice White concurred in the judgment of the Court but expressly declined to endorse any views Justice Souter might have expressed about the viability of the *Chevron* test.
   c. Justices Blackmun, Marshall and Scalia concurred in the judgment of the Court based on their view that a constitutional decision can never be applied prospectively only.
   d. Justices O'Connor and Kennedy and Chief Justice Rehnquist dissented. Relying on the *Chevron* test, they would not have permitted retroactive refunds.

2. The position of the United States Supreme Court on the availability of a "prospective only" defense to states in denying refunds remains uncertain even after *James Beam*. Four justices appear to be committed to application of the *Chevron* test to determine whether refunds will be granted retroactively. Three current justices of the Court appear to be committed to the concept that changes in constitutional decision must be applied retroactively. Justice Souter appears to join this later group of three, thereby making the Court evenly divided. The views of Justice Thomas, who was appointed to the Court after the decision in *James Beam*, are not yet known.
3. The retroactivity issue may be finally decided by the appeals now pending in the United States Supreme Court in the Federal Pension Cases. In *Davis v. Michigan Dep. of Treasury*, 489 U.S. 803 (1989) the United States Supreme Court held that a state's failure to exempt from tax pensions of federal retirees was unconstitutional when such an exemption was granted to state retirees.


b. Others? [South Carolina, North Carolina, Kansas]