ORIGINAL

In the

Supreme Court of the United States

EXXON CORPORATION,

Appellant,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Appellee.

No. 79-509

Washington, D.C.
March 18, 1980

Pages 1 thru 49

Hoover Reporting Co., Inc.
Official Reporters
Washington, D. C.
546-6666

IN THE SUPREME COURT OF THE UNITED STATES

EXXON CORPORATION, Appellant,	:	
v.	:	No. 79-509
WISCONSIN DEPARTMENT OF REVENUE, Appellee.	:	

Washington, D. C.,

Tuesday, March 18, 1980.

The above-entitled matter came on for oral argument at 10:15 o'clock a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

THOMAS G. RAGATZ, ESQ., 1 South Pickney Street, Madison, Wisconsin 53703; on behalf of the Appellant

GERALD S. WILCOX, ESQ., Assistant Attorney General of Wisconsin, 114 East, State Capitol, Madison, Wisconsin 53702; on behalf of the Appellee

- - -

C O N T E N T S

- - -

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments first this morning in Exxon Corporation v. Wisconsin Department of Revenue.

Mr. Ragatz, you may proceed whenever you are ready.

ORAL ARGUMENT OF THOMAS G. RAGATZ, ESQ.,

ON BEHALF OF THE APPELLANT

MR. RAGATZ: Mr. Chief Justice, and may it please the Court:

This is an appeal from a decision of the Wisconsin Supreme Court that reversed a lower court decision that had excluded from Wisconsin taxation the income of appellant's expiration and production department earned outside the State of Wisconsin.

The basic issue here, as asserted by the appellee, is whether a vertically integrated multistate corporation can be automatically characterized as unitary and automatically required thereby to subject its total corporate income to apportionment even though the taxpayer can conclusively identify and accurately measure its exploration and production income at its situs origin outside the state.

Now, contrary to the position of the appellant, the appellee asserts that once a taxpayer is determined

to be unitary and engages in any activities in the state of Wisconsin, then virtually all its corporate income is subject to apportionment by Wisconsin and the taxpayer is not permitted to prove extraterritorial taxation by establishing either that the income was derived from sources outside the state of Wisconsin or that the quantity of income attributable to Wisconsin is out of all appropriate proportion to the activities of the taxpayer in Wisconsin.

Now, whether or not appellant is found to be unitary is not the basic issue. Appellant does not concede that it is a single unitary business, but even assuming arguendo that it is unitary, that does not answer the question of whether the due process and commerce clauses of the United States Constitution permit imposition of the unitary per se approach with full apportionment, regardless of unrefuted proof that the result is to tax situs income derived and accurately measured outside the state of Wisconsin.

Appellant's position here involves a two-step analysis: First, as to what are the constitutional principles previously defined by this Court to limit state taxation of extraterritorial income; and, second, as to whether the appellant's proof in the record here satisfies the burden of proof as defined by this Court to establish a constitutional violation.

The leading decisions of this Court on apportionment are the Hans Rees case decided in 1931, Bass, Ratcliff decided in 1924, Butler Brothers in 1942, and more recently Moorman Manufacturing company decided in 1978. All of these cases are consistent with the proposition that a taxpayer does have and in fact must have the right --- must have the opportunity to prove the unconstitutionality of an apportionment assessment by establishing a taxation of extraterritorial income.

In Hans Rees, the issue was not whether the taxpayer was unitary, which was assumed by this Court. The real issue was whether or not the assessment there taxed income which was earned outside the state of North Carolina. This Court found a due process violation based upon the taxpayer's proof that the income attributable to North Carolina was out of all appropriate proportion to the activities of the taxpayer in that state; thus Hans Rees met its burden of proving extraterritorial taxation.

This decision was consistent with the prior Bass, Ratcliff case, only there the taxpayer's proof did not establish that New York was taxing income not earned in that state. Now, despite the fact that the taxpayer was found to be a so-called unitary business, this Court nevertheless examined the record for proof of

extraterritorial taxation, but found such proof to be lacking.

Butler Brothers involved a similar analysis as to a unitary business. This Court decision notes that the taxpayer failed to prove that the apportionment formula there attributed to California for taxation income which was earned elsewhere by not showing that the factors responsible for the income were present in other states but were not present in California; thus, Butler Brothers failed to sustain its burden of proof.

Finally, in Moorman, this Court only commented on the so-called unitary concept in a footnote but did analyze the record and found that the taxpayer did not show that a significant portion of its income being taxed by Iowa was in fact generated outside the state. The majority opinion by Mr. Justice Stevens notes the lack of "any separate accounting analysis" showing what portion of Moorman's profits were attributable to sales, to manufacturing, or to other portions of the taxpayer's operations, and the opinion expressly suggests that it should not be impossible for a unitary corporation to prove its actual income from activities in a particular state.

Now, we should note parenthetically here that neither Bass, Ratcliff, Butler Brothers nor Moorman

involved situs income which was geographically located and accurately measured outside the taxing state, but that the fact situation here presents such a record for perhaps the first time for the Court to deal with tangible situs income derived from natural resources. Thus, the law as previously decided by this Court expressly recognizes that a taxpayer contesting an assessment under an apportionment cormula must have the opportunity to prove extraterritorial taxation even though deemed to be a unitary business.

As a consequence, it is clear that this Court has consistently treated unitary as a possible condition precedent to the application of an apportionment formula, but has simultaneously made clear that the factual issue of unitary is totally irrelevant to the issue of extra-territorial taxation and to the proof thereof.

Moreover, until the decision of the Wisconsin Supreme Court, which is here before you --

QUESTION: Except if it weren't unitary, it would be rather relevant, wouldn't it?

MR. RAGATZ: If the taxpayer wasn't unitary, you wouldn't meet the condition precedent and you wouldn't even get to the analysis of extraterritorial taxation.

QUESTION: Why wouldn't you, if the state tried to tax it, why, they would tell them it couldn't.

MR. RAGATZ: Well, we would be here as we are now, Mr. Justice White --

QUESTION: Saying they were taxing out of state income?

MR. RAGATZ: We would be saying that you were reaching outside the state to tax extraterritorial income.

Now, the decision of the Wisconsin Supreme Court -- until the decision of the Wisconsin Supreme Court here, it seemed apparent that the Wisconsin statute involved was consistent with the proof prescription contained in these four decisions I have just mentioned.

Our section 7107 specifies that a corporation engaged in business within and without the state shall be taxed only on such income as is derived from business transacted or property located within the state. But here the Wisconsin Supreme Court dismissed appellant's unrefuted separate functional accounting proof of income earned outside the state by labeling as dicta this Court's prescription in the Moorman decision for proving extra-territorial taxation by separate accounting analysis. Thus, the Wisconsin court refused to consider our proof and adopted its unitary per se approach which clearly is totally inconsistent with the prior decisions of this Court.

Now, under the Wisconsin --

QUESTION: Just as a matter of curiosity, in your separate accounting how did you allocate the costs of your central office to operations in Wisconsin?

MR. RAGATZ: There are two types of separate accounting in the record, Mr. Justice Blackmun. There was separate geographical Wisconsin accounting, but the separate accounting that we are really relying on here was the separate functional accounting of the taxpayer's three main functional operating departments, exploration and production, refining and marketing. Now, only the marketing department engaged in any activities in Wisconsin, and the trial court found that these three departments were organized and operated as separate segments and separate functional operations and this decision was affirmed by the Wisconsin Circuit Court on the first level of appeal.

Now, the trial court also found that the taxpayer used internal transfer prices between its functional departments that were the equivalent to third-party competitive prices. Now, that finding of fact was not even appealed by the state, were not even challenged by the state on appeal. The trial court further found that the income of each of appellant's functional operating departments could be determined from its books and records without resort to actual third-party sales.

QUESTION: I am sure Mr. Justice Blackmun, as I am, is waiting for your answer to his question about the central office overhead.

MR. RAGATZ: I am trying to get to that, but I wanted to give you the background of the facts to answer the question.

QUESTION: We understand that part of it.

MR. RAGATZ: The finding of fact that the accounting for the functional departments could be determined from the taxpayer's books and records also was not appealed, not challenged on appeal. Now, the fact that these two findings were not challenged means that the appellee has conceded the validity and the accounting integrity of the determination of the exploration and production department net income. Now, that is a long way around to answer your question, but I felt the background was necessary.

The central office charges were allocated on the basis of similar to a cost of service arrangement with the various functional departments, and again this was not challenged by the State of Wisconsin and the separate functional accounting for each of these operating departments, including particularly the exploration and production department, stands unrefuted and unchallenged in the record. So that issue --

QUESTION: Would you suggest that wherever a company claims that it can do this, that it is also claiming that it shouldn't be treated as a unitary business?

MR. RAGATZ: Perhaps not in every case, but certainly where a factual record is made that demonstrates conclusively that the income being taxed by a state is extraterritorial, then whether or not the taxpayer is unitary --

QUESTION: Well, that part of its business isn't part of the unit then?

MR. RAGATZ: That would be our argument.

QUESTION: So you would say here that the only unitary business there was in Wisconsin was the marketing then?

MR. RAGATZ: That is what the trial court determined and we are well satisfied with that decision, Mr. Justice White.

QUESTION: But the Supreme Court of Wisconsin didn't agree with you on that point?

MR. RAGATZ: The Supreme Court of Wisconsin didn't agree with us on much of anything and --

QUESTION: What do you think a unitary business finding means? Doesn't it mean it is sort of a truism for saying you must treat it as a ball and go through -- as one ball of wax and go through this formula as the

fairest way of allocating income source?

MR. RAGATZ: Well, the position of the appellee would be -- and perhaps the Wisconsin Supreme Court -- would be that you lock-step yourself into and if you have any activities in the state, then your total --

QUESTION: But in your books and in talking about unitary businesses and allocation formulas, doesn't unitary mean that it is so unitary that it is appropriate to apply an allocation formula?

MR. RAGATZ: To be very honest, Mr. Justice White, I can't say that I know what unitary means because it is used in so many inconsistent ways. It is not a precise term certainly in the cases around the country. It is not a term --

QUESTION: But the way it is used in this case, you would think it automatically precludes your attempt to separately account.

MR. RAGATZ: That is the position of the appellee, as I understand it, and our position is that that is -- that unitary is a superfluous concept and that you must look to the underlying constitutional principles of both due process and the commerce clause to determine whether a particular activity can be apportioned. The test applied by the Wisconsin Supreme Court to determine what is unitary begs the question of whether or not the

particular activity has any rational relationship to the activities in the State of Wisconsin which would authorize the state without violating due process to tax that activity. And we assert here that the exploration and production income which was generated entirely outside the state, which could be identified at its geographical location, which could be accurately measured there, and the measurement has not even been challenged, that this demonstrates that that exploration and production income is extraterritorial, it has no relation to the state of Wisconsin.

In fact, we have findings of fact in the trial court that -- those that I have already cited -- indicating that the exploration and production and the refining net income had no integral relationship with the marketing activities that were carried on in the state of Wisconsin.

QUESTION: What of companies who are conglomerates, even if they are not separately organized as corporations, say they have ten divisions, each division is engaged in an absolutely separate business, one in making clothes and something else, running theatres, another manufacturing trucks, another division which runs banks, do they treat each one of them as unitary businesses or do they --

MR. RAGATZ: Well, I can't speak for corporations

generally, Your Honor, but my perception and my understanding is that each of those, if the proof is proper, can be identified as separate unitary businesses and only those businesses who have material activities in the state of Wisconsin could be apportioned. In other words --

QUESTION: And you are saying that your company should be treated that way?

MR. RAGATZ: I am saying that one of our --

QUESTION: You are separate enough, anyway?

MR. RAGATZ: -- due process arguments is that each functional department can be treated as a separate unitary business. But whether or not it is treated as unitary, the root question is whether the constitutional principles, particularly the rational relationship principle permits the state of Wisconsin to reach out and tax income that the record conclusively establishes was derived outside the state.

QUESTION: How many states in the country does Exxon do business in at the present time?

MR. RAGATZ: My belief is all of them, Your Honor.

QUESTION: I suppose if every state in the union had the same apportionment as Wisconsin, you might be taxed more than 100 percent?

MR. RAGATZ: Well, not if every state had

identical definitions and identical formulas, but clearly that is not the case. While something like 44 states have three-factor formulas, Wisconsin being one of them, the definitions and the manner of application may differ from state to state such that there is no uniformity.

QUESTION: I see. I understand that. I was putting that as the hypothetical question.

MR. RAGATZ: I guess if every state apportioned in an identical manner, you wouldn't have the argument perhaps under due process, but you would still have the argument that if the situs state where the oil well is located had the power to tax all of the income from that oil well, and other states in addition were apportioning that income from the oil well, that you would still have a commerce clause argument because of the burden of multiple taxation.

So I don't think that even a uniform, entirely uniform apportionment formula resolves the commerce clause question based upon the situs income which is here before the Court now, the situs income derived from natural resources.

QUESTION: Does this record show oppressive multiple taxation?

MR. RAGATZ: My position is that it does, Your Honor. The record shows that the Wisconsin assessment

here in issue attributed to Wisconsin income out of all appropriate proportion to the taxpayer's activities in Wisconsin which, as you will recall, were only marketing. One of the exhibits in the record demonstrates that the appellee has attributed to these Wisconsin marketing operations income at a rate equal to approximately two and a half times the rate actually earned by the entire marketing function.

QUESTION: Well, I am asking does the record show actual multiple taxation, so that you are being doubly taxed?

MR. RAGATZ: The record does not show the actuality of multiple taxation in actual numbers. The record does show the geographical locations where the exploration and production activities are conducted, which are all outside Wisconsin, and the record shows the Wisconsin income with and without the inclusion of the exploration and production income, apportionable income which thereby pinpoints the amount of approximately $2.6 million of exploration and production income which was attributed to Wisconsin under the assessment in issue. Now --

QUESTION: Does the record tell us whether Texas uses a three-factor formula or just taxes separately as you would have Wisconsin do?

MR. RAGATZ: I do not believe, Your Honor, that that is in the record.

QUESTION: Could I ask one other question. I hope I am not interrupting your answer to Mr. Justice Blackmun, but as I remember the case, the situs sales to third parties was treated as situs income and excluded. Am I correct in that?

MR. RAGATZ: That's correct, Your Honor.

QUESTION: Is the theory of that exclusion that those sales were not part of the unitary business or alternatively that even if they were part of the unitary business, they should not be treated as part of the taxable income?

MR. RAGATZ: Wisconsin has a statute, part of this statute in issue that says the income from any farm, mine or quarry shall be allocable and not apportionable. Now, the appellee conceded on the record that oil and gas extraction is mining for that purpose. In fact, the appellee conceded that the principle of situs income by allocating the sales at the wellhead to third parties and not apportioning it, but by contending that all the rest of the exploration and production income is apportionable, the appellee both invokes the multiple taxation doctrine, because the situs income is subject to the power of tax outside the state, and it also provides the basis for a

due process violation because of ignoring the rational relationship requirement between that exploration and production income and the state of Wisconsin.

QUESTION: May I ask whether the asset factors and the payroll factors that contributed to the generation of the sales to third parties at situs were included in the denominator of the formula?

MR. RAGATZ: My understanding is that they were not, although they were exluded by something the record calls a barrel formula which is an extremely complex and an arbitrary method of dividing the apportionable property from the non-apportionable property and the apportionable payroll from the non-apportionable payroll. The record will show admissions by the witnesses for the Department of Revenue that this is an arbitrary separation. In fact, sales percentages were used to make part of the adjustment here in issue, part of the formula, which have no real bearing on how much property or how much payroll was involved. But if the Court wants to slug its way through that barrel formula --

QUESTION: As I understand, there is no real issue on the fairness of the formula if it is appropriate to apply the formula.

MR. RAGATZ: Well, there was an issue below and in fact part of that issue was remanded, but that is

not before the Court. What we brought here is the basic constitutional questions of due process and the commerce clause.

I would next like to talk about the line of cases cited in our brief where the identification and accurate measurement of extraterritorial income subjected to apportionment by a non-situs state shows the risk or buden of multiple state taxation which thereby invokes this multiple taxation doctrine because the situs states unquestionably have the power to tax that income.

Now, the appellee asserts that the Moorman decision abandons the multiple taxation doctrine, but I assert that decision does not so hold and that, rather than having abandoned that long-established doctrine, Moorman merely found the taxpayer there unable to invoke it because of a failure to prove the source or location of its income.

I believe the language of the Court was that the taxpayer did not meet the factual predicate. Well, that factual predicate I understand to mean that proof is required as to the situs where the income was derived but not proof that it had actually been taxed at that situs.

Now, if the doctrine were to be abandoned by requiring the actuality of multiple taxation, then that

would turn state taxation into a foot race with the swiftest state to tax a particular activity declared the winner, and I can't think of a less desirable situation.

I have mentioned several of the items in the factual record and, unless the Court has questions, I am going to pass on with those. Those are very carefully laid out in our brief.

I want to mention one, however, that the trial court did find as a fact that the Wisconsin taxation of the appellant's exploration and production and its refining net income subjected the appellant to multiple state taxation on such income. And on appeal at the first level in the Wisconsin Circuit Court, this finding of multiple state taxation was affirmed. However, that was subsequently reversed, along with the finding of three unitary businesses when the Wisconsin Supreme Court took its unitary per se approach.

Now, the factual basis for the findings of fact are unrefuted in the record, particularly those findings of fact that were reversed as a matter of law, and the finding of three unitary businesses was reversed as a matter of law without consideration of the facts. But the factual record here specifically identifies by separate functional accounting the undisputed income of the exploration and production function which was earned

entirely outside the state of Wisconsin. The record shows the geographical locations and it shows the $2.6 million worth of exploration and production income which is included in the Wisconsin assessment, and all of this income was subject to being taxed in the states of its origin.

Now, this clearly supports the finding of fact of the trial court that the assessment at issue subjected the appellant to multiple state taxation. Now, the --

QUESTION: Mr. Ragatz, could I ask you one other question, a factual question. Lately we have heard a lot about windfall profits that oil companies may have earned or may be earning as a result of increase in the value of oil. If there are such things, and I guess they come to a period later than are at issue here, which of the divisions would earn such profits? Do you have any idea?

MR. RAGATZ: Well, the years in issue here were 1965 through 1968, so I am not aware of any windfall profits and certainly there is nothing in the record that would indicate anything like that. My personal answer to the question, which is not in the record and I would have to qualify it in attempting to answer your question, would be that windfall profits might -- if that is an appropriate term, and I guess I am not willing to accept the term -- but large profits might be measured from the

exploration and production department, where the exploration and production was done in the 1920's at the 1920 level of prices, and the sales of the oil and gas are done at today's prices, you are going to show a large gross profit on such sales which somebody might call a windfall profit. But when you consider the replacement costs of those reserves, it is hard for me to think of that as a windfall.

I would like to remind the Court that the issue, the integrity of the determination of the exploration and production income is not at issue and the appellee should not be heard to dispute the fact that the record shows the correct amount of the exploration and production income, nor should the appellee be allowed to dispute the fact that the record shows that that income was earned entirely outside the state of Wisconsin, nor the fact that the assessment in issue includes a significant portion of that income.

Thus, based upon the proof from the Court's prescription for finding extraterritorial taxation, I respectfully submit that these facts must invalidate the assessment, and I respectfully request that the decision of the Wisconsin Supreme Court be reversed on the basis that section 7107 of the Wisconsin statutes is unconstitutional as applied here by the appellee to tax the

exploration and production net income earned outside the state, and that such application constitutes a violation of both the due process and the commerce clauses of the United States Constitution.

Thank you.

QUESTION: Well, you are suggesting the other side shouldn't say a word because you are saying that they may not say that this so-called income that is admittedly earned outside the state, none of it was earned in Wisconsin and yet they are taxing it.

MR. RAGATZ: They are taxing it, Your Honor, and they have not even challenged on appeal the determination of that income. And having established in the record where that income was earned and the fact that it was not earned in Wisconsin, we feel that we have established the extraterritorial nature of that income and established that the assessment here constitutes extraterritorial taxation.

QUESTION: Of course, I suppose they could say that this is unitary business and the way to find out where income is earned is to apply the state formula.

MR. RAGATZ: But the unitary approach is just a rationalization then for the state to tax extraterritorial income and it doesn't get at the root constitutional issues and those issues are whether there is a

rational relationship --

QUESTION: And your approach is just a way to say the formula is inaccurate?

MR. RAGATZ: The formula as applied here results in the taxation of extraterritorial income, yes, Your Honor.

QUESTION: I see.

MR. RAGATZ: Thank you.

MR. CHIEF JUSTICE BURGER: Very well.

Mr. Wilcox.

ORAL ARGUMENT OF GERALD S. WILCOX, ESQ.,

ON BEHALF OF THE APPELLEE

MR. WILCOX: Mr. Chief Justice, and may it please the Court:

The appellees here ask this Court to reaffirm what has been already said in Butler Brothers. Exxon in the instant case has not challenged the Wisconsin formula. It has challenged the right of Wisconsin to apply its three-factor formula to some of its business income. One of the terms used is situs income.

Now, the unitary approach, the three-factor unitary method takes into consideration situs income. All three of the denominators are based on situs. The income that appellant is talking about as situs income is income from a unitary business. Now, a unitary business

is by definition a single, one business. Income from such businesses cannot be attributed to it in part, it cannot be attributed to parts or to part. The basis of the unitary concept is that income cannot be a function of any given factor, but it is a function of the business.

Situs is taken into consideration by Wisconsin and by 40 other states who have adopted a similar three-factor formula. The basis for the formula essentially is an attempt by the states to find a reasonable formula in which to tax large multi-state unitary businesses in a uniform and equitable manner. I believe that this formula that Wisconsin has adopted and that several, forty-some other states have adopted does just that.

Wisconsin is not taxing extraterritorial income. Wisconsin has never admitted that these figures shown by the appellant proves that it is taxing extraterritorial income. We are not disputing a separate functional accounting or whatever they want to call it for their own business purposes, but they have no income from exploration and production unless this Court is going to go back to the imputed income theory. The income is the income from their total unitary business.

Wisconsin applied its formula, it taxed 1/500th of that income. I do not believe that under --

QUESTION: Mr. Wilcox, do you believe that

Wisconsin could constitutionally adopt a system that your colleague has suggested that you must follow?

MR. WILCOX: Do you mean could we adopt a system where we tax --

QUESTION: Could you say all the companies like Exxon who are capable of doing it are supposed to divide up their so-called unitary business and do a cost accounting job and figure out the income from their various divisions and if there is income from outside the state we just won't take it?

MR. WILCOX: Well, that is interesting. If the states took that approach -- and I assume that some will, because they find it advantageous -- what could result if the corporation has a net loss under that reasoning, some states could say, well, you may have had a total loss nationwide, but you don't have a loss here, you've got income here because exploration and production or whatever it might be, refining, produces income, what we would have is we --

QUESTION: Does any state that you know of allow this type of accounting and tax returning that your colleague suggests?

MR. WILCOX: I think some states may have tried separate accounting themselves. I know in one case California did and their own supreme court rejected it.

So I can't say that no state would attempt separate accounting if that might prove advantageous. I think it is inconsistent, but I can't say that, Mr. Justice White.

QUESTION: Suppose if the exploration and development division or what they argue is a separate division is the most profitable of the three, is it not likely that the state of Texas might prefer using Exxon's approach and tax on that basis?

MR. WILCOX: If that is where all their income is, I think it is in other states, but I don't believe those states generally do tax it. But yes, you're right, they might prefer to tax that way. I don't think they should.

QUESTION: Because I suppose just looking at the state statute, you couldn't really tell what that state would regard as a unitary business and conceivably they could say, well, a unitary business down in Texas is exploration and development, just as Exxon argues here -- and I suppose Exxon down there would take the position you are taking up here.

MR. WILCOX: That is possible.

QUESTION: And that certainly raises the possibility of an inconsistent result at least.

MR. WILCOX: I think one of the basic points I would like to make is that Wisconsin does have a three-

factor formula. Now, during the period there was one little discrepancy between some of the states. We had the cost of manufacturing rather than payroll, but essentially it meant the same thing and the enumerator in that case was zero, so Exxon only came out ahead if anything on that. But essentially it is uniform.

And going back to Adams Express and going through Butler Brothers, this Court has recognized that it is difficult to tax multi-state unitary businesses. I am not here to suggest anything else. I am suggesting there has been an approach adopted by most of the authorities, I think it is a reasonable approach. It has been adopted by Wisconsin and, like I said, forty-some other states. That alone is designed to prevent duplicate taxation. It is also designed to tax if we have the perfect formula no more than 100 percent. It is designed to tax exactly that and no more. Unfortunately, a lot of the states, including Wisconsin, exclude certain income, so I don't even think it ever would.

Now, you can constantly attack such a formula by stating, well, if Wisconsin had put in payroll some false figures, they obviously can attack that formula on that basis. But to attack the three-factor formula in a unitary approach through the use of separate accounting I think is inconsistent with a lot of this Court's

decisions --

QUESTION: Don't you first have to determine what the unitary business includes? I suppose there will be some out of state income from some unrelated activities that you just don't count as part of the unitary business.

MR. WILCOX: Well, I think that is part of appellant's argument.

QUESTION: Well, don't you?

MR. WILCOX: I think you do have to determine what is included in a unitary business, and I guess in one of the briefs filed by one of the amicus has indicated that Exxon is not a unitary business in this area. I don't know what is. It has been said that a unitary business involves a series of transactions, and I think in this case you have the typical unitary business where you have got the flow of goods, you start at exploration and production, you move to refining, you end up with the final product being --

QUESTION: Well, that may be so but I guess in this case it is just by the accident of legal entity and ownership that you can treat it altogether. I suppose if all of Exxon's production was owned by a separate company, an independent company, and its refining was owned by an independent company, and its marketing by an independent company, there wasn't common ownership but they did

business in the same way, there was the same flow of oil from well to refinery to marketing, it would be -- economically it would be the same operation, but you certainly couldn't treat it as a unitary business.

MR. WILCOX: Not Wisconsin, not under Wisconsin law. I guess I would dispute the economic conclusion. I think that the determination to be a corporate structure, under one corporate structure -- and I don't know why Exxon decided to be under one corporate structure, rather than three or more -- I think that is a very basic determination from a business standpoint. I assume they have a good business reason for doing it.

Obviously you can share costs, administrative costs, you can share supply costs. In their determination, they came out with the determination that the supply --

QUESTION: I suppose you treat it as a unitary us iness even if there is a holding company and it has three separate subsidiaries, one production, one refining and one marketing, you would treat it as --

MR. WILCOX: Wisconsin would not treat as a unitary business if there is more than one corporate structure.

QUESTION: I see.

MR. WILCOX: In other words, we stay within the corporate structure. Now, I am not saying that

constitutionally we have to, but we do under the statute.

QUESTION: And Wisconsin didn't force this choice upon Exxon?

MR. WILCOX: We didn't force them to incorporate as they did, no.

I guess as I have indicated, to suggest that a business is unitary and then permit the corporation, a unitary corporation to come forth and assign certain of its income to particular departments is a contradiction. What you have is saying we've got a single business -- that is what unitary means -- and now we come back and say well, you can break it down in parts, you have a very difficult problem of attributing income and that is where the unitary business concept was conceived.

I submit that to allow separate accounting after there has been a determination as to unitary business, to impeach or to break down that business would mean that the states would literally start over to try to find a reasonable way to tax these large multistate corporations. I don't think that would benefit either the corporations or the states.

The finaly point I really have to make is the one that was stressed continually and apparently the one that the reply brief and the appellant has finally hung its hat on, is the concept of situs. This income, the

separate income that they talk about -- which, by the way, under their figures is three-fourths of their income -- should belong in a particular place, and the appellee does not agree with that. The comments as to what the appellee has conceded, I will not get into, but we do not concede that. It is income from the unitary business. The situs factor is in all formulas, it is in a denominator. Its situs factor deals with property, you can determine what property is, you can determine what payroll is, and you can determine where sales is. These factors are considered, they are then used to apportion the income which you cannot place in a particular spot.

QUESTION: Are you connected with the interstate Multistate Tax Commission?

MR. WILCOX: We are not a member of the Multistate Tax Commission.

QUESTION: Were you ever?

MR. WILCOX: Not to my knowledge, but I can't answer that for sure.

QUESTION: And do you know whether there is any pending effort in Congress to address establishing some uniform system in taxing interstate businesses around the country?

MR. WILCOX: Well, I'm not aware that there is anything present. There has obviously been several

attempts in this direction with limited degree of success, I am aware of that. But right now I can't tell you what is going on.

QUESTION: Mr. Wilcox, before you sit down, is there anything in the Wisconsin statute that would prevent Wisconsin -- let me give you a -- assume for a second that the marketing division was the really profitable one within the company, that their accounting showed that, and it might therefore be in Wisconsin's interests to treat the marketing operation as a separate unitary business, as I think the Department of Revenue did at one stage of this proceeding. Is there anything in the statute, the Wisconsin statute that would prevent Wisconsin from saying, well, we have decided to define unitary just to include the marketing operation?

MR. WILCOX: I don't think the statute prevents that. I think that would be inconsistent. Wisconsin never treated the market separate. Initially, what --

QUESTION: Didn't the taxing authority treat marketing separate in this case?

MR. WILCOX: What initially happened is Exxon filed tax returns on the basis of --

QUESTION: They said just Wisconsin, and then the first round didn't they just expand the --

MR. WILCOX: Oh, you mean the Tax Appeals

Commission.

QUESTION: Yes.

MR. WILCOX: Okay. The Department of Revenue, my client, did not.

QUESTION: I'm sorry. Somewhere along the line then.

MR. WILCOX: Initially, yes, they did divide up Exxon into essentially three unitary businesses.

QUESTION: Isn't it fairly reasonable to assume that had that been the most profitable division of the company, that that might have stuck?

MR. WILCOX: You are saying that we might not have appealed?

QUESTION: Yes.

MR. WILCOX: I think that might be true. I don't think that would have been right, but that might have been true, yes.

QUESTION: And isn't it equally possible that -- I'm just thinking of the possibilities of multiple taxation -- that down in Texas they might regard the exploration and development as the separate unitary business? There is probably nothing in their statute that would preclude them from doing it.

MR. WILCOX: No, Mr. Justice Stevens, I am not here to suggest that all states, any more than all

corporations, act consistently when they see that another approach would be more advantageous from a financial position. I think they should and I think this Court recognized the fact that in Butler Brothers -- and I think really in Moorman, Moorman had a single factor formula which obviously gave the Court difficulty.

QUESTION: I would make the suggestion that Mr. Justice White did, that perhaps the best answer to this problem would be to get Congress into the act.

MR. WILCOX: Well, I would hope that we would not have to wait for that, frankly. There are all kinds of methods one can pick, all kinds of approaches, but we do have I think a sense of uniformity now, more than we have had before. Now, it is not perfect but --

QUESTION: But the uniformity that you describe is uniformity in the prevailing practices to use three-factor formulas, but is there uniformity in how you go about defining unitary businesses, which is perhaps equally important but I'm not sure there is the same degree of uniformity on that problem, is there?

MR. WILCOX: Well, again I haven't dealt too in depth on whether Exxon is a unitary business. I think the record does support it. I have dealt in depth in my brief on that. I guess the reason I haven't is I believe the appellant's reply brief sort of suggests that that is

not the approach they are taking, I realize they still leave that open. But I believe that Exxon is a unitary business. There may be a business under one corporate veil that, you know, is not unitary.

QUESTION: Your argument, as I understand it, is that once you define the unitary business then it is just a question of applying the formula to find out what portion is reasonable attributable to the state.

MR. WILCOX: Essentially, yes, but I think it has to be properly applied. I'm not saying, as suggested by the appellant, that there is no way to challenge the application of the three-factor formula. There are. I mean you can show we put in our formula things we should not have. We did in fact not include the right property, for instance. Those factors, property, sales and payroll, can be essentially fairly easy to determine on a situs basis. Now, there is difficulty. There is no perfection there, but I think essentially they can be determined. Income cannot be. I think that has been recognized and I think it is a reasonable conclusion.

Income cannot be assigned to a particular function. Big, large businesses, and even small businesses -- income -- and the Court has said this in other cases -- only ends up from the final product sales, but you cannot attribute it only to sales. It results not just from the three

factors used, although those are the three income producones. It results from the total business, including administrative costs, supply costs, what have you, but you cannot break it down. If you could or if we say you can, there will be no end to separate accounting. I know what accounting can do and I know what it cannot do.

There were value judgments in this accounting. I take them to be good business value judgments, but I do not believe that we can subject or you can tax corporations based upon their separate accounting analysis or separate functional accounting. Financial accounting and tax accounting do not coincide.

QUESTION: Suppose just parallel to Exxon there is another operation going on from Texas to refining to Wisconsin by three separate corporations all independently owned, but they had exactly the same flow, and it was just that the market allocated where the income, who was going to earn the income. Somebody sold to the refiner and the refiner sold to the distributor and the distributor sells to the -- and you accept that, you have to accept that, I gather. You are just going to get part of the marketing income allocated to you and you are not going to be able to say, well, part of the income of the refiner we deserve.

MR. WILCOX: Not under the Wisconsin statute, we can't and --

QUESTION: Well --

MR. WILCOX: There is at least a sale there, I believe, Your Honor.

QUESTION: Oh, yes.

MR. WILCOX: But you do have separate corporations, you have --

QUESTION: You have separate sales, you have -- but it turns out, when you compare that Exxon has made exactly internally, that one company has made exactly the same allocation of profits to its refining, to its exploration and to its marketing as these separate companies end up doing, just at arm's length.

MR. WILCOX: Well, they said they have. They have called --

QUESTION: Well, let's assume they have, let's assume it is absolutely identical. You would still say that that is just a lot of nonsense -- not a lot of nonsense, but you just don't have to pay any attention to it because you have a formula that you just know better allocates income.

MR. WILCOX: I guess I wouldn't use the term nonsense, but I would answer yes, I do believe it better allocates income because of the judgments -- and I think they may be reasonable business judgments -- but what you have, just take the other side of the coin, let's assume

that, okay, by separate accounting this is possible. Well, what you have then is that somehow some state is then going to be able to tax supposedly the separate business called exploration and production, but they will be taking it, if there is a single corporation, on computed income. I can imagine Exxon's objection to that.

QUESTION: But the same guy inevitably in this kind of a setup is setting both the selling price and the buying price. I mean there is no real negotiation, is there?

MR. WILCOX: Well, they said it is based upon Pratt's Oil Gram and they claim there is no negotiation, but I just -- in the oil industry, to suggest that this type of price is one that tax authorities have to accept, I just can't conceive of how it would work.

QUESTION: Let me just pursue that for a second. I understood that the prices that they used for the intra-corporate transfers were the same prices that were generated when they sold at arm's length to third parties, and that you in effect assumed that their accounting had produced results which would have been produced had the company divisions been independently owned. Am I wrong in that?

MR. WILCOX: Well, I think --

QUESTION: But you said nevertheless you still

had the right to treat it as a unitary business.

MR. WILCOX: I think the statements about what we conceded, right from the beginning those figures were objected to as irrelevant. We did not admit to the validity of those posted fuel prices to the extent that they compared to price factors sold to third parties. I still object to it because the fact is the oil wasn't sold. If all that oil was sold, they would not have had the crude oil for their own refineries. Now, there is testimony in the record that the reason they operated as a single corporate structure was because it does spread the risk, they have supply for their refineries. They were able to have enough crude oil so that 70 percent of their refining capacity would be available by their own use of the crude. Now, had they sold it all out, the price would have obviously been different. It would have probably --

QUESTION: Well, General Wilcox, let me put the question this way: I sort of thought we were taking the case as though, like you take a complaint and you assume what they have alleged is true, even though the case hasn't been tried, that the Wisconsin Supreme Court more or less took the Exxon accounting as though it -- assuming for the purposes of decision, everything they say is true, that this is good sound accounting and

if it was at arm's length it would have come out precisely the same way, and nevertheless we reach the result that it is a unitary business and the formula is appropriate. And there is no finding of fact one way or another, as I understand it, but it seems to me we must take the case tht way because if you want to challenge the accounting then the rationale of the Wisconsin Supreme Court would be quite different I think, or am I missing something?

MR. WILCOX: No, I think you've analyzed the Wisconsin Supreme Court decision essentially correct. It is not clear to me what they did find on separate accounting, I will be honest. It is clear to me that right through all of the --

QUESTION: If you think the accounting is material, we ought to send it back for some findings of fact. If we accept their theory and say, well, that may be true but nevertheless if Wisconsin (a) is correct in treating it as a unitary business, and (b) having so treated it has the right simply to apply its formula and not get into the accounting, then we can accept everything they say about the accounting and still affirm. But if the accounting is material, we have to take quite a different analysis, it seems to me.

MR. WILCOX: Okay. There are two approaches.

Now, the Butlers Brothers indicated in that decision that separate accounting may be fine for business purposes. I stick with that. I think it may be very good. It may be absolutely necessary. But this is a tax case. Now, I do believe separate accounting may be used for certain purposes. It might be used to show that the formula overextended. That would then mean that you would have to change your formula. I do not believe it can ever be used to determine how a state is going to tax, but I think if you have a valid formula to start with, and we --

QUESTION: Well, it is also really relevant to the question of whether it is proper to treat as a unitary business because the whole reason for the unitary business is to solve the problem of how much is fair to attribute to Wisconsin in some big business, we don't know how much business was done here, and so you develop the unitary business concept and say we don't know, we will use a formula and that will give us a rough estimate. But if they can come up with real precise figures that you would accept, then I suppose that raises the question of whether you need or is it permitted to use a unitary business approach. I'm not suggesting I know the answer, but it seems to me the integrity of their accounting may be relevant to the question of whether it is proper to use the unitary business device which is a substitute for

accurate accounting when it is unavailable.

MR. WILCOX: Again, integrity in accounting, I'm not challenging it for the business purpose but I am for tax purposes and I think you have -- that is the question, and I think if the unitary concept has meaning then you don't have separate accounting to start over again and break apart what you've put together. I think that the separate accounting, as the appellant claims it proves, does not prove that here at all. It does not prove that Wisconsin over-reached. It does not prove that Wisconsin is taxing things out of all rational relationship.

QUESTION: It sounds though, with your colloquy with Justice Stevens, that you accept the fact that Exxon's figures with respect to its three departments are precisely the same figures that they would be if they were three independently owned corporations. Even so, you may apply the formula and come out with quite a different result than you would get if you treated the marketing division as a separate corporation, as you would if it were independently owned.

MR. WILCOX: I don't believe I accept their figures would be the same if they were three independent corporations. I certainly don't, because it would --

QUESTION: Well, the Wisconsin Supreme Court accepted the integrity of the figures, didn't they?

MR. WILCOX: But I don't think that follows that they said they would be the same if they were three independent corporations, because I don't believe they would. You have one corporation with different administrative expenses because of that, I would assume. But no, I think if you had three independent corporations, you may sell to each other but there are different restrictions on how profit is divided up. I don't concede that.

I thank you.

MR. CHIEF JUSTICE BURGER: Very well.

Do you have anything further, Mr. Ragatz?

ORAL ARGUMENT OF THOMAS G. RAGATZ, ESQ.,
ON BEHALF OF THE APPELLANT -- REBUTTAL

MR. RAGATZ: I believe I have a minute or two left.

MR. CHIEF JUSTICE BURGER: You have two minutes left.

MR. RAGATZ: Perhaps I can shed a little further light in response to some of the questions that Mr. Wilcox had, but first I would point out that as I understand Mr. Wilcox's argument, he still really hasn't reached the constitutional principles. He is dealing with this illusive, ill-defined concept of unitary and saying that if the state determines that a taxpayer

is unitary, then automatically thereafter the income is subject to apportionment and don't confuse us with the facts from a separate accounting analysis because they don't count.

Well, you can't write the Constitution out by a state statute adopting an apportionment formula. The state is just arguing for unitary per se and not considering the constitutional principles.

Now, Mr. Wilcox indicated that we were attacking the Wisconsin formula. We have never asserted that. We are not attacking the formula. We are attacking what the formula was applied to. If the formula is applied merely to the marketing income, we have no problem with that. But to apply it to the extraterritorial income which the record conclusively proves was identified and accurately measured outside the state, it gets us right square into both the due process and the commerce clause analysis.

QUESTION: Mr. Ragatz, didn't you say earlier that if the 44 states which applied the three-factor formula all taxed Wisconsin income of Exxon, like Wisconsin does, there would be no multiple taxation?

MR. RAGATZ: I do not believe that was my answer, Mr. Justice Rehnquist. I pointed out I think in response to that question that that would not solve the commerce clause problem, because the situs states, the

producing states have the power to tax that situs income there and for another state to apportionment, even if all the apportionment formulas were uniform, does not remove the overlap or the risk of overlap there.

QUESTION: But is unexercised power a constitutional defect?

MR. RAGATZ: The long line of cases that establish the multiple taxation doctrine have established that it is the risk or burden of multiple taxation, not the actuality of multiple taxation. This Court has said so in a couple of cases as recent as 1975.

QUESTION: But the Justice asked you if all the states operated exactly like Wisconsin and applied their formula which would be just like Wisconsin to Exxon, just like Wisconsin had, there would not be double taxation.

MR. RAGATZ: If the states did not --

QUESTION: They have a formula and that is all they do, they apply their formula.

MR. RAGATZ: Oh, mathematically, you could probably come out with 100 percent of the income but I don't believe that reaches the commerce clause question or the situs income question for the producing states have the right to tax it. In response to --

QUESTION: They have the right to tax it, but

you are just saying if in the producing state they have an extraction tax, just a gross tax on extraction, would you say that is the kind of a situs tax you are talking about?

MR. RAGATZ: If it is taxing the same activity that Wisconsin is trying to tax, then it --

QUESTION: Well, it is a gross tax, it is a gross production tax.

MR. RAGATZ: But if that --

QUESTION: It isn't a net income tax.

MR. RAGATZ: If that gross production is sitused in that state and then for Wisconsin to use that gross production in computing its formula, you end up with an overlap. There are at least six of the producing states that do tax income at situs.

QUESTION: Well, on that basis the same thing if the producing state just has property taxes.

MR. RAGATZ: The property tax I don't believe is analogous to the situation here at issue.

QUESTION: I know you have to say that.

MR. RAGATZ: And here we are dealing with Wisconsin's statute that specifically allocates the income from a farm, mine or quarry to situs.

QUESTION: Mr. Ragatz, do you contend that it is constitutionally impermissible for Wisconsin to treat this as a unitary business?

MR. RAGATZ: I contend that it is constitutionally impermissible for Wisconsin to put on blinders and say that if this is a unitary business everything from there on can be apportioned.

QUESTION: I understand that. Do you contend that it is constitutionally impermissible for Wisconsin to treat this business before us as a unitary business?

MR. RAGATZ: Not if a second step in the anslysis is required and that is to determine whether there is a rational relationship between the income --

QUESTION: Your answer then is no?

MR. RAGATZ: That's correct, Your Honor. In four cases that I have discussed here, I believe they support that answer.

QUESTION: But you would say yes it is if they treat it as a unitary business for purposes of applying their formula?

MR. RAGATZ: I'm not sure I understand your question.

QUESTION: Well, you say that Wisconsin says it is unitary and therefore our formula applies, and if that is what calling a unitary business necessarily entails, it is unconstitutional to treat it as a unitary business.

MR. RAGATZ: The application of the Wisconsin

statute we contend is unconstitutional and we further contend that if the proof of extraterritorial taxation that is contained in the record here is not sufficient, then I respectfully submit that perhaps such proof is judically impossible.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 11:14 o'clock a.m., the case in the above-entitled matter was submitted.)

- - -