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Library

STATE OF WISCONSIN

TAX APPEALS COMMISSION

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HERCULES INCORPORATED Hercules Plaza Wilmington, DE 19894-0001	*	DOCKET NO. 94-I-1494
Petitioner,	*	**DECISION AND ORDER**
vs.	*	
WISCONSIN DEPARTMENT OF REVENUE P.O. Box 8933 Madison, WI 53708	*	
Respondent.	*	

****

MARK E. MUSOLF, COMMISSION CHAIRPERSON, JOINED BY DON M. MILLIS AND DAVID PROSSER, JR., COMMISSIONERS:

The above-entitled matter was heard at Waukesha on December 12, 1995. The facts are partially stipulated. Petitioners are represented by Attorney David D. Wilmoth of Quarles & Brady and Attorneys Paul H. Frankel, Hollis L. Hyans, and Michael A. Pearl of Morrison & Foerster LLP. Attorney Michael J. Buchanan represents the respondent.

As set forth below, we modify the respondent's action.

FINDINGS OF FACT

We adopt the facts stipulated by the parties (omitting references to exhibits) and find additional facts from the record as follows:

Stipulated Facts

1. At all times relevant, Hercules Incorporated ("petitioner"), a Delaware corporation, had its corporate headquarters and principal place of business in Wilmington, Delaware.

2. Petitioner's operations, including management of its investment portfolio, were managed from its offices in Delaware.

3. Prior to November 1, 1983, petitioner was in the business, among

other businesses, of manufacturing and marketing polypropylene. The polypropylene manufacturing business was not a part of petitioner's operations conducted in Wisconsin.

4. Polypropylene is a thermoplastic that is used to manufacture a wide variety of products, including appliance parts, automobile components, fibers, housewares, and other consumer products, packaging, and textiles.

5. Prior to July 1984, petitioner's domestic operations were divided into five separate and distinct lines of business:

(1) Organics
(2) Plastics
(3) Aerospace and Explosives
(4) Water Soluble Products
(5) Other Products.

The polypropylene manufacturing business was part of the Plastics business until November 1, 1983.

6. After July 1984, petitioner was reorganized into three business segments:

(1) Hercules Specialty Chemicals Company;
(2) Hercules Aerospace Company; and
(3) Hercules Engineered Polymers Company.

The polypropylene manufacturing business was not included in any of these business segments.

7. Petitioner's operations in Wisconsin consisted of one paper chemicals manufacturing plant in Milwaukee. That plant's four main products were Kymene, used in wet-strengthened tissues and toweling, and Aqualpel, Pexol and Scripset, all used as sizing agents in chemicals for the paper industry. No polypropylene was used or manufactured at this plant. Petitioner's operations in Wisconsin also include a sales office in Green Bay for the sale of paper industry chemicals.

8. At no time did petitioner own or lease facilities located in Wisconsin

relating to the manufacture or marketing of polypropylene.

9. On June 28, 1983, petitioner entered into a Joint Venture Agreement with Montedison S.p.A. ("Montedison"), an Italian company and a major worldwide producer of polypropylene. Pursuant to this agreement, Himont was formed on November 1, 1983, to acquire the polypropylene businesses formerly owned by petitioner and Montedison.

10. After petitioner divested itself in 1983 of its polypropylene business, it no longer had any facilities, personnel or technology to engage in, nor did it engage in, the business of manufacturing or marketing polypropylene.

Stipulated Facts Regarding Himont

11. Himont is a Delaware corporation, with its principal place of business in Wilmington, Delaware. Himont conducted business in corporate form. At all times it was a separate legal entity, with its own management and its own Board of Directors.

12. Petitioner and Montedison each received 50% of the stock in Himont in return for the transfer of their respective polypropylene assets and technology.

13. In addition to the Himont stock received by petitioner, Himont provided to petitioner a promissory note in the original principal amount of seventy million dollars ($70,000,000). This note was designed to equalize the relative value of the assets acquired by Himont from petitioner and Montedison, due to the fact that the value of the assets acquired from petitioner exceeded the value of the assets acquired from Montedison. The note was payable in five years at variable interest rates.

14. In 1986, petitioner received interest from Himont in accordance with the terms of the $70 million note. The interest received by the petitioner on the note from Himont was deposited in the petitioner's general corporate account.

15. Petitioner and Montedison entered into a Shareholders Agreement,

dated as of October 31, 1983, and a Pledge Agreement.

16. On November 1, 1983, petitioner ceased conducting its polypropylene manufacturing business by terminating all of its employees involved in that business and selling all of that business' real and personal property, and related technology, to Himont. All personnel involved in petitioner's polypropylene business prior to the 1983 sale were offered employment by Himont, and none were ever re-employed by petitioner.

17. When Himont was created, it contracted for certain administrative services from petitioner and from Montedison pursuant to a series of written agreements (collectively referred to as the "Services Agreement"). The services petitioner provided to Himont included accounting, contracting, payroll, finance, and insurance services, among others. Services were performed from 1983 through 1991.

18. No officer of petitioner served concurrently as an officer of Himont.

19. Petitioner leased 33,000 square feet of office space to Himont at petitioner's headquarters in Wilmington, Delaware, beginning in 1983 through April 1988.

20. Himont and petitioner entered into a Polypropylene Supply Agreement.

21. Himont and petitioner executed a Consignment Agreement dated October 31, 1983.

22. The total dollar amounts of polypropylene the petitioner purchased from Himont for each of the following years were:

FYE October 31, 1985	$117.2 million
FYE October 31, 1986	$121.6 million
FYE October 31, 1987	$146.0 million
FYE October 31, 1988	$133.4 million.

For each of the above years, the sales were less than 13% of Himont's total sales.

23. Petitioner's and Himont's personnel did not participate in common profit-sharing or pension plans, nor did petitioner provide employee benefit programs for Himont. To the extent former employees of petitioner had accrued or vested benefits at the time Himont was created, those accrued assets, and the associated liabilities, were acquired by Himont from petitioner.

24. The employees of the petitioner who were hired by Himont initially received the same salaries, including bonuses and incentives, benefits, seniority, and pension plan, from Himont that they had received from the petitioner.

25. In February 1987, Himont sold approximately 22.6% of its stock at $28 per share in a public offering. Upon completion of the sale, petitioner and Montedison each owned approximately 38.7% of Himont's issued and outstanding stock.

26. At the time of Himont's public offering, it was a worldwide manufacturer and distributor of a broad range of polypropylene and polypropylene-based materials and was the largest producer of polypropylene in the world, employing approximately 2,800 people worldwide, of which approximately 1,200 were in North America. At that time, Himont deployed a worldwide sales distribution network for distribution of its products in approximately 100 countries.

27. Negotiations between petitioner and Montedison resulted in the sale to Montedison, in September 1987, of petitioner's 38.7% interest in Himont for $59.50 per share.

28. Petitioner realized a 1987 net capital gain from the sale of its 38.7% interest in Himont in the amount of $1,338,501,966.

29. The proceeds from the sale of the Himont stock in 1987 were used by the petitioner as follows:

- 30.6% to construct a plant for the aerospace business;
- 35.6% to repurchase petitioner's own common stock; and

- 33.7% to pay the petitioner's taxes.

Additional Findings of Fact Regarding Himont

30. Petitioner and Himont were functionally integrated. They engaged in transactions which were not at arm's-length, including the sale by Himont of polypropylene to petitioner at a discount from market, the sale by petitioner to Himont *at cost* of a wide range of administrative services (see Finding 17, above), and the rental of substantial space by petitioner to Himont, also at cost (see Finding 19, above).

31. There was centralized management between petitioner and Himont. Petitioner had a management role in Himont grounded in petitioner's operational expertise in the polypropylene business. Petitioner had the authority to select, and dismiss if appropriate-- in each case with the concurrence of Himont's Board--Himont's president, who in turn selected other key Himont officials. The president had primary responsibility for the operation of the Company worldwide. Petitioner also nominated Himont's Vice Presidents for Financial Accounting and Administration and the head of Himont's North American operations. Petitioner selected as Himont's first president the manager of petitioner's polypropylene business, who left petitioner to assume the position. Petitioner selected three of the six members of Himont's Board of Directors until 1987, when it selected three of 11 members. Petitioner also had the authority to select the chairman of Himont's Board of Directors, who was Himont's Chief Executive Officer (CEO). In 1987, petitioner's just-retired CEO became CEO of Himont. At that same time, three new "outside" director positions were added to the Board along with two new "inside" director positions. Himont's new CEO (who was petitioner's former CEO) and Himont's president became the new "inside" directors. Thus, petitioner effectively controlled five of 11 members of Himont's Board in 1987.

32. Montedison selected the Vice Chairman of Himont's Board of Directors and nominated Himont's Vice Presidents for Business Management and Technology and the head of Himont's European operations as well as a key employee in

the financial area.

33. There were economies of scale between petitioner and Himont, reflected in petitioner's agreement to purchase most of its polypropylene needs from Himont, which were substantial (see Findings 20 and 22, above), and in petitioner's providing to Himont a variety of services and space, at cost, throughout the period under review.

34. Petitioner's investment in Himont served an operational purpose by reducing petitioner's exposure to commodity petrochemicals "without sacrificing our commitment to the polypropylene market" and by giving petitioner "immediate entry into the European staple fibers market."[1]

35. After Himont was formed, Petitioner did not provide it with financing or guarantees to assist in obtaining financing, nor was there joint ownership or use of any trademarks, service marks, trade names, logos or product designs.

36. On its 1985, 1986, and 1987 Wisconsin corporate income tax returns, petitioner reported dividends received from Himont as apportionable to Wisconsin.

Stipulated Facts Regarding Erbamont

37. On June 30, 1983, in exchange for a 50% interest in Adria Labs, Incorporated, petitioner acquired from Montedison 8% of the stock of Erbamont N.V. ("Erbamont"), a New York Stock Exchange listed company engaged in the international pharmaceutical and health care business.

38. In connection with the creation of Himont, petitioner acquired an additional 5% of Erbamont's stock from Montedison, resulting in petitioner's ownership of 13% of Erbamont's stock.

39. In March 1986, petitioner sold its 13% interest in Erbamont and realized a net capital gain in the amount of $70,892,163. The proceeds from the sale

[1] *Hercules Annual Report 1983*, p. 2.

were deposited in petitioner's general corporate account.

Additional Findings of Fact Regarding Erbamont

40. The petitioner's Board of Directors monitored its Erbamont stock holdings for performance.

41. No functional integration, centralized management or economies of scale existed between petitioner and Erbamont. Except for electing one or two of the 12 members of Erbamont's Board of Directors, petitioner never participated in or controlled Erbamont's management. Erbamont had its own management team, none of whom were former employees of petitioner, and there were no business transactions or contracts between petitioner and Erbamont.

42. Petitioner's ownership of Erbamont stock served an investment rather than an operational purpose.

Other Stipulated Facts

43. In 1987, petitioner made sales of its products in the amount of $36,715,206 in the state of Wisconsin, out of total sales of $2,102,189,360.

44. Petitioner reported tax on its 1986 through 1989 Wisconsin corporation income tax returns on a separate company basis.

45. Petitioner did not include the capital gains from the sales of its interests in Erbamont and Himont in apportionable income in its 1986 and 1987 Wisconsin corporation income tax returns, nor did it include the interest received from Himont in its 1986 return, but treated these items as nonapportionable, nonunitary nonbusiness income.

46. Petitioner reported on its 1987 Wisconsin return income from its manufacturing and marketing activities subject to apportionment in the amount of $27,117,509. Petitioner calculated its 1987 Wisconsin apportionment percentage as being .970635%, resulting in $263,212 of apportioned Wisconsin income, and petitioner paid Wisconsin corporation income/franchise taxes in the amount of $12,575.

47. By letter dated March 17, 1992, petitioner received a Notice of Field Audit Action issued by the respondent assessing Wisconsin corporation income/franchise taxes in the following amounts:

Year	Tax	Interest	Total
1986	$ 103,905	$ 64,529	$ 168,434
1987	1,064,899	533,208	1,598,107
1988	0	0	0
1989	0	0	0
Total	**$1,168,804**	**$597,737**	**$1,766,541**

48. Petitioner timely filed a petition for redetermination dated May 8, 1992, in which it objected to the adjustments made by the respondent in the Notice of Field Audit Action with respect to the Wisconsin tax treatment of the interest received from Himont and the gain derived from the sales of petitioner's interests in Erbamont and Himont.

49. By Notice of Action dated November 3, 1994, the respondent denied petitioner's petition for redetermination and issued a Notice of Amount Due in the amount of $2,136,202 (tax of $1,168,803 and interest of $967,399).

50. Inclusion of the capital gain derived from the sale of Himont stock increases petitioner's 1987 net income apportioned to Wisconsin from $263,212 to approximately $13,255,112.

51. Petitioner timely filed a petition for review, dated December 21, 1994, protesting the respondent's denial of its petition for redetermination.

WISCONSIN STATUTE INVOLVED[2]

(1987-88)

71.25 Situs of income; allocation and apportionment. For purposes of determining the situs of income under this section:

* * *

[2] Previously §71.07(1m)(b)9 and 10, Stats. (1985-86)

(5) CORPORATIONS ENGAGED IN BUSINESS BOTH WITHIN AND WITHOUT THIS STATE.

(a) *Apportionable income.* Except as provided in sub. (6), corporations engaged in business both within and without this state are subject to apportionment. Apportionable income includes all income or loss of corporations, other than nonapportionable income as specified in par. (b), including, but not limited to, income, gain or loss from the following sources:

* * *

9. Interest and dividends if the operations of the payer are unitary with those of the payee, or if those operations are not unitary but the investment activity from which that income is derived is an integral part of a unitary business and the payer and payee are neither affiliates nor related as parent company and subsidiary. In this subdivision, "investment activity" includes decision making relating to the purchase and sale of stocks and other securities, investing surplus funds and the management and record keeping associated with corporate investments, not including activities of a broker or other agent in maintaining an investment portfolio.

10. Sale of intangible assets if the operations of the company in which the investment was made were unitary with those of the investing company, or if those operations were not unitary but the investment activity from which that gain or loss was derived is an integral part of a unitary business and the companies were neither affiliates nor related as parent company and subsidiary. In this subdivision, "investment activity" has the meaning given under subd. 9.

ISSUES PRESENTED AND CONCLUSIONS OF LAW

1. Did the respondent properly include in petitioner's apportionable income, pursuant to § 71.25(5)(a), Stats. the gain realized by petitioner on the sale of its 38.7% interest in Himont, Inc. in 1987? The Commission's conclusion is *yes*.

2. Did the respondent properly include in petitioner's apportionable income, pursuant to § 71.25(5)(a), Stats. the interest received by petitioner from Himont, Inc. in 1986 and 1987 on the $70 million Working Capital Note? The Commission's conclusion is *yes*.

3. Did the respondent properly include in petitioner's apportionable income, pursuant to § 71.25(5)(a), Stats. the gain realized by petitioner on the sale of its

13% interest in Erbamont, N.V. in 1986? The Commission's conclusion is *no*.

4. Did the respondent's inclusion of these amounts of gain and interest in petitioner's apportionable income violate the Due Process and/or Commerce Clauses of the United States Constitution? The Commission's conclusion is *no*.

OPINION

In assessing the disputed tax, the respondent determined that the operations of Himont and Erbamont were "unitary" with those of the petitioner during the years at issue and therefore subject to apportionment under § 71.25(5)(a).

Under both the Due Process and the Commerce Clauses of the Constitution, a state may not, when imposing an income-based tax, "tax value earned outside its borders". *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 164, 103 S.Ct. 2933, 2939 (1983), quoting *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982).

In determining whether a state has overstepped its bounds in this regard, the taxpayer has the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed. *Exxon Corp. v. Wis. Dept. of Revenue*, 447 U.S. 207, 221 (1980).

A state may constitutionally tax an apportioned sum of a corporation's multistate business without isolating its intrastate income-producing activities if the business is unitary. *Allied Signal v. Director, Tax Div.*, 504 U.S. 768, 119 L.Ed 2d 533, 553 (1992). The Supreme Court said:

> [T]he unitary business rule is a recognition of two imperatives: the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income; and the necessary limit on the States' authority to tax value or income which cannot in fairness be attributed to the taxpayer's activities within the State.

Ibid.

In *Allied Signal* the Supreme Court reaffirmed its earlier determination in *Container Corp., supra,* that the constitutional test of unitariness focuses on functional integration, centralization of management and economies of scale and that these "essentials" could respectively be shown by: transactions not undertaken at arm's length; a management role by the parent which is grounded in its own operational expertise and operational strategy; and the fact that the corporations are engaged in the same line of business. *Allied Signal,* 119 L.Ed at 549 and 553.

But at the same time, the Court made it clear that the parties to a capital transaction "need not be engaged in the same unitary business as a prerequisite to apportionment in all cases... *What is required instead is that the capital transaction serve an operational rather than investment function.*" *Id.* at 552 (Emphasis supplied). The court further declared that "[t]he existence of a unitary relation between payee and payor is one justification for apportionment, but not the only one." *Ibid.*

Unitariness Between Petitioner and Himont

Functional Integration. Petitioner and Himont engaged in transactions which were clearly not at arm's length. These included the sale of a substantial quantity of polypropylene from Himont to petitioner at a discount from market as well as the sharing of a wide range of administrative services provided to Himont by petitioner at cost, and the rental of space to Himont by petitioner at cost. These services included: legal; health, environment and safety; human resource; corporate reporting; facilities accounting; project closing; cost accounting and operational reporting; control and inventory reconciliation; data input; salary payment of U.S. employees; bank reconciliation; foreign exchange; tax reporting and planning; accounts receivable and credit management; audit; advanced office systems; secretarial, mail and receptionist; advertising support; and research and development. In addition, the space leased by petitioner to Himont was in petitioner's headquarters building. The operations of petitioner and Himont were thus functionally integrated.

Centralization of Management. Petitioner clearly had a management role in Himont during the period under review, a role which was grounded in petitioner's own operational expertise and strategy in the polypropylene business. That role is evidenced by petitioner's selection of a substantial number of members of Himont's Board of Directors as well as the Chairman of the Board, who served as Himont's Chief Executive Officer. In addition, petitioner had the authority to select and dismiss Himont's president, who was Himont's chief operating officer and who controlled the selection of several other key officers. In 1987, both Himont's CEO and its President were former executives of petitioner.

This power to hire and fire Himont's president, together with a guaranteed Board majority to perpetuate that power,[3] guaranteed petitioner an ongoing management oversight role grounded in its own business operational expertise. The fact that the concurrence of Himont's Board was required is of little moment because the authority to hire and fire the president effectively gave petitioner control over Himont's operations through the president. No other conclusion is reasonable, and there is nothing in the record to rebut it. The fact that Himont's board approved all management recommendations says nothing about the extent to which petitioner controlled or influenced those decisions through the president.

Further supporting this conclusion is the fact that petitioner selected as Himont's president during its formative years, including the period under review, the person who had been responsible for managing petitioner's own polypropylene business prior to the formation of Himont. In addition, in 1987 petitioner selected its just-retired CEO as Himont's CEO. This demonstrates petitioner's determination to assure that its business and operational expertise would continue in the operation of Himont even

[3] The Shareholders Agreement required Montedison to vote its shares to give petitioner this power, which is essentially guaranteed by limits on Montedison's power to sell or pledge its stock.

though Himont was a stand-alone entity. As the Supreme Court has said:

> In any event, although potential control is, as we said in *F.W. Woolworth*, not *"dispositive"* of the unitary business issue, *id.* At 362, 102 S.Ct. at 3134 (emphasis added), it is *relevant*, both to whether or not the components of the purported unitary business share that degree of common ownership which is a prerequisite to a finding of unitariness, and also to whether there might exist a degree of implicit control sufficient to render the parent and the subsidiary an integrated enterprise.

Container Corp., supra, 463 U.S. at 177 (footnote 16).

We therefore conclude that there was centralization of management between petitioner and Himont because of petitioner's actual and implicit control over Himont's management, primarily through its president but also through Himont's Board Chairman.

This is not to say that Montedison did not also have a strong management role in Himont. After all, petitioner and Montedison were the parents of Himont. But the record shows that petitioner's management role in Himont, particularly its *operational* management role, was greater during the period under review.

<u>Economies of Scale</u>. Although Himont and petitioner were not both engaged in the business of manufacturing and marketing polypropylene, petitioner continued to consume a substantial amount of polypropylene in its business, and by agreement purchased most of its polypropylene needs from Himont, accounting for a significant part of Himont's sales. This obviously produced economies of scale between them, evidenced by the discounted price to petitioner and expressly acknowledged in the Shareholders Agreement dated October 31, 1983.

In addition, there were obvious economies of scale between Himont and petitioner as the result of the arrangement for sharing at cost petitioner's employees, services and facilities. Had petitioner not been a large consumer of Himont's polypropylene and provider of the same administrative services required by Himont as petitioner was already providing to itself, these economies of scale would not have been possible for either petitioner or Himont. Obviously, the scale of petitioner's and Himont's administrative operations could not have been maintained without this administrative cost sharing arrangement. This was especially important for Himont, which relied on this economy of scale to be up and running from day one and continued to so rely because the sharing arrangement was never terminated. The unsubstantiated testimony presented by petitioner that polypropylene and the various services would have been available elsewhere on comparable terms did not refute the obvious conclusion that these economies of scale existed between Himont and petitioner.

Did the Himont Investment Serve an Operational Function?

As noted above, *Allied Signal* made clear that income from a capital transaction which serves an *operational*[4] rather than an *investment* function can be subject to apportionment by a state even where the payor and payee are not engaged in the same unitary business.

There can be no doubt that, from inception to disposition, petitioner's investment in Himont served an operational purpose tied to its ongoing operations. Petitioner's 1983 Annual Report refers to the formation of Himont that year as the culmination of

> restructuring...to reduce [petitioner's] exposure to petrochemical commodities... Even as we reduce our exposure to commodity petrochemicals, *we do so without sacrificing our commitment to the polypropylene market...* HIMONT should be the lowest cost producer of this versatile plastic on a world-wide scale, geographically diversified basis.[5]

That same Annual Report proclaimed that petitioner "gained immediate entry into the European staple fibers market through HIMONT's 40,000-ton-per-year staple fiber plant

[4] Justice O'Connor's dissent in *Allied Signal* laments that the Court "leaves 'operational function' largely undefined," but she agrees with the majority "that there need not be a unitary relationship...in order for a state to tax investment income."

at Terni, Italy."[6]

Petitioner's Himont joint venture thus served not only the stated operational purpose of reducing its exposure to petrochemical commodities, but also gave petitioner access to additional European markets and provided a guaranteed supply of polypropylene for its other operations at a discount from market.

Finally, although not itself determinative of an operational purpose or unitariness,[7] the sale of Himont and resulting proceeds allowed petitioner "to bolster our growth plans for Aerospace, Specialty Chemicals, and Engineered Polymers."[8]

Therefore, both because we conclude that Himont's operations were unitary with those of petitioner and that petitioner's investment in Himont served an operational purpose, we conclude that the respondent properly subjected to apportionment petitioner's interest income from the Working Capital Note and its capital gain on the sale of Himont stock, pursuant to § 71.25(5)(a), Stats., *supra*, including 71.25(5)(a)9 and 10.

The Maryland Tax Court recently reached this same conclusion as to the operational purpose of petitioner's Himont investment in *Hercules, Inc. v. Comptroller of the Treasury*, ¶201-521 CCH Md. Tax Rptr. (1995).

In so concluding, we are mindful of the fact that Himont was a joint venture between petitioner and Montedison and that neither party had absolute control of Himont. The issue before us, however, is whether as a factual and legal matter unitariness and an operational relationship existed between petitioner and Himont, which we must answer affirmatively.

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[5] *Hercules Annual Report 1983*, p. 2.
[6] *Id.*, p. 14.
[7] *See*, *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 326 (1982).
[8] *Hercules Annual Report 1987*, p. 3.

Unitariness Between Petitioner and Erbamont

The petitioner has shown that unitariness did not exist with Erbamont, and the respondent virtually concedes this.[9] But respondent claims apportionability under the second clause of § 71.25(5)(a)10, *supra*, which allows apportionment if "the investment activity from which that income is derived is an integral part of a unitary business and the payer and payee are neither affiliates nor related as parent company and subsidiary."

We disagree with respondent for two reasons. First, Erbamont ("the investment activity") was not part of petitioner's unitary business because Erbamont and petitioner were not unitary. And without unitariness or a showing that the investment served an operational purpose, the Due Process and Commerce Clauses preclude state apportionment. *See, Allied Signal, supra,* 119 L.Ed at 553.

Second, Erbamont was, although not a "subsidiary" of petitioner, surely an "affiliate" inasmuch as petitioner owned 13% percent of Erbamont's stock and had at least one representative on Erbamont's Board of Directors. *See, Albany International Corp. v. WDOR,* ¶400-067 CCH Wis. Tax Rptr., p.30,229 (WTAC 1994).[10] The Erbamont dividends, therefore, do not fall within this statutory apportionment language.

Accordingly, we conclude that the respondent improperly subjected to apportionment petitioner's dividends from Erbamont.

Constitutional Issue: Due Process and Commerce Clauses

The petitioner also attacks respondent's inclusion of its gain from the sale of Himont stock under the Due Process and Commerce Clauses of the U. S. Constitution, claiming that the resulting income attributed to Wisconsin is "out of all appropriate proportion to the business transacted in the State" or has "led to a grossly distorted result," citing *Container Corp., supra,* 463 U.S. at 170, which also requires the

[9] Respondent's Brief, p. 49.
[10] Companies in which ownership ranged from less than 10% to 55% were determined to be "Affiliates."

taxpayer to prove so by "clear and cogent evidence."

But the constitutional focus in *Container Corp.* is the "proportion" of income taxed by application of a state's apportionment formula. And although petitioner complains that respondent's apportionment of the Himont gain attributes to Wisconsin 50 times more income than would otherwise be taxed from petitioner's "core business operations," it is not the apportionment formula which produces this differential; it is the fact that Himont and petitioner were unitary and that petitioner's investment in Himont served an operational function, thereby subjecting the gain to state apportionment.

We also reject petitioner's attempt to use "separate accounting" to prove disparity in petitioner's apportionment formula. There is nothing in the record indicating that separate accounting is an issue in this case, or that petitioner ever requested of respondent separate accounting for its Wisconsin operations. As the Supreme Court noted in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 438 (1980):

> [S]eparate geographical 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. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of a 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. (Citations omitted.)

Indeed, petitioner filed tax returns for the period under review as a separate company and included *dividends* from both Himont and Erbamont as apportionable to Wisconsin. In this regard, it is interesting that the Supreme Court has held that, "for constitutional purposes capital gains should be treated as no different from dividends." *Allied Signal, supra,* 119 L.Ed. at 547 (Citation omitted).

Further, the percentages of income computed by petitioner on its tax returns as apportionable to Wisconsin were only .999989% for 1986 and .970635% for 1987. Petitioner has presented no evidence to show that these percentages are in any way constitutionally flawed.

Alternatively, petitioner asserts that respondent's apportionment formula unconstitutionally fails to take into account factor representation reflecting Himont's property, payroll and receipts which generated the gain being apportioned.

Container Corp., supra, 463 U.S. at 169-70, explains that, in order for a state apportionment formula to be fair under both the Due Process and Commerce Clauses, it must have both "internal consistency" and "external consistency." But the petitioner has not addressed either of these components in its brief, instead relying only on its "separate accounting" analysis, which we have already disposed of.

Petitioner also relies heavily on *American Tel. & Tel. v. WDOR*, 143 Wis.2d 533 (Ct. App. 1988), where the Court of Appeals overturned an apportionment which resulted in "far too much income being apportioned to Wisconsin" and did "not reflect a reasonable sense of how A.T. & T.'s income is generated and taxes value earned outside the borders of Wisconsin." *Id.*, at 551. But as we said in *Albany International Corp. v. WDOR*, ¶400-067 CCH Wis. Tax Rptr. 30,225 at 30,236 (WTAC 1994), the *A.T. & T.* Case is of only limited value here because of the failure of the Court to provide "any mathematical computations or percentages regarding the magnitude of the disproportionality it found." *NCR Corp. v. WDOR*, ¶203-412 CCH Wis. Tax Rptr. 15,778, 15,800 (Dane Co. Cir. Ct. 1993).[11]

Absent a showing by petitioner that respondent's apportionment formula is not internally or externally consistent, the formula must be found constitutionally sufficient.

[11] The Dane County Court also found the A.T.& T. decision of "limited value" in analyzing Wisconsin's apportionment formula.

ORDER

The respondent's action on petitioner's petition for redetermination is affirmed as to the interest income from Himont Incorporated and the gain on the sale of stock in Himont Incorporated, and reversed as to the gain on the sale of stock in Erbamont N.V.

Dated at Madison, Wisconsin, this 26th day of February, 1997.

WISCONSIN TAX APPEALS COMMISSION

Mark E. Musolf, Chairperson

Don M. Millis, Commissioner

David Prosser, Jr., Commissioner

ATTACHMENT: "**Notice of Appeal Information**"