ORIGINAL

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE

SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 81-523

TITLE CONTAINER CORPORATION OF AMERICA, Appellant
v.
FRANCHISE TAX BOARD

PLACE **Washington, D. C.**

DATE January 10, 1983

PAGES 1 thru 40

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IN THE SUPREME COURT OF THE UNITED STATES

CONTAINER CORPORATION OF AMERICA,

Appellant

v. No. 81-523

FRANCHISE TAX BOARD

Washington, D.C.

Monday, January 10, 1983

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:46 p.m.

APPEARANCES:

FRANKLIN C. LATCHAM, ESQ., San Francisco, California; on behalf of the Appellant.

NEAL J. GOBAR, ESQ., Deputy Attorney General of California, San Diego, California; on behalf of the Appellee.

CONTENTS

ORAL ARGUMENT OF:	PAGE
FRANKLIN C. LATCHAM, ESQ., on behalf of the Appellant	3
NEAL J. GOBAR, ESQ. on behalf of the Appellees	20
FRANKLIN C. LATCHAM, ESQ. On behalf of the Appellant -- Rebuttal	38

PROCEEDINGS

JUSTICE BRENNAN: You may proceed, Mr. Latcham.

ORAL ARGUMENT OF FRANKLIN C. LATCHAM, ESQ.

ON BEHALF OF THE APPELLANT

MR. LATCHAM: May it please the Court, this is an appeal from the California Court of Appeals, the California Supreme Court having declined to hear the case. The Court of Appeals sustained the trial court in holding that Container Corporation of American, Appellant herein, and its foreign subsidiaries were engaged in one unitary business. However, the Court, in its opinion, based its opinion upon different legal standards than those adopted by this Court in the recent ASARCO and Woolworth cases. The Court also rejected Container's other constitutional arguments.

This case again presents the unitary business issue, but in a context different from ASARCO and Woolworth. There the cases involved taxation by a non-domociliary state of dividends from foreign subsidiaries. Here a non-domociliary state, California, is attempting to combine the parent and foreign subsidiaries' income in one tax base and apportion part of that income to California by the payroll/property/sales formula.

QUESTION: They would also, I take it, include the assets in the calculations.

MR. LATCHAM: They would include the subsidiaries'

assets in the calculations, is that your question?

QUESTION: Yes.

MR. LATCHAM: In the formula, that is right. The subsidiaries' payroll, property, and sales are included in the denominator of the formula.

QUESTION: Which wasn't true in --

MR. LATCHAM: Which was not true in ASARCO and Woolworth, but the court didn't get to that specific problem.

QUESTION: Although there was some interest in it.

MR. LATCHAM: Yes.

Here, as contrasted with ASARCO and Woolworth, there is immediate state taxation of the foreign subsidiaries' income even though it is not distributed to the parent.

In regard to the unitary issue, Container -- I want to say one more thing about the order of our arguments. Container's position is that it may prevail on any one of the following arguments: First, under the due process clause because Container is not unitary with its foreign subsidiaries; second, under the due process clause because California is taxing extraterritorial income due to distortion in the formula; third, under the commerce clause because of double taxation; and, fourth, under the commerce clause because the California system prevents the United States from speaking with one voice in the field of foreign relations.

QUESTION: Mr. Latcham, would you be here making the same argument if these subsidiaries were all domestic subsidiaries

operating in precisely the same way as these foreign subsidiaries?

MR. LATCHAM: We would be making the same argument, I think, Your Honor --

QUESTION: You wouldn't be making the latter argument?

MR. LATCHAM: We would be making the unitary argument.

QUESTION: Yes, the same -- So, the unitary argument is the same whether these are foreign or domestic subsidiaries?

MR. LATCHAM: That is correct, Your Honor. And, also, I think we would be making -- The due process distortion argument is the same.

In regard to the unitary argument, Container and its foreign subsidiaries are a separate business operation.

Now, I would say in regard to reviewing the facts, Container has no quarrel in general with the Court of Appeals' statement of fact except in a few instances noted in our main brief in which we believe the Court of Appeals made errors in its statement, but we believe we would prevail on the statement of facts in the Court of Appeals case. We, of course, disagree with their legal conclusion.

In any event, we would invite the Court to read the record, which is rather short, comprising a stipulation of facts and uncontroverted testimony.

QUESTION: Mr. Latcham --

MR. LATCHAM: Yes.

QUESTION: There were no administrative proceedings

within the California State tax system prior to this that were contested? I mean, was the record stipulated at the administrative stage?

MR. LATCHAM: Well, the administrative proceeding in California was under a protest due to the Franchise Tax Board based on their proposed deficiency based on the fact that Container and its subsidiaries were unitary. So, there was that informal administrative proceeding in which the Franchise Tax Board held that they were unitary, the deficiency was upheld, we then went to court.

QUESTION: Well, how is the stipulation -- Had there been depositions? I am curious to know. For instance, if I were a state tax collection agency employee and all of the information were in the possession largely of the taxpayer -- how would you go about stipulating?

MR. LATCHAM: Well, we went about stipulating the facts much as we have done in many, many cases in California. We took statements from the employees and principal officers of the parent company, presented that information to the Franchise Tax -- or the Deputy Attorney General representing the Franchise Tax Board. Of course, he had the opportunity to ask any questions or look at any documents or records he cared to including the full audit statement and that is how I prepared it.

QUESTION: What was the total amount of tax in controversy?

MR. LATCHAM: The total amount of tax in controversy is approximately $71,000 for the three years in question.

QUESTION: That is the difference California says it can tax you and what you say California can tax you?

MR. LATCHAM: That is right.

QUESTION: And that is for three years?

MR. LATCHAM: Three years, yes. That is on page nine of the Joint Appendix.

QUESTION: Is the same thing true for all the intervening years?

MR. LATCHAM: For all intervening years up through 1972, the stipulation says the Franchise Tax Board determined additional liabilities due to the proposel worldwide combination, that is correct, Your Honor.

QUESTION: It is a long time ago, isn't it?

MR. LATCHAM: It is a long time ago and, as a matter of fact, the problem is even with us today, I am told, the company and many other companies.

Container is a Delaware corporation with headquarters in Chicago. It manufactures and sells cartons and boxes within the United States with some sales to Puerto Rico and Canada. The subsidiaries are organized and operating in six countries, three in Europe, Germany, the Netherlands, and Italy, and three in Latin America, Colombia, Venezuela, and Mexico.

The subsidiaries are involved generally in the same line

of business as the parent, however, the subsidiaries are fully integrated, self-sustaining operational units. They buy most of their raw materials locally. They manufacture and sell within their countries of operation with some sales into contiguous countries, but none into the United States.

The most profitable subsidiaries are those in Colombia and Venezuela and have substantial outside shareholders. A third of the shareholders in Colombia are local people, 20% in Venezuela.

The subsidiaries make no sales of raw materials or finished products to the parent. The parent makes no sales of finished products to the subsidiaries and only a small percentage, less than one percent, of the subsidiaries' purchases of raw materials to the subsidiaries. These sales, incidentally, were for fair market value and could have been purchased from other parties.

The subsidiaries did no business in California or the United States. They have no property, payroll, or sales in California or the United States. Their business was entirely within their own countries with some sales to contiguous countries.

Now, we believe that under the clear guidelines of the ASARCO and Woolworth cases that Container must prevail on the unitary issue.

In those cases, the Court said -- Of course, you have to have majority ownership, but the Court said, the following

factors of profitability must arise from the business as a whole, functional integration, centralized management, economies of scale. In this case, there is little, if any, functional integration. As I said, the subsidiaries were fully integrated, self-sustaining units. There was no meaningful product flow between parent and subsidiaries.

We suggested in the main brief that the Court might consider the product flow as a bright-line standard in determining the unitary business doctrine.

We would restrict this, of course, to manufacturing, mercantile, and producing business. This would be an objective test as compared to the more subjective test involved in central management and economy of scale. Such a test would arise from the reason for formulary apportionment which is the inability of the state to determine where income is earned.

QUESTION: Now, the flow of goods test was not really one that was suggested by this court in the majority opinion in ASARCO and Woolworth, was it?

MR. LATCHAM: Well, I think, Your Honor, that it was suggested. It was certainly to me inferred from the language of the majority opinion in which the court talked about a flow of international commerce and they did talk about a flow of product in the discussion of what is functional integration in the ruling.

The subsidiaries all had their own departments necessary

to the operation of their business such as engineering, design, accounting, personnel, and so forth. They occasionally sought technical information from Container, but for the most part, they solved their own problems themselves or with the use of independent consultants.

As in the Woolworth case, no phase of any subsidiaries' business was integrated with that of the parent nor was there centralization of management as discussed in ASARCO and Woolworth. The subsidiaries' management were solely responsible for the day-to-day operation and all other aspects of their business. They were, incidentally, mostly local people.

Container's only involvement was the approval of major capital appropriations which originated from the subsidiaries. Of course, as in ASARCO and Woolworth, there were discussions back and forth between Container and the subsidiaries, but the subsidiaries management were in control and held responsible for the operations.

QUESTION: But, I suppose the parent elected the boards.

MR. LATCHAM: Well, as a matter of fact, the record shows that the parent had less than a majority of the directors on the overall.

QUESTION: What do you mean, they had the majority of the directors? Do you mean --

MR. LATCHAM: They elected less than a majority.

QUESTION: Well, didn't it take a majority vote to

elect all the directors?

MR. LATCHAM: No. I mean they had less than a majority of Container personnel as --

QUESTION: That is a totally different statement.

MR. LATCHAM: Yes.

QUESTION: They elected all of the directors. They controlled the election of any directors.

MR. LATCHAM: Well, yes, that is true, Your Honor.

QUESTION: It is just that they put their own -- What do you call a Container person that was on the board? He also held an office in Container?

MR. LATCHAM: Yes, that is true, Your Honor. I was about to say that, of course, in the case of the Colombian and Venezuelan subsidiaries the public shareholders would have the right to elect directors and the stipulation of facts also states that for the most part the Container personnel who were directors were not directly involved in the operation of the subsidiaries.

As I said, of course, there were discussions back and forth between the parent and subsidiaries much like those in the Woolworth case. In essence, we maintain that Container's management was overseeing its investment in the subsidiaries. Certainly there was no economy of scale arising from centralized management in this case.

QUESTION: You are not suggesting it is just as if Container had invested in a chain of hotels in South America?

MR. LATCHAM: I am not suggesting it is the same as if the foreign subsidiaries were operating hotels, no, Your Honor.

As a matter of fact, as I have said, there was occasional technical information and other services that came from Container to the subsidaries, but we would maintain this is not an economy of scale. In other words, the various departments of Container did not also provide the same services to the subsidaries, so that the accounting department of Container or the personnel department or the tax or engineering were doing the same work for Container and the same work for the subsidiaries. There was not that duplication going on, therefore, there was not a spreading of cost that would come from such duplication.

In place of the three tests stated in ASARCO and Woolworth, the Franchise Tax Board argues for a sweeping contribution test plus a presumption that corporations are unitary if they are in the same line of business. This is essentially the test used by the Court of Appeals below. In essence, we maintain the Franchise Tax Board is suggesting that this Court should overrule ASARCO and Woolworth and reinstate the decision of the lower court below as the proper test for a unitary business.

Going on to due process question, we believe that it is clear that extraterritorial income is being taxed and that worldwide unitary method of California is invalid on its face and as applied in this case.

The facts here show California is attempting to reach out-of-state income. As I have said, the subsidaries do no business in California or the United States. They have no payroll, property, or sales in California or the United States. California is providing no services to those subsidiaries. In fact, there is no showing that Container's operational profits, that is the profits it got from its business in the United States and California, were enhanced by the operation of the subsidiaries in spite of the fact that the Franchise Tax Board claiming that formulary apportionment makes for a better determination of Container's income. Of course, the effect is to shift substantial income from the subsidiaries, particularly in Venezuela and Colombia, to Container, and, therefore, to California.

But, we maintain the formulary appportionment is skewed in the international arena. It works all right within the domestic United States where we have the same political system and a homogeneous economy.

QUESTION: How does it work out if the subsidiary has a loss?

MR. LATCHAM: How does it work if the subsidiary has a loss? Then, indeed, Your Honor, part of the income of Container would be apportioned to the subsidiary and, of course, the other way around.

QUESTION: It is a two-way street.

MR. LATCHAM: Well, it is not a two-way street, of

course, in this case, because the very substantial profits of the subsidiaries which have been going on for a considerable period of time.

As I have said, in the international arena in this case, and we would maintain generally, especially in regard to developing countries where you have a much lower payroll and profitability is higher, you are going to have distortion and this case illustrates; the wages here in Colombia and Venezuela, which are the most profitable subsidiaries, were lower and the profitability much higher. As a result, half of the income of the Venezuelan and Colombian subsidiaries is apportioned to Container and, therefore, partly to California. Each of those subsidiaries earned about $4 million a year. Half of that, $2 million, by formulary apportionment, is apportioned to Container and about 30% of the total of the subsidiaries' income is shifted to Container.

We, of course, are using separate accounting as a measuring standard, but this has been approved by this Court in the Norfolk and Hans Rees cases and considered by the Court in Moorman and Exxon as usable standards where the taxpayer introduces evidence explaining why the formula produces an unfair result. We have introduced that evidence in this case by showing lower payrolls and higher profits in the most profitable subsidiaries, those in Venezuela and Colombia, because of the difference in political and economic environment as between

those countries and the United States.

Furthermore, we are not using separate accounting in this case purely as an internal measure to determine profitability. We were required to use separate accounting, or at least the foreign subsidiaries were, by the countries in which they operate, so that standard is set up by those countries and it is the custom of nations to use separate accounting as I will mention in a moment.

QUESTION: Venezuela and Colombia didn't require you to use separate accounting in California, did they?

MR. LATCHAM: They did not, Your Honor. They did not. They certainly required it, however, in Venezuela and Colombia.

We also maintain that California's worldwide method violates the commerce clause because it leads to double taxation, both inherently and in this case. There is a clear case of double taxation here. California, by applying an apportionment method, is taxing income in part which foreign countries, through separate accounting, has taxed in full. This is similar in effect to the Japan Line case where Japan was taxing the property, Container, in full in Japan and California, by an apportionment method, was taxing them in part. There is no question that double taxation has occurred on the facts.

QUESTION: Does California recognize at all that taxes have been paid on some of this income that it has included in this formula?

MR. LATCHAM: No, they do not, Your Honor. They do not allow a credit or any deduction for taxes paid in foreign countries. So, as far as they are concerned, it is irrelevant.

As I said, the subsidiaries filed returns in these countries on a separate accounting basis and paid the tax thereon. The Board took separate accounting income, book separate accounting income, which is very close to taxable separate accounting income, and included that separate accounting income in the tax base with Container's income and apportioned part of it to California. The deficiency in this case results from that direct action.

QUESTION: What if the subsidiaries paid a substantial amount of dividends to Container? What happens to those dividends? Is that also included in Container's income?

MR. LATCHAM: That is not included in Container's income insofar as California is concerned, because the commerical domocile is in Chicago.

I might mention, however, that California has a special statute which states that to the extent dividends are paid to a company with a commerical domocile outside of California the interest deductions of the corporation are reduced on a dollar-for-dollar basis. So, California does take those separate dividends into account.

The Japan Line case noted that in the field of foreign commerce as compared to interstate commerce double taxation, even

though small in amount, is a special problem that would invalidate a state tax. This is not a case of the possibility of double taxation, double taxation has actually occurred because of California's method, therefore, we maintain it is invalid under the commerce clause.

Finally, we maintain that the worldwide unitary method impairs the ability of the United States to speak with one voice. Double taxation here illustrates the problem through the Internal Revenue Code and the tax treaties entered into by the United States and many major foreign trading powers. A system has been worked out for avoiding double taxation; that is the separate accounting arm's-length method. It avoids double taxation in this case.

This Court long ago recognized that the federal government, not the states, must predominate in the field of foreign relations. Japan Line is a recent case upholding that.

QUESTION: What does California do about a British corporation? Suppose this were considered -- Container, is it an Illinois corporation?

MR. LATCHAM: It is Delaware headquartered in Illinois.

QUESTION: So, what if it were a British corporation?

MR. LATCHAM: A British parent company?

QUESTION: Yes, with headquarters in New York. What would California do, treat it the same?

MR. LATCHAM: California treats -- It applies the

unitary method to all multinational corporations whether the parent is headquartered in the United States or in a foreign country.

As I understand your question --

QUESTION: Yes.

MR. LATCHAM: -- if the British company is an English, United Kingdom corporation with a subsidiary operating in California, California would apply the unitary method there also.

QUESTION: Even if it didn't have a subsidiary, if it were just doing business there and had income from there.

MR. LATCHAM: They would apply it, yes, in that situation.

QUESTION: Mr. Latcham, in our proposed treaty with the United Kingdom, the Senate, of course, removed the language that would have denied the states the right to apply this formulary apportionment which certainly is at least an indicator that the federal government isn't interested in speaking with one voice in this area.

MR. LATCHAM: Well, I would say in regard to the treaty, Your Honor, there was -- A majority of the Senate voted in favor of the treaty retaining that provision, but a two-thirds majority did not.

QUESTION: Right.

MR. LATCHAM: And, in the legislative history to that treaty, there is considerable indication that many senators were

concerned that this problem should not be taken up by Congress through the treaty mechanism, but it should go to both houses of Congress.

So, I think it is an inconclusive determination as to what the Senate meant.

QUESTION: But, it is a negative indicator in that argument, is it not?

MR. LATCHAM: It is a negative indicator. On the other hand, the foreign governments, as evidenced by the amicus briefs in this case, and have complained continuously about the unitary method. I think the United Kingdom is continuing to complain. As we have cited in our brief, there was a recent parliamentary debate in which they indicated that they had an understanding that something was to be done about the problem and nothing has been done and a threat of retaliation --

QUESTION: Has the Solicitor General weighed in on this question, not in this case anyway?

MR. LATCHAM: I was going to mention that very point, Your Honor. The Solicitor General did advise this Court in the Chicago Bridge case --

QUESTION: Yes.

MR. LATCHAM: -- that in their view the worldwide unitary method as imposed by the states does impair the ability of the federal government to carry out its foreign policy.

QUESTION: Did he say just to the extent it applies to

foreign corporations?

MR. LATCHAM: No, he did not, Your Honor. He said that it applied to U.S. based --

QUESTION: Just this kind of a case?

MR. LATCHAM: Just this kind of a case, because Chicago Bridge presents just this kind of a case.

I will reserve some time for rebuttal. Thank you.

JUSTICE BRENNAN: Attorney General Gobar?

ORAL ARGUMENT OF OF NEAL J. GOBAR, ESQ.

ON BEHALF OF THE APPELLEES

MR. GOBAR: Mr. Acting Chief Justice, may it please the Court:

Here, Container concedes, apparently for the purposes of domestic taxation, taxation of interstate commerce that is, and also it concedes for the purpose of taxing its own activities in Canada, that the formula apportionment method is proper. However, it seeks preferential treatment, a special rule, for the major companies which are doing business in foreign countries through their subsidiaries. It apparently seeks to draw a distinction between its activities through a subsidiary in a foreign country and its activities which it does itself.

California applies the formulary apportionment method, the combined reporting method, uniformly to all businesses. It feels that such special treatment is inappropriate; that its treatment, its even-handed treatment of all unitary business

operations is proper.

As indicated, there are two commerce clause arguments and there are two due process arguments presented by Plaintiff.

We here will respond first to the commerce clause arguments. We will talk about them together. We feel they are answered substantially by this Court's decisions and language in the Mobil case, Bass, Ratcliff; and, secondly, we will go on to the discussion of the due process extraterritorial argument which we feel is most recently discussed and responded to in this Court's Exxon case. Thirdly, we will talk about unitary business facts which we feel are shown to clearly exist under this Court's most recent Woolworth statement of the rule and the test and the Butler Brothers case which clearly applies the unitary formula in a situation similar to this and we feel that the facts, as appear in the record, unlike those partial statements of facts which Your Honor has heard properly by an advocate this afternoon will clearly establish that we have a clear unitary business here.

First, with respect to the commerce clause argument, these are predicated upon this Court's 1979 Japan Line argument and case and decision which did not involve a situation which we have here and we feel is not applicable. We feel this was recognized by this Court in the Mobil case as well as in the language of the Japan Line case itself. That case, which involved a taxation of a foreign instrumentality which was in the United States solely while moving in foreign commerce, and

had been subject pursuant to a specific convention to taxation in full at its place of domocile, is certainly the opposite of what we have here. We are here talking about taxing a unitary business. We are here talking about taxing an American company.

The considerations before the Court in the Japan Line are not the considerations when we are taxing an American company who chooses to do business in foreign countries by setting up separate subsidiaries which it fully controls and operates as part of its unitary business rather than merely sending its own employees there as a division.

Unlike the Japan Line case, here we have no federal one voice which prevents combined reporting. As has been indicated by questions of the Court already, Congress has refused in any way, shape, or form to limit the power of the states to tax unitary businesses by formula apportionment. Congress has had a number of bills before it for a number of years. Congress is the appropriate person, the appropriate agency, to place limitations upon the state's right to tax -- to use the formulary method of taxing particularly with respect to domestic corporations.

The Executive Department at no time, not withstanding the contentions of the Solicitor General in a different case, at no time, to our knowledge, has suggested that there be any limitation placed upon the taxation by the state of income of a unitary business which is controlled by an American company

such as Container here. To the best of our knowledge, only on one occasion was it suggested that even activities of any foreign-controlled company be subjected to a different treatment than the fair uniform treatment which we have by formula apportionment. And, that case, as indicated, was rejected by the Senate and we have no knowledge of any attempt by the Executive Branch to pursue that matter further.

QUESTION: Now you spoke of foreign-controlled companies. Does that mean a foreign situation where Container, for example, were a foreign corporation in the true sense or is it just control by foreign shareholders?

MR. GOBAR: We are talking -- When I say "foreign-controlled company," I am talking about a foreign company who has a subsidiary here.

QUESTION: Which is not this case?

MR. GOBAR: Which is not this case.

QUESTION: You feel that is a very different case than this one?

MR. GOBAR: That is a very different case. The commerce clause --

QUESTION: How do you read the Solicitor General's submission in the Chicago Railroad case?

MR. GOBAR: I read that just like I read the AC briefs filed by --

QUESTION: You disagree with your colleague on the other

side that the --

MR. GOBAR: Yes. I believe that his main concern is with the foreign commerce and not with how we tax our domestic companies.

I believe the indications of this Court in the Japan Line case, the fear of retaliation, with respect to that other situation which we do not have here. I haven't seen any suggestion of any foreign country, nor do I believe there is, that they are concerned how the United States taxes Container corporation. And that is all we are doing here. We are taxing Container Corporation. The only question is how do we measure container Corporation's tax. I don't think Colombia would want us telling them how they can tax a company which is in Colombia. What these Plaintiffs are here trying to do is they are a domestic company and they are wrapping themselves in a foreign flag. That is not what we have here. We are talking about taxation of a domestic company who chooses to go into foreign countries and set up subsidiaries. This operation could have been conducted through divisions and in that case presumably there would be no question, as this Court seemed to indicate in the Mobil case. There would be no question about the appropriateness of our tax.

We see no substantial distinction that there is any basis for a different rule since they choose to do business through subsidiaries. If this were not the case, form would control over substance. And, as Container went to Colombia in

the 1940's and set up this subsidiary business and operation, they could go there, start the operations, and while it is a loss operate it as a division.

QUESTION: Well, on that basis, the whole unitary concept is meaningless anyway. In any situation -- In any of these situations, you could do your work through divisions.

MR. GOBAR: My point, Your Honor, is that the unitary formula method should be applicable as California has uniformly applied it regardless of the activities -- whether the unit -- you have to have a unitary business, but regardless of whether the unit is operated through a single corporation or through a parent in a number of subsidiaries, the treatment has to be the same if they are both unitary businesses to avoid the ability, which the major companies here are trying to retain in this case, to shift their income by switching from a division situation subject to formula apportionment while it is a loss, and as Your Honor pointed out, when they start they are losses, and you run your loss divisions in and that reduces your California tax.

Italy was a loss during this period. Some of the other foreign subsidiaries which they have here, they were allocated, even taking the CCA's figures, which we feel are wrong, but even accepting their figures, some of the income was increased, would have been increased under the formula method. So, it is not a one-way street. We have a fair method and it goes either way.

The Caterpillar case, which was argued before Your Honor last April, is a good illustration. It is a fair, even, two-way street. Needless to say, taxpayers normally will not come and object if we reduce their tax through the formula apportionment so the only cases you will see is where it is increased.

But, as we indicated, there is no one-voice situation here where -- equivalent to that we had in Japan Line.

Further, with respect to the presentation of the Solicitor General, in oral argument the Solicitor General conceded that there was no treaty anywhere, any specific provision of any treaty which precluded its use. So, he doesn't disagree on that point.

And, as I indicated, we think basically this is a type of question, any restrictions on the state, is a matter for Congress and for the treaty process to be followed. This is not a constitutional limitation.

QUESTION: And to what oral argument were you referring to?

MR. GOBAR: The oral argument in the CDI Caterpillar case.

QUESTION: Last term?

MR. GOBAR: Last term. I think it was April, Your Honor.

QUESTION: General, may I ask you a question about the SG's position in Caterpillar. If we happen to agree with the SG's

arguement as presented in his brief in that case, would that mean that we would have to address you in this case? If we agreed with the Solicitor General's position in Caterpillar, would that control in this case?

MR. GOBAR: Not if it is what I believe it is.

QUESTION: He relied explicitly on Japan Line and argued that it was clear that double taxation would result. He carried that argument over into the Caterpillar case. He also argued quite explicitly that the United States government had an interest in the type of system that the Solicitor General supported in Caterpillar which was quite different from the unitary formulary apportionment that you advocate.

I understood you to say that you didn't think the Executive Branch disagreed with your position, but it seems to me that the Solicitor General at least or rather explicitly does. I wonder what you --

MR. GOBAR: Well, the Solicitor General, in a brief in Caterpillar -- Incidentally, if I might give the citation on that. That was April 19th oral argument and reporter's transcript, page 18.

QUESTION: Doesn't the Solicitor General file the written amicus brief in the Chicago Bridge?

MR. GOBAR: He did in that case. He has not filed anything --

QUESTION: No, but that is a pending hearing, is it not?

MR. GOBAR: It is not in tamden with this case.

QUESTION: No, no.

MR. GOBAR: It is pending. It is still undecided by this Court.

QUESTION: Yes. And there is a brief of the Solicitor General in that case?

MR. GOBAR: That is my understanding, yes.

QUESTION: And, what about the same question Justice Powell put to you about his position there? Isn't his position there inconsistent with yours here?

MR. GOBAR: Well, he makes a broad statement. For example, he says there is double taxation in the Container Corporation.

QUESTION: And he argued Japan Line?

MR. GOBAR: And he argued Japan Line. We strongly deny that. There is no double taxation here in fact or in law. So, if you agree with him on that, then we are in a little bit of trouble.

QUESTION: How can you say that for in Colombia, for example, where the amount of the tax is the amount of that you have attributed for their whole income down there? How can you say that the facts here do not show double taxation?

MR. GOBAR: The facts here do not show double taxation, Your Honor, because all California is doing is apportioning eight percent of the total worldwide income to California. The

taxpayer concedes that about seven percent of the total worldwide income is possibly taxable by California. We have taxed only less than one percent difference in this taxation.

Now, even if you accept the figures from Colombia, the separate accounting figures -- First of all, I would state, I don't think anywhere in the record is there any showing of what the actual tax basis was by any of these countries. There is lots of talk of separate accounting records, there is some talk -- They don't even know the actual taxes that were paid. They say, but, our 2952's reported to the federal government show that they are something like this, but we don't know what their actual tax basis was.

But, even if you accept their figures and you total the amount of tax which the State of California taxed and the amount of tax which all of them taxed, that is less than 15% of the worldwide income. They simply have not shown any improper tax by California.

Further --

QUESTION: Well, your definition of double taxation is a tax bill that exceeds your entire income?

MR. GOBAR: I don't define the term, Your Honor, and I stay away from it, because, quite frankly, I think it has been used in many different cases to mean different things. When somebody says double taxation, they automatically mean something --

QUESTION: But, in a property tax concept, it was more

sensible really, because you could talk about a specific piece of property having a situs in one state being taxed, two separate things, but I am not sure how much sense the term itself means when you talk about income tax.

MR. GOBAR: We agree 100%, Your Honor, exactly. You are talking -- In the property tax in the Japan Line case, they said we will take a situs taxation approach and following the treaty or whether the old method of domocile or whatever it may be, we will accept the full tax at the domocile.

The whole basic principle of what we are talking about here today, unitary apportionment, is predicated on the recognition that you cannot assign a site to income. You have an indivisible item. Whether you divide the income of a unitary business by separate accounting or formulary apportionment or whatever method, you are trying to divide something which is indivisible. And, the income comes from the operation as a whole and that is why the Japan Line analysis is, we feel, totally inappropriate to be applied in this particular case.

We feel -- We don't deny that the Court had a legitimate concern with unfair or excessive taxation by any one, but, as applied to unitary apportionment, we feel that the standard has to be basically the same idea that we have in the due process. You have to look to see what the fair apportionment of the business unit. In this case, the methods -- The double taxation problem won't go away by ruling for Caterpillar because -- For

example, let's take Colombia and Venezuela. First of all, there are no treaties, no tax treaties between the United States and Venezuela or Colombia or Mexico. Therefore, they are free to do whatever taxation any way they want to. In fact, what they do is they don't allow deductions of expenses which are incurred out of the country.

Therefore, they don't even allow, for their tax purposes, a deduction of any of the expenses of the expertise which might be provided by the parent.

There is no limit. They could tax on an unlimited amount of income. They can measure it any way they want to. And, it is indicated in the stipulation that even the general accepted accounting methods are inappropriate, are different, in some of the foreign countries than they are in the United States

Basically, and this also answers the contention of the Solicitor General, we just do not have here any one voice. The so-called arm's-length method, there is no suggestion, there is no showing that it has been applied by anyone. And, on the contrary, the recent studies which have been provided by the U.S. government last year by the General Accounting Office, show and suggest that the so-called method of arm's length, which counsel for -- which the Appellant would have this Court say is a one voice, must-have-been-adopted situation, there is no uniformity in that. The GAO says we don't think it works very well. In fact, the most used method is the apportionment

type method and we suggest you consider the federal government going to apportionment. A number of commentators who are mentioned -- This discussion is contained in the brief of the Multistate Tax Commissioner in the Chicago Bridge and Iron case. Since the Solicitor General's brief wasn't filed in this case, the response was filed by MTC in that case -- shows that we do not have one voice. Their method is not working and commentators have criticized it severely.

Now, I am not saying that this is a panacea or the easy answer or that there are no problems with taxation by the formula apportionment. What I am saying is it is not the type of problem that is to be solved by saying that the due process clause or the commerce clause prohibits the states from using the method.

We submit it is the best method available at this time; that if it is to be restricted, if it is to be used, it should be done by Congress after appropriate studies, after appropriate evaluation. And, if there are to be limitations upon the states' use of it, there should -- And, the Executive Department feels it is appropriate, there should be appropriate hearings and evaluation and find a good or better method. So far -- California has been using this method for, I think half a century. We have not found a better method and we don't think the United States has either. We think it is the fairest method.

QUESTION: What is involved in the so-called arm's-

length system of taxation?

MR. GOBAR: Well, what is involved in it is theoretically you take this unitary business, which this Court has said by its very nature is indivisible, and say we try to divide it. We try to assume that we could separate these --

QUESTION: Isn't that what the foreign countries do who are taxing these particular subsidiaries involved in this case?

MR. GOBAR: I have never heard of a foreign country doing it. As far as I know, the only country that has any kind of regulation of any detail as to what to do in these cases is the United Kingdom.

QUESTION: Do any of the foreign countries put an income tax on these subsidiaries?

MR. GOBAR: Yes, I believe so.

QUESTION: How do they tax them?

MR. GOBAR: They tax them by their own separate accounting or whatever method they use.

QUESTION: Do they do it by an arm's-length method?

MR. GOBAR: I don't think they do it by an arm's-length method, because, for example --

QUESTION: How do they do it? They don't do it like California does.

MR. GOBAR: I don't know the details of how they do it. All we know from this record is that Colombia has taxed

them and other people have imposed their income taxes. But, we do know, we do know that when Colombia does tax the subsidiary there, it does not allow any deduction for payment for services rendered in the United States for its effect. So, therefore, we do know --

QUESTION: But, it doesn't use the formulary system like California?

MR. GOBAR: As far as I know, it does not use a formulary method for its own determination nor does it use an arm's-length method.

QUESTION: Do you think that system is unfair?

MR. GOBAR: Which, the arm's-length method?

QUESTION: No, whatever system it is that Venezuela is using.

MR. GOBAR: Whatever they use? Yes, I think it is unfair.

QUESTION: Unfair to them?

MR. GOBAR: Well --

QUESTION: They should be able to tax more?

MR. GOBAR: No, I think they should tax less. I think they should tax less, because we have shown here, Your Honor, that there are substantial contributions by CCA to these foreign subsidiaries. It guarantees or loans 60% of the monies these foreign subsidiaries get and there has been no indication they get any substantial payment for it. So, there is no expense

going out of Colombia and they are taxing all of the benefits there. Well, in the United States, there would either be a formulary apportionment or we would have to -- If we applied an arm's-length method, we would have to determine what is an appropriate method of giving a deduction and reducing those amounts.

The other problem with the -- In other words, what I am saying, Your Honor, is there is no uniformity. Even the so-called arm's-length method is not a uniformly adopted --

QUESTION: Would your position be the same if the parent here, so-called parent, owned only 33% of the --

MR. GOBAR: No, no, Your Honor. California has no dispute with the ASARCO. We do not try to include any of the subsidiaries in ASARCO that were excluded there. We require that there be actual control. Nor do we have any dispute with Woolworth. We require that there be actual control, effective control, and we say that there has been and is here actual effective control. All subsidiaries were 100% owned or 80% in one country and two-thirds in the other one and there was, in fact, absolute control.

And, with my time running out, if I may just get to a few points, I would like to suggest that this case is very unitary. The facts are set forth in the brief, but there is functional integration clearly from the record here.

CCA provided and trained expert personnel for key

corporate and operational jobs for the subsidiaries. CAA provided the machinery as well as the expertise which was necessary to set up these foreign companies and operate these foreign manufacturing outfits. They provided 90% of the Latin America's machinery directly. These amounts were $5 to $7 million a year.

They had technical service agreements wherever the country law allowed them which specifically provided for furnishing, at the request of the subsidiaries as needed, of any technical or other business assistance. They guaranteed and loaned over 60% of the funds. They established these subsidiaries and participated in the establishment and any capital decisions had to go through the parent. It was just the local decisions that were left to the operation locally.

And, this is no different than the operation within the United States. They were all diversified companies. Exxon was a diversified company. They had their separate divisions which had autonomous responsibility. But, if they didn't operate, they were told to -- They were controlled and overruled as necessary above. They had centralized management. They had an overseas division whose purpose was to oversee and insure compliance with the standards and with the profitability of the subsidiaries.

They used the same auditing except for two Eureopean subsidiaries. They had overlapping directors and officers. They retained employee benefits. People that went to the foreign

subsidiaries retained employee benefits and obviously loyalty to the CCA.

They had to give all financial and tax reports necessary to effect their supervision. And, in fact, it is stipulated that, in fact, CCA controlled, on page 14 of the Joint Appendix, they controlled the subs.

We feel that these are all indications -- Oh, I forgot to talk about Mr. Latcham's flow of goods. They obtained through central purchasing -- They obtained, not huge amounts, but substantial amounts. They directed furnished -- I believe it has been suggested at least one percent, and these are all estimates, because the records haven't been made available in detail, but they also procured, just like in Butler Brothers, they procured another substantial amount of the raw materials which were used by the subsidiaries.

When you are dealing in foreign countries, when you are dealing in the paperboard packaging, normally you are not going to be shipping raw materials long distances. You are going to get them locally. But, the mere fact that they did have to furnish a significant amount shows that the importance -- It is much more significant in a case like this that there is a five percent or six percent furnishing. That shows they are there. That shows they are giving them support.

We feel that the test of this Court, which has been applied most recently in Woolworth, looking at the economic

realities, the income is not derived from an unrelated business activity which constitutes a discreet business enterprise. We think they are clearly unitary.

I am through. I haven't spoken of distortion. We feel no distortion is shown.

Thank you, Your Honor.

JUSTICE BRENNAN: Thank you, Mr. Attorney General.

Mr. Latcham, have you anything further?

MR. LATCHAM: Just a few things in rebuttal, Your Honor.

JUSTICE BRENNAN: You have four minutes left.

MR. LATCHAM: Thank you.

ORAL ARGUMENT OF FRANKLIN C. LATCHAM, ESQ.

ON BEHALF OF THE APPELLANT -- REBUTTAL

MR. LATCHAM: One thing in regard to the Solicitor General's brief, there is simply no question that he applied -- His brief applies both to U. S. based companies and foreign based companies. He says so --

QUESTION: You are talking about --

MR. LATCHAM: His submission in the Chicago Bridge case.

QUESTION: -- in Chicago Bridge?

MR. LATCHAM: That is right, Your Honor, which certainly represents the position of the United States on this question of worldwide unitary apportionment. And, it is perfectly clear. He says in his brief, "if, as we submit, the court concludes

that the Illinois combined reporting requirement, either, (a) creates a substantial risk of international multiple taxation, or, (b) impairs federal uniformity in the conduct of foreign relations. That is the end of the matter and the judgment below should be reversed." That, of course, applies to a U.S. based company.

The record in the case -- Incidentally, the Solicitor General has questioned how -- The Deputy Attorney General has stated that the record isn't clear how the tax returns were filed in the foreign countries, but I call Your Honor's attention to page 72, paragraph 140, of the Joint Appendix that says: "The returns were filed," and these were the returns by the subsidiaries, "taking into account only the applicable income and deductions incurred by the subsidiary or subsidiaries in that country and not taking into account the income and deductions of CCA or the subsidiaries operating in other countries."

Mr. Gobar has also suggested that maybe the record isn't clear on the payment of taxes by these subsidiaries. I call the Court's attention to Joint Appendix, page 84, where, for the most part, and I mean in 90% of the cases, the actual taxes paid by the subsidaries are set forth. So there is no question about the actual taxes being paid. In a few instances, it shows the provision for taxes set up on the books, but those are distinctly a minority and certainly subject to the trusted NFA.

I think the facts, and Mr. Gobar has mentioned something about the facts, I think the facts are clear and I needn't dwell on them any longer. I will stand on our factual statement.

The question of whether Congress should act in the area, here we have presented to the Court issues that this Court has resolved many, many times, double taxation, due process, distortion problems, the unitary question, those are all issues that this Court has addressed recently and in many times in the past and I would submit that they shouldn't be addressed again.

I think this is clearly a case where California is overreaching. There is no question that it is taxing income earned outside the state and, indeed, outside the country in foreign countries. And, there is no reason why this corporation should have to pay additional taxes simply because it is engaged in foreign commerce. That is certainly contrary to the Constitution.

Thank you, Your Honor.

JUSTICE BRENNAN: Thank you, counsel. The case is submitted.

THE CLERK: The Court is now in recess until tomorrow at 10:00.

(Whereupon, at 2:47 p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:
CONTAINER CORPORATION OF AMERICA, Appellant v. FRANCHISE TAX BOARD
81-523

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BY _____
(REPORTER)