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DEVELOPMENTS IN THE LAW

New York Court of Appeals rules that New York City may tax a non-domiciliary corporation on proceeds received from investment in corporation with business activities in City

In order for a state or locality to impose a tax on a non-domiciliary corporation consistent with the Commerce Clause and the Due Process Clause,¹ a nexus must exist between the taxing jurisdic-

¹ See *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 219-20, 227-30 (1980). See generally Walter Hellerstein, *State Taxation of Interstate Business: Perspectives on Two Centuries of Constitutional Adjudication*, 41 TAX LAW. 37, 54-77 (1987) (describing contemporary analytical framework of constitutional decisions); *Developments in the Law-Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 956-962 (1962) (discussing principles of Commerce Clause and Due Process limitations on state taxation).

Some commerce clause decisions held that interstate activities were flatly untaxable. See *Spector Motor Serv., Inc. v. O'Connor*, 340 U.S. 602, 603 (1951) (distinguishing between taxes on interstate corporations by their direct or indirect effect on interstate commerce). However, other decisions rejected this line of reasoning and held that a state could charge a corporation for its fair share of the tax charges without unduly burdening interstate commerce. See *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938). These cases decided that the Commerce Clause cannot be used as a shield "to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business. 'Even interstate business must pay its way.'" *Id.* (quoting *Postal Tel.-Cable Co. v. Richmond*, 249 U.S. 252, 259 (1919)); see also *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988) (stating that conflict occurs when state tries to tax interstate activities).

The Supreme Court enunciated a four-part analysis to evaluate the validity of state taxes with respect to the Commerce Clause in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). In *Complete Auto*, Mississippi's tax on the in-state transportation of automobiles manufactured out-of-state was found not to violate the Commerce Clause because: "[1] the tax [was] applied to an activity with a substantial nexus with the taxing State; [2] the tax [was] fairly apportioned; [3] the tax [did] not discriminate against interstate commerce; and [4] the tax [was] fairly related to the services provided by the State." *Id.*; see also *Goldberg v. Sweet*, 488 U.S. 252, 260-67 (1989) (applying *Complete Auto Transit* test).

Early due process decisions looked solely to the geographical relationship between the taxpayer's activities and the taxing state. See *International Paper Co. v. Massachusetts*, 246 U.S. 135, 145 (1918). However, subsequent decisions upheld state taxes that taxed out-of-state business activity. See *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-21 (1920). These taxes were upheld because they apportioned for taxation a company's profit derived from the company's profit-generating activities within the taxing jurisdiction. *Id.* To satisfy due process protection concerns, the Court looks to (1) minimum contacts between the activities of the interstate business and the taxing state and (2) a rational relationship between income attributed to the state and the intrastate activities of the taxpayer. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). Generally, due process

diction and the corporate income being taxed.² A nexus is clearly present when the taxpayer's activities within the forum generate income.³ The Supreme Court has also found a nexus, in some in-

requirements are subsumed within the Commerce Clause analysis. *Trinova Corp. v. Michigan Dep't of Treas.*, 111 S. Ct. 818, 828 (1991). *But see Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1909 (1992) ("[D]ue Process Clause and the Commerce Clause are analytically distinct."). It is submitted that *Quill* can be reconciled with previous precedent in cases where the taxpayer has some tangible connection with the state.

Although not applicable to this Survey, state taxation of non-domiciliary corporations is further limited by the Foreign Commerce Clause, *see Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 452 (1979); *see also* Patrick F. Philbin, *Sidestepping Issues of Constitutionality in Reviewing the Application of Worldwide Taxation: Franchise Tax Board of California v. Alcan Aluminum Ltd.*, 31 HARV. INT'L L.J. 671, 672-73 (1990), and the Equal Protection Clause, *see Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 668-69 (1981); *Southern Ry. v. Greene*, 216 U.S. 400, 417-18 (1910). *See generally* Mathew J. Zinn & Steven Reed, *Equal Protection and State Taxation of Interstate Business*, 41 TAX LAW. 83 (1987) (describing Equal Protection limitation on state taxes).

² Compare the Commerce Clause test applied in *Complete Auto*, 430 U.S. at 274, with the Due Process Clause test applied in *Mobil*, 445 U.S. at 425. *See Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 164-67 (1983) ("Under both the Due Process Clause and the Commerce Clause . . . a state may not, when imposing an income-based tax, 'tax value earned outside its borders.'") (quoting *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982)); *Exxon*, 447 U.S. at 219-20 (noting that Constitution requires nexus). *But see Quill*, 112 S. Ct. at 1916, 1919 (White, J., dissenting) (stating that nexus requirements stem from due process concerns).

In *Quill*, the Supreme Court was called upon to evaluate the constitutionality of a North Dakota statute under both the Commerce Clause and Due Process Clause. *Quill*, 112 S. Ct. at 1907. The statute required an "out-of-state mail-order house that has neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State." *Id.*

Because the mail-order company had purposefully availed itself of the forum, the Court held that the State could establish a due process nexus. *Id.* at 1910-11. However, the Court held that the statute violated the Commerce Clause because the petitioner lacked physical presence within the state and therefore petitioner had no "substantial nexus with the taxing state." *Id.* at 1912.

In explaining the distinction between Commerce Clause nexus and due process nexus, the Court noted the different theoretical underpinnings of the two constitutional provisions. *Quill*, 112 S. Ct. at 1909. The Due Process Clause concerns "whether an individual's connections with a State are substantial enough to legitimate the State's exercise of control over him." *Id.* at 1913. Conversely, the Commerce Clause nexus is driven "not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Id.* While this distinction may be appropriate when evaluating the first or minimum contacts prong of the due process inquiry, as in *Quill*, *see id.* at 1910, it is less applicable when evaluating the second or fairness prong, *see id.* at 1913; *cf. id.* at 1919 (White, J., dissenting) (noting that Court has never found sufficient due process nexus while finding insufficient Commerce Clause nexus until *Quill*). If it is fair to the non-domiciliary corporation to subject it to taxation consistent with due process precepts, concomitantly, it would not appear to offend interstate notions of comity to force that corporation to pay a tax. *Id.* at 1920-21.

³ *See Exxon*, 447 U.S. at 219-20 (operating income derived from out-of-state subsidiaries may be taxed when taxpayer is operating vertically integrated enterprise); *Mobil Oil*, 445

stances, when a non-domiciliary corporation receives investment income from a separate corporation.⁴ In that situation, the nexus requirement is satisfied by the forum activities of the taxpayer which are said to have contributed to the realization of income outside the forum.⁵ However, a less certain question is whether an independent nexus is created when the corporation providing the investment income to the taxpayer generates this income within the taxing forum.⁶ Recently, in *Allied Signal, Inc. v. Commissioner of Finance*,⁷ the New York Court of Appeals addressed this question while upholding the constitutionality of New York City's corporate tax.⁸ In a 4-3 decision authored by Judge Titone, the court found that such a nexus existed and held that a jurisdiction may tax a non-domiciliary corporation on investment income earned within the taxing jurisdiction, even though it is unrelated to the

U.S. at 436-42 (recognizing that activities of the affiliates and subsidiaries furthered Mobil's in-state activities).

⁴ See, e.g., *F.W. Woolworth Co. v. Taxation & Revenue Dep't*, 458 U.S. 354, 364-66 (1982) (holding retail activities of foreign subsidiaries in foreign country unrelated to retail activities in taxing state); *ASARCO*, 458 U.S. at 325-30 (holding income and dividends derived from out-of-state activities unrelated to taxpayer's mining operation in taxing state); see also *Silent Hoist & Crane v. Division of Taxation*, 494 A.2d 775, 783-84 (N.J. 1985) (analyzing "unitary business principle"), *cert. denied*, 474 U.S. 995 (1985).

The Supreme Court has upheld taxation when some degree of functional integration, known as a "unitary business" relationship exists between the non-domiciliary taxpayer and the corporation providing the investment income. See *Container Corp.*, 463 U.S. at 163-67; *Mobil Oil*, 445 U.S. at 439-40 ("[T]he linchpin of apportionability in the field of state income taxation is the unitary-business principle."); Walter Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076*, 79 MICH. L. REV. 113, 117-18 (1980) (describing "unitary-business" principle). "Unitary-business principle" analysis satisfies constitutional inquiry because the in-state activities of the corporate parent supply the necessary due process contacts. *Mobil Oil*, 445 U.S. at 438. Moreover, tax distribution under the "unitary-business principle" is not unduly burdensome because the corporation is merely paying to each taxing forum a tax on its proportionate share of the income attributable to that state. *Id.* at 445-46.

When evaluating the presence or absence of a unitary business, the Court looks to: (1) functional integration between the two entities; (2) economies of scale; and (3) interlocking management. *Container Corp.*, 463 U.S. at 179.

⁵ *Mobil*, 445 U.S. at 438.

⁶ See *Allied-Signal, Inc. v. Division of Taxation*, 112 S. Ct. 2251 (1992). Although the Court held that taxation of the forum subsidiary's income was unconstitutional under the unitary-business analysis, the Court did not examine whether the nexus between the income and the forum rendered the tax constitutional. *Id.* at 2261-64.

⁷ 79 N.Y.2d 73, 588 N.E.2d 731, 580 N.Y.S.2d 696 (1991).

⁸ *Id.* at 75-76, 588 N.E.2d at 732, 580 N.Y.S.2d at 697. New York State taxes corporations similarly. Gary Spencer, *Out-of-State Business Income Tax Upheld*, 4-3, N.Y.L.J. Dec. 24, 1991, at 1. One estimate is that the tax supplies 'tens of millions of dollars' to the State's coffers each year. *Id.*

taxpayer's business activities in the taxing jurisdiction.⁹

Bendix, a domiciliary of Michigan, owned 20.6% of ASARCO Inc.'s ("ASARCO") outstanding common stock.¹⁰ ASARCO, a New Jersey mining and refining corporation, has its headquarters in New York City.¹¹ In 1981, Bendix received \$2,795,137 dividend income and \$211,513,354 capital gains income in connection with its ASARCO stock transactions.¹² Bendix's only other activities in New York City consisted of its International Group operations, which were totally unrelated to ASARCO's business operations.¹³ On its corporate tax return, Bendix computed its tax liability based solely on the amount apportioned for the activities of the International Group and did not include as income the amount received in connection with its ASARCO stock.¹⁴ A New York City audit assessed a deficiency against Bendix, which petitioner contested in Supreme Court, New York County.¹⁵ The court upheld the assessment,¹⁶ and the Appellate Division affirmed.¹⁷

⁹ *Allied-Signal*, 79 N.Y.2d at 75-76, 588 N.E.2d at 732, 580 N.Y.S.2d at 697.

¹⁰ *Id.* at 77, 588 N.E.2d at 733, 580 N.Y.S.2d at 698. *Allied-Signal*, petitioner in this cause of action, is the successor-in-interest to Bendix. *Id.* at 78, 588 N.E.2d at 734, 580 N.Y.S.2d at 699. Bendix, a noted corporate predator, was itself swallowed by *Allied-Signal* during a takeover battle for Martin Marietta Corp. See *Transition for Agee*, N.Y. TIMES, Dec. 25, 1982, at A30.

¹¹ *Allied-Signal*, 79 N.Y.2d at 79, 588 N.E. 2d at 734, 580 N.Y.S.2d at 699.

¹² *Id.*

¹³ *Id.* In *Allied-Signal*, the litigants stipulated that "Bendix and ASARCO were at no relevant time engaged in a unitary business relationship." *Id.* at 78 n.6, 588 N.E.2d at 733 n.6, 580 N.Y.S.2d at 698 n.6. The sole function of Bendix's International Group was to develop business abroad. *Id.* at 77, 588 N.E.2d at 734, 580 N.Y.S.2d at 699.

¹⁴ *Allied-Signal*, 79 N.Y.2d at 77-78, 588 N.E.2d at 733, 580 N.Y.S.2d at 698. The New York City General Corporate Tax on corporate investment income is calculated by determining a proportionate assessment that "reflects the degree of New York City presence of the issuers of the securities in which the taxpayer has invested (i.e., the corporations which have generated the taxpayer's investment income)." *Id.* at 76-77, 588 N.E.2d at 732-33, 580 N.Y.S.2d at 697-98. The amount of income allocated to the City, and subsequently taxed, is determined "by multiplying the taxpayer's total investment income by its 'investment allocation percentage' (IAP)." *Id.* at 76, 588 N.E.2d at 732, 580 N.Y.S.2d at 697. The IAP is a percentage representing the proportion of the investment issuer's activity in New York City. *Id.* IAP is calculated "by first multiplying the amount of each of the taxpayer's investments by the percentage of the issuer's entire capital allocated to the City on the issuer's own New York City return." *Id.* at 77, 588 N.E.2d at 733, 580 N.Y.S.2d at 698. Then each proportional amount is added together and divided by the total of the taxpayer's investments. *Id.*

¹⁵ *Id.*

¹⁶ *Allied-Signal, Inc. v. Commissioner of Fin.*, 146 Misc. 2d 632, 637, 552 N.Y.S.2d 195, 199 (Sup. Ct. N.Y. County), *aff'd*, 167 A.D.2d 327, 327, 562 N.Y.S.2d 76, 77 (1st Dep't 1990), *aff'd*, 79 N.Y.2d 73, 588 N.E.2d 731, 580 N.Y.S.2d 696 (1991).

¹⁷ *Allied-Signal v. Commissioner of Fin.*, 167 A.D.2d 327, 327, 562 N.Y.S.2d 76, 77 (1st Dep't 1990), *aff'd*, 79 N.Y.2d 73, 588 N.E.2d 731, 580 N.Y.S.2d 696 (1991).

The threshold issue addressed by the Court of Appeals majority was whether the attribution of contacts from the non-domiciliary taxpayer to the corporation producing the investment income—and thus the investment income itself—was necessary to satisfy constitutional concerns.¹⁸ Judge Titone first found three recent Supreme Court decisions inapplicable because in each case the income generating corporation had no ties to the taxing forum.¹⁹ When domestic corporations generate investment income, the court determined that the proper inquiry was whether “the taxing power exerted . . . bears fiscal relation to the protection, opportunities and benefits given by the state.”²⁰ Citing the Supreme Court’s opinion in *International Harvester Co. v. Wisconsin*

¹⁸ *Allied-Signal*, 79 N.Y.2d at 80-81, 588 N.E.2d at 734-35, 580 N.Y.S.2d at 700.

¹⁹ *Allied-Signal*, 79 N.Y.2d at 80-82, 588 N.E.2d at 734-36, 580 N.Y.S.2d at 700-01.

On this point, even the dissenting Judge Bellacosa agreed with the majority that *Woolworth*, *ASARCO*, and *Mobil* “do not hold that a unitary business relationship between the taxpayer and the investment income payer is a constitutional *sine qua non* to municipal taxation of investment income.” *Id.* at 89, 588 N.E.2d at 741, 580 N.Y.S.2d at 706 (Bellacosa, J., dissenting).

Judge Titone addressed petitioner’s argument that the lack of a unitary business relationship between Bendix and ASARCO negates any possibility of a sufficient nexus by examining three cases: *F.W. Woolworth Co. v. Taxation & Revenue Dep’t*, 458 U.S. 354 (1982), *ASARCO Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307 (1982), and *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980).

In *Woolworth*, petitioner sought to avoid tax liability for dividends paid to it by three wholly owned foreign subsidiaries, and one foreign subsidiary in which it had a controlling interest. *Woolworth*, 458 U.S. at 356-57, 359. Although the subsidiaries and the parent were engaged in retail sales, the parent’s managerial control over the subsidiaries was decentralized, and the companies were not connected by centralized purchasing, warehousing, or manufacturing. *Id.* at 364-67. Thus, the Court held that the state was “attempting to reach ‘extra-territorial values’ wholly unrelated to the business of the Woolworth stores in the [taxing state].” *Id.* at 372 (citation omitted).

In *ASARCO*, the taxpayer received income from dividends and capital gains from companies in whose stock “it owned a major interest.” *ASARCO*, 458 U.S. at 308-310. Although the subsidiaries engaged in activities similar to that of the parent, and even though one subsidiary sold to ASARCO a share of its output which was proportionate to ASARCO’s stock ownership, the court held that the subsidiaries were discrete enterprises. *Id.* at 320-24.

In *Mobil*, petitioner’s failure to prove that the business activities of its subsidiaries were unrelated to the parent left the court to consider only whether the foreign source of the income or the corporate form of the dividend payer rendered the tax unconstitutional. *Mobil*, 445 U.S. at 437-40. The Court held that the state had the right to tax dividends related to Mobil’s in-state activity. *Id.* at 439.

²⁰ *Id.* Although valid as a general proposition, this standard has been criticized as a source of guidance. Walter Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 Va. L. Rev. 149, 159 (1976) (“classic but imprecise formulation”); Bernard Schwartz, *Commerce, the States, and the Burger Court*, 74 Nw. U. L. Rev. 409, 426 (1979) (noting standard can be reduced to absurdity).

Department of Taxation,²¹ the majority held that the City's tax on the dividend and capital gain income that Bendix received from its investments in ASARCO, insofar as it was properly premised on ASARCO's activities within the City, was supported by a sufficient taxing nexus.²² The court reasoned that the City indirectly bestowed a benefit on Bendix by directly conferring benefits on ASARCO that in turn contributed to ASARCO's capital appreciation and its ability to pay substantial dividends.²³

Finally, the court held that there was no requirement that the tax be reasonably related to Bendix's own in-state activity.²⁴ Rather, the court reasoned that where a tax is "premised on the presence of an entity other than the taxpayer . . . the tax must be fairly related to that entity's activities within the taxing jurisdiction, not the taxpayer's."²⁵

In vehement dissent, Judge Hancock attacked the majority's reasoning.²⁶ Citing *ASARCO Inc. v. Idaho State Tax Commission*²⁷ and *F.W. Woolworth Co. v. Taxation and Revenue Department*,²⁸ Judge Hancock argued that the Supreme Court "expressly rejected the attempts of [states] to expand [nexus concepts] . . . to embrace corporations where, as here, the only claimed relatedness is in the

²¹ 322 U.S. 435 (1944). In *International Harvester*, plaintiff contended that the Due Process Clause prohibited Wisconsin's tax on dividends earned by out-of-state shareholders. *Id.* at 439. Four years earlier, in *Wisconsin v. J.C. Penny Co.*, 311 U.S. 435 (1940), the Court upheld Wisconsin's taxing scheme as an assessment against the corporation's activities within the state. *Id.* at 441-42. After *J.C. Penney* was decided, the Wisconsin Supreme Court characterized the tax as a burden imposed solely on the stockholders. See *Wisconsin Gas Co. v. Wisconsin Dep't of Taxation*, 10 N.W.2d 140 (Wis. 1943). Based on the Wisconsin Court's holding, *International Harvester* then argued that a nexus was impossible since the dividends were declared and paid in another jurisdiction, and ninety-eight percent of the corporation's shareholders resided out-of-state. *International Harvester*, 322 U.S. at 446 (Jackson, J., dissenting). The Court upheld the tax, stating that:

A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers.

Id. at 441-42.

²² See *Allied-Signal*, 79 N.Y.2d at 82-84, 588 N.E.2d at 736-37, 580 N.Y.S.2d at 701-702.

²³ *Id.*

²⁴ *Id.* at 84-85, 588 N.E.2d at 737-38, 580 N.Y.S.2d at 702-703.

²⁵ *Id.*

²⁶ *Id.* at 92, 588 N.E.2d at 743, 580 N.Y.S.2d at 708 (Hancock, J., dissenting).

²⁷ 458 U.S. 307 (1982).

²⁸ 458 U.S. 354 (1982).

financial contribution that one [corporation] makes to the other.”²⁹ Thus, Judge Hancock concluded that it would be unfair to attribute ASARCO’s activity in the taxing forum to Bendix where the corporations similarly lack relatedness.³⁰

In a separate dissent, Judge Bellacosa, joined by Chief Judge Wachtler argued that the activities of Bendix, the taxpayer, rather than ASARCO, are dispositive when deciding nexus.³¹ Under the

²⁹ *Allied-Signal*, 79 N.Y.2d at 94, 588 N.E.2d at 744, 580 N.Y.S.2d at 709 (Hancock, J., dissenting). In *ASARCO and Woolworth*, a bare financial relationship—the payment of dividends—did not sustain a due process nexus. See *ASARCO*, 458 U.S. at 326-29; *Woolworth*, 458 U.S. at 363-64.

Judge Hancock argued that state taxation is impermissible in the absence of a “unitary-business relationship.” *Allied-Signal*, 79 N.Y.2d at 94, 588 N.E.2d at 744, 580 N.Y.S.2d at 709 (Hancock, J., dissenting). According to Judge Hancock, state taxation is constitutional so long as the corporation derives some equivalent benefit from the taxing state. *Id.* at 96-97, 588 N.E.2d at 745, 580 N.Y.S.2d at 710 (Hancock, J., dissenting). Benefits accrue from the subsidiary to the taxpayer, he reasoned, only when the aggregate of contacts are such that the two comprise a unitary business. *Id.* Thus, the unitary-business principle operates as “a limitation on the circumstances when such taxation is permitted.” *Id.* at 95, 588 N.E.2d at 745, 580 N.Y.S.2d at 710 (Hancock, J., dissenting).

³⁰ *Allied-Signal*, 79 N.Y.2d at 95-97, 588 N.E.2d at 744-45, 580 N.Y.S.2d at 709-10 (Hancock, J., dissenting). Bendix’s relationship with ASARCO was similar to ASARCO’s relationship and Woolworth’s relationship with their respective subsidiaries in *ASARCO* and *Woolworth*. *Id.* Therefore, the tax as applied to Bendix is constitutionally infirm because “the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state.” *Id.* at 93-94, 588 N.E.2d at 743, 580 N.Y.S.2d at 708-09 (Hancock, J., dissenting) (quoting *Mobil*, 455 U.S. at 441-42). Accordingly, Judge Hancock rejected the notion that ASARCO’s own in-state activities accrued to Bendix. *Id.* at 103-04, 588 N.E.2d at 749-50, 580 N.Y.S.2d at 714 (Hancock, J., dissenting).

³¹ *Allied-Signal*, 79 N.Y.2d at 85, 588 N.E.2d at 738, 580 N.Y.S.2d at 703 (Bellacosa, J., dissenting). In his analysis, Judge Bellacosa first considered whether Bendix had sufficient contacts with New York City to support a constitutional nexus, and then determined whether the tax imposed was reasonably related to those contacts. *Id.* at 85-91, 588 N.E.2d at 738-42, 580 N.Y.S.2d at 703-07 (Bellacosa, J., dissenting).

As to the first determination, Judge Bellacosa focused on the activities of Bendix within the taxing forum, specifically the activities of Bendix’s International Group. *Id.* at 88, 588 N.E.2d at 740, 580 N.Y.S.2d at 705 (Bellacosa, J., dissenting). Based on this relationship, he concurred with the majority in result, holding that Bendix had sufficient contacts with the forum to justify some taxation. *Id.* As to the second determination, Judge Bellacosa once again focused on Bendix, foregoing attribution of ASARCO’s activities to Bendix. *Id.* at 91, 588 N.E.2d at 742, 580 N.Y.S.2d at 707 (Bellacosa, J., dissenting). Since the tax was based on activities unrelated to Bendix, he concluded that it was unreasonable. *Id.*

Similar to Judge Hancock’s analysis, Judge Bellacosa’s analysis is predicated on the assumption that ASARCO’s activities cannot be attributed to Bendix. *Id.* at 90-91, 588 N.E.2d at 741-42, 580 N.Y.S.2d at 706-07 (Bellacosa, J., dissenting). Essentially, the tax fails the second prong of Judge Bellacosa’s analysis for the same reason it fails Judge Hancock’s nexus test analysis: no relationship exists between the tax and the taxpayer’s business activities. However, it is submitted that Judge Bellacosa’s proportionality requirement has the potential to reach an opposite result when the amount of the taxpayer’s related activities dwarfs the amount of the taxpayer’s unrelated activities. In that case, the tax may appear

majority's analysis, he noted, New York City would be "impos[ing] a clearly offensive and duplicative tax—a governmental version of double-dipping."³²

Subsequent to the New York Court of Appeals decision, the United States Supreme Court in *Allied-Signal v. Division of Taxation*³³ found a similar New Jersey tax unconstitutional based on the same transaction taxed by New York City.³⁴ In that case, New Jersey attempted to include the capital gains income Bendix derived from its sale of ASARCO stock within Bendix's unitary tax base for apportionment purposes.³⁵ The New Jersey Supreme Court found the two corporations sufficiently related to justify the attribution of contacts from taxpayer to investment,³⁶ but the United States Supreme Court found that no such relationship existed and thus the attribution was improper.³⁷ Although the Court noted that when the transaction serves an "operational rather than an investment function"³⁸ such a relationship is unnecessary, the Court held that in this case the ASARCO transaction served only an investment function.³⁹ The Supreme Court's decision does not directly address the New York Court's holding, nevertheless, the decision indicates that when evaluating the apportionability of a corporate taxpayer's investment income, the proper focus is on the taxpayer's activity within the taxing forum and its use of the investment income.⁴⁰ Therefore, by implication, it is submitted that the Court of Appeals erred by focusing on the activities of the cor-

ostensively reasonable even though it bears no relationship to the taxpayer's in-state activities.

³² *Id.* at 91, 588 N.E.2d at 742, 580 N.Y.S.2d at 707 (Bellacosa, J., dissenting).

³³ 112 S. Ct. 2251 (1992).

³⁴ *See id.* at 2255-57. As in the New York City scenario, New Jersey was attempting to tax the unrelated non-business income of a non-domiciliary. *See id.* Unlike the case decided by the New York Court of Appeals, the only income before the Supreme Court was the capital gains income realized from the sale of the ASARCO stock. *Id.*

³⁵ *Id.* at 2257.

³⁶ 592 A.2d 536, 544 (N.J. 1990).

³⁷ *Allied-Signal*, 112 S. Ct. at 2263.

³⁸ *See id.* at 2263-64. The New Jersey Supreme Court upheld the tax by finding that Bendix and ASARCO were engaged in a unitary business. *Id.* Reversing that holding, the Supreme Court held that no such relationship existed. *Id.* In reaching its decision, the Court noted that a unitary business relationship was not necessary to support a tax. *Id.* at 2263. Instead, the Court focused on whether the transaction served an operational rather than investment function. *Id.*

³⁹ *Id.* at 2263-64.

⁴⁰ *Id.*

poration generating the investment.⁴¹

Both the Commerce Clause and the Due Process Clause require a state or local tax to fairly apportion the forum tax burden.⁴² However, as Judge Bellacosa noted, New York City's tax on a non-domiciliary corporation's investment income confers a windfall on New York City because ASARCO theoretically pays for those state privileges and benefits being attributed to Bendix through its own tax liability.⁴³ Thus, New York City incurs no additional liabilities due to Bendix's putative activities.⁴⁴ Although New York City is admittedly strapped for revenues, allowing such taxation will only hurt it in the long run. Non-domiciliary corporations will avoid investing in New York City corporations in order to avoid the current taxation scheme, thus creating a disincentive for corporations to establish themselves in New York City.⁴⁵ Perhaps, in light of the recent Supreme Court decision, the New York Court of Appeals will change its position on this issue—the fiscal

⁴¹ *Id.* By focusing on the function of the investment income rather than the subsidiaries' contacts, the Court has implicitly recognized that the relationship between the taxpayer and the forum is paramount. This analysis renders irrelevant consideration of the relationship between the income source and the forum.

It should be noted that New York City filed an amicus brief with the Supreme Court in which it described the New York City tax and the holding of the New York Court of Appeals. Amicus Brief of the City of New York, 112 S. Ct. 2251 (1992) (No. 91-615). The New York Court of Appeals decision was neither discussed nor cited in the Supreme Court's decision.

⁴² *See supra* note 2. Such a tax would unduly burden interstate commerce because it would seek to export the forum tax burden. *See Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1913 (1992). Such a tax may also violate due process requirements because it would be over-taxing the non-domiciliary taxpayer and, in effect, taxing value earned outside the forum's borders. *See id.* at 1909-10.

⁴³ *See Allied-Signal*, 79 N.Y.2d at 90-91, 588 N.E.2d at 741-42, 580 N.Y.S.2d 706-07; *see* note 15 and accompanying text. This exposes the underlying fallacy behind the attribution of ASARCO's activities to Bendix. Under the majority's reasoning, those activities are being taxed twice, once by ASARCO and once by Bendix.

⁴⁴ *See id.*

⁴⁵ *See* JEROME R. HELLERSTEIN, *STATE TAXATION* § 9.11[2], at 539 n.210 (1983). Practically speaking, the tax has the disadvantage of discouraging corporate investment in corporations domiciled in New York City. *Id.* Corporations should tend to invest in jurisdictions where they would only be subject to taxation once. *Id.* However, New York State considers the tax a business advantage because investment income is apportioned and not totally allocated to the jurisdiction. *See* Spencer, *supra* note 8, at 1. New York State and New York City believe that they tax proportionately less of a corporation's investment income than other jurisdictions. *See id.*

integrity of New York City must not come at the expense of the Constitution.

Brian E. Kennedy