

policy consideration protecting direct solicitation would seem to apply equally here.

The same fundamental problem again is confronted in connection with the Court's finding that Lilly's suit to enforce its Fair Trade prices against a nonsigner is separable from the interstate sales of Lilly and, therefore, subject to licensing. In suits upon the interstate contracts themselves, a state cannot deny a foreign corporation access to its courts until compliance with a registration statute.¹⁹ However, in the action brought by Lilly, it can be argued that the suit is to fix the price of a product sold by a local retailer. This would seem to make it a matter of purely local concern, which could be barred by New Jersey's qualification statute.²⁰

However, it seems difficult to segregate the interstate sales of certain products and a suit to fix the price at which those products are ultimately resold. The purpose of the suit is to protect the good will of the manufacturer,²¹ which is represented by the trademark on the goods sold interstate. The protection of Lilly's good will by means of Fair Trade prices is an inherent part of the marketing arrangement for the interstate goods.²² Furthermore, the fixing of prices in New Jersey is part of a nationwide plan and is thus related to the commerce that Lilly does in other states.²³ Although, again, it is a very difficult line to draw, it seems that there is a sufficient nexus between the suit and Lilly's interstate activity so that it should not be barred.

The *Lilly* case is illustrative of the difficulties inherent in this particular area of constitutional law. It would also seem to have broad application. In particular, a foreign corporation which does not have its own retail outlets must now consider the licensing statutes of foreign states if it wishes to send agents into those states to conduct any sort of promotional or advertising campaign aimed at the public.

WALTER F. WELDON, JR.

Constitutional Law—Taxation—State Application of Allocation Formulas to a Multi-State Public Utility.—*Virginia Electric and Power Co. v. Currie*.¹—Virginia Electric and Power Company (VEPCO) is a Virginia corporation generating electricity primarily in Virginia and distributing it throughout much of Virginia and parts of North Carolina and West Virginia. In April, 1954, VEPCO filed its 1953 North Carolina income tax return computing it with reference to the state statutory allocation formula

¹⁹ *International Text Book Co. v. Pigg*, 217 U.S. 91 (1910); *Sioux Remedy Co. v. Cope*, supra note 6.

²⁰ Supra note 3.

²¹ *Old Dearborn Distributing Co. v. Seagram Distillers Corp.*, 299 U.S. 183 (1936).

²² *Remington Arms Co. v. Lechmere Tire and Sales Co.*, supra note 12.

²³ *Schweggman Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 386 (1951); *Weco Products Co. v. G.E.M. Inc.*, 1960 C.C.H. Trade Co. par. 69, 639 (Minn. Dist. Ct.).

¹ 254 N.C. 17, 118 S.E.2d 155 (1961), cert. denied, 81 S.Ct. 1919 (1961).

which requires utilization initially of a gross receipts factor only.² However, VEPCO paid no tax on this return and instead determined its tax liability by a separate accounting procedure. VEPCO then petitioned the North Carolina Tax Review Board for permission to pay the tax on this separate accounting basis or, in the alternative, by addition of the payroll factor to, or substitution of it for, the gross receipts factor. VEPCO argued that a tax based on the statutory gross receipts formula would subject it to taxation on a greater portion of its net income than is reasonably attributable to business earnings within North Carolina. By way of alternative relief, the Board allowed VEPCO to substitute the average of the gross receipts and payroll ratios in place of the gross receipts formula.

VEPCO thereupon filed exceptions urging, in addition to its previous contentions, that separate accounting best reflects its earnings attributable to North Carolina. Both the Superior Court of Wake County and the Supreme Court of North Carolina adjudged that VEPCO failed to sustain its burden of proof. **HELD:** The additional tax was not excessive, nor was VEPCO taxed on net income not reasonably attributable to its business in North Carolina, nor did the Tax Review Board abuse its discretion or act unlawfully or arbitrarily.

Under both the due process and the commerce clause, the validity of a state tax may depend upon whether the activities, which constitute the basis of the tax, are carried on within or without the territorial limits of the taxing state. It is well-established that, to be valid, a state tax on, or measured by, the income of a foreign corporation which engages both in intrastate and extrastate activities must be apportioned or allocated to its activities within the state.³ Given concededly taxable subjects such as the privilege of doing a local business or the earning of net income from interstate commerce attributable to local sources, the problem becomes one of ascertaining the locally taxable base. The allocation (apportionment) formulas have served this function.⁴

The current use of a formula as a tax device may be traced to Pennsylvania's efforts to determine what portion of a railroad's property would

² The substantive statute levying the tax is § 105-134 of the North Carolina General Statutes in effect in 1953. North Carolina's statute provides that, in the case of an electric utility, net income shall be allocated to North Carolina on the basis of the relationship of gross receipts received from North Carolina business to total gross receipts. Provision is made for appeal to the Tax Review Board which may permit assessment of the income tax on a separate accounting basis by states or by the addition of the payroll factor to, or substitution of it for, the gross receipts factor.

³ *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948); *Ratterman v. Western Union Tel. Co.*, 127 U.S. 411 (1888). See also Landis, *The Commerce Clause as a Restriction on State Taxation*, 20 Mich. L. Rev. 50, 84 (1922). As to the necessity of statutory provisions allocating to the taxing state a portion of the total income of a business that extends in to other states, see annot. in 130 A.L.R. 1183, 1203, and 90 A.L.R. 490, supplemented in 156 A.L.R. 1384. See also 75 L. Ed. 879, 893.

⁴ Silverstein, *Problems of Apportionment in Taxation of Multistate Business*, 4 Tax L. Rev. 207, 208 (1949).

have its situs in the state during the tax year. In *Pullman's Palace Car Co. v. Pa.*,⁵ the first case to come before the United States Supreme Court involving the validity of allocation formulas for revenue purposes, the Court decided that a tax, based on such proportion of the capital stock of the company as the number of miles over which it ran cars within the state had to the total mileage in every state over which its cars were run, was a just and equitable method of assessment. Since then, due to increased state need for revenue⁶ and the implicit approval given by the Supreme Court to the theory of allocation formulas,⁷ their widespread use has become a fact of life for concerns doing a multi-state business.⁸ Harassed corporations alleging multiple taxation soon initiated litigation, and the Supreme Court adopted a viewpoint quite sympathetic to the interests of the state tax commissioners. In *Nashville, C. & St. L. Ry. v. Browning*,⁹ Mr. Justice Frankfurter urged that "by its very nature the problem is incapable of precise and arithmetical solution, and a local formula should not be overturned unless it can be shown to project the taxing power of the state beyond its borders." In *International Harvester v. Evans*,¹⁰ the Court declared that "rough approximation rather than precision is sufficient."

With respect to the quantum of proof required to overturn a state formula the Supreme Court and state courts have been very exacting.¹¹ In only a few instances has the taxpayer sustained the burden of showing that under the facts of the particular case, the formula resulted in unconstitutional taxation of extraterritorial values or produced an arbitrary or unreasonable result.¹²

In the instant case the North Carolina court ruled that accurate segregation of VEPCO's income under the separate accounting method could not be achieved because VEPCO is a unitary business. Several courts and commentators have espoused this view.¹³ In separate accounting the jurisdictional

⁵ 141 U.S. 18 (1891). Also, that same year the Supreme Court decided *State of Maine v. Grand Trunk Railway Co.*, 142 U.S. 217 (1891), which was the first case involving apportioned gross receipts although the court in its opinion treated that fact as being of little significance.

⁶ See Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 Vand. L. Rev. 21, 22 (1959), for a discussion of the factors requiring the states to seek additional revenue. See also Pierce, *State Fiscal Needs and Interstate Commerce*, 18 Ohio St. L.J. 43, 54 (1957).

⁷ Cases cited note 5 supra.

⁸ Studenski and Glasser, *New Threat in State Business Taxation*, Harv. Bus. Rev., Nov.-Dec. 1958, p. 77.

⁹ 310 U.S. 362, 365 (1940).

¹⁰ 329 U.S. 416, 422 (1947).

¹¹ *Butler Bros. v. McCaugan*, 315 U.S. 501 (1942); *Norfolk & W.R. Co. v. North Carolina*, 297 U.S. 682 (1936); *Bass, Ratcliff and Gretton, Ltd. v. State Tax Com.*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Crawford Mfg. Co. v. State Com. of Revenue and Taxation*, 180 Kan. 352, 304 P.2d 504 (1956).

¹² *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931); *Panhandle Eastern Pipe Line Co. v. Michigan Corp. & Secur. Com.*, 346 Mich. 50, 77 N.W.2d 249 (1956).

¹³ *John Deere Plow Co. of Moline v. Franchise Tax Board*, 38 Cal. 2d 214, 238 P.2d 569 (1951); Altman & Keesling, *Allocation of Income in State Taxation* 89-97

breakdown of business activity is achieved by adopting the individual taxpayer's general accounting system rather than through the use of fractions arbitrarily chosen. Although the tax due under the statutory gross receipts formula was \$77,574, and the alternative levy allowed by the Tax Review Board amounted to \$65,548, VEPCO's accountants reached a figure of only \$19,026 by using separate accounting. VEPCO was required to prove that a tax of \$19,026 was the more accurate tax, but the only way it could have done so, i.e., by separate accounting, was considered by the court to reflect inaccurately the income of a multi-state unitary business.

It cannot be disputed that the instant case is supported by authority. Many critics of separate accounting have expounded at length on its shortcomings, but these same critics have failed to appreciate the inherent deficiencies of allocation formulas. Allocation formulas by their very nature permit of no modification. Often, statutory provisions allow substitution of other factors and even of separate accounting if the result would be inequitable under the particular facts but, in practice, these alternatives are seldom allowed.¹⁴

Essentially, the problem raised by VEPCO and other similar cases is an economic rather than a judicial one and involves highly technical questions of accounting and finance rather than issues of law, such as the amount of proof required. This was especially true in the case of VEPCO which was required by the state Public Utilities Commission to segregate its income attributable to North Carolina for rate making purposes. VEPCO argued that the North Carolina court should honor the Public Utility Commission's findings, but the court felt that different factors are involved in rate making and that VEPCO failed to show the contrary. It is submitted that separate accounting is more flexible and actually, rather than approximately, reflects a corporation's income attributable to a certain state. If the Public Utility Commission accepted VEPCO's computations as to its income attributable to North Carolina then clearly separate accounting is not impossible in the case of unitary business. As separate accounting is based on actual facts rather than arbitrarily chosen ratios then presumably economic truth is reached rather than guessed at.

If every state legislature enacted identical allocation formulas and the regulatory bodies and courts of the states administered these formulas uniformly, corporations doing a multi-state business would have no reason to engage in litigation in this area.¹⁵ Such a scheme, i.e., uniform allocation formulas, has been advocated for almost four decades.¹⁶ However, unless all

(2d ed. 1949); Wilkie, *Uniform Allocation of Income from Unitary Business*, 37 *Taxes* 437 (1959).

¹⁴ Silverstein, *supra* note 4, at 218.

¹⁵ Barret, "Substance" vs. "Form" in the Application of the Commerce Clause to State Taxation, 101 *U. Pa. L. Rev.* 740, 754 (1953).

¹⁶ Chevals, *The Uniform Apportionment Formula for State Income Taxes*, 33 *Taxes* 212 (1955). For a detailed analysis of the Uniform Act, see Pierce, *The Uniform Division of Income for State Purposes*, 35 *Taxes* 747 (1957).

states approve such a plan, multiple taxation would still result. Perhaps the only feasible solution would be federal action, and this is currently being considered.¹⁷

PAUL G. GARRITY

Contracts—Federal Arbitration Act—Severability of Arbitration Clause.—*El Hoss Engineering & Transport Co. v. American Independent Oil Co.*¹—El Hoss Engineering & Transport Co. (El Hoss), a Lebanese corporation with its principal place of business in Lebanon, entered into an agreement with American Independent Oil Co. (Aminoil), a Delaware corporation with its principal place of business in New York City. Under the terms of the agreement Aminoil was to sell to El Hoss automotive and construction equipment and El Hoss was to lease this same and other equipment to Aminoil, and furnish such transportation as Aminoil would need. Immediately preceding the signature of Aminoil's agent was the following clause:

"and accepted by the Company this 1st day of October, 1959, subject to compliance with the conditions of this agreement as to guarantees or endorsements by third parties in favor of the Company covering the unpaid installments on purchase price, performance bonds and insurance coverage, etc., not later than fourteen (14) days from the date of the acceptance by the Company."

The agreement included a standard arbitration clause.²

Aminoil extended the time for the posting of the performance bond and insurance from October 14 to November 1, and then to November 20, as it and El Hoss were negotiating with regard to same. Then in December, El Hoss filed a petition under Section 4 of the Federal Arbitration Act³ to compel arbitration as to the terms and suitability of the performance bonds and insurance which it was prepared to furnish. The petition was granted,⁴

¹⁷ Pub. L. No. 86-272, § 201, 73 Stat. 556 (Sept. 14, 1959). Congress directed the Senate Committee on Finance and the House Committee on the Judiciary to hold hearings and report proposed legislation to provide uniform standards to be observed by the states.

¹ 289 F.2d 346 (1961), petition for cert. filed, 30 U.S.L. Week 3026 (U.S. July 6, 1961) (no. 209).

² "11. In the event of any disagreement between the parties hereto as to the effectuation of this agreement, or performance thereof, or any part of the agreement, each party undertakes to use its best efforts to resolve said disagreement without submission to arbitration. However, should such solution be impossible, the parties hereto will select a mutually acceptable arbitrator whose decision as to the matters presented to him shall be final. If the parties cannot agree on such an arbitrator, each shall nominate an arbitrator of its choice and these shall in turn select a third, and the decision of a majority of this panel of three shall be final as to all matters submitted. This paragraph shall not effect the rights of the company to terminate this agreement under the provisions of paragraphs three (3) and four (4) of section one (1)" *Supra* note 1, at 348.

³ 61 Stat. 671 (1947), as amended, 9 U.S.C. § 4 (1958).

⁴ 183 F. Supp. 394 (S.D.N.Y. 1960).