

sell securities originate there. Securities were physically kept at Banker's Trust, a New York bank.

44. Money from IBM's investment portfolio is used by IBM for plant expansion, working capital or any other business purpose designated by IBM management.
45. In its 10-K report to the Securities and Exchange Commission and in its annual reports to stockholders, IBM does not show its investment portfolio as a separate activity.
46. IBM's investment portfolio is not a discrete business enterprise, unrelated to its unitary business.
47. The investment portfolio department had no bank accounts or bank dealings in Wisconsin and the department enjoyed no benefits or privileges under Wisconsin law.
48. IBM's royalties were derived from an integral part of its unitary data processing and office equipment business. The royalties are in the mainstream of IBM's business. Its research and experimental efforts developed technology which IBM used to manufacture products itself and to license others to manufacture products.
49. The data processing and office equipment business (including the business which generates royalties) functioned as a single unit. The portion of the data processing and office equipment business which generated royalties depended on and contributed to the operation of the remainder of the data processing and office equipment business.
50. IBM was in a high technology business. The creation, use and licensing of patents, trademarks, technical know-how and similar assets were inseparable from IBM's data processing and office equipment business.
51. Within the IBM corporate structure, research and development activities were organized on the divisional level. The division headquarters were in Yorktown Heights, New York, where over 1,000 scientists were employed. Research findings were transmitted to developmental laboratories (IBM had approximately 18

such laboratories) where new products were developed.

52. Research and development activities and sales of patents and IBM products were part of a continuous cycle. Ongoing research and development activities produced new technology, which resulted in new patents. The patents were used to produce new products and were licensed to other companies, which produced revenue. The revenue was reinvested in additional research and development.
53. The manufacturing divisions of IBM had an ongoing dependency on technological development. Developmental laboratories were located at the manufacturing plants.
54. Products on which patents were obtained were developed for use in IBM's regular business operations.
55. Research and development expenses, including salaries and the cost of securing and protecting patents, were treated as part of IBM's regular business operations.
56. IBM spent the following amounts for research and development: \$730 million in 1973, \$890 million in 1974 and \$946 million in 1975.
57. Any competitor of IBM may license any patent developed by IBM, assuming an appropriate royalty is paid. In addition to licensing patents in exchange for royalties, IBM entered into hundreds of cross-licensing agreements with competitors and others during the 1973-1975 period.
58. The payment of royalties from IBM World Trade to IBM, as well as from other companies to IBM, were arm's length transactions motivated by a business purpose.

The Commission concluded:

- A. IBM World Trade Corporation is not a "discrete business enterprise" but rather an integral part of IBM's worldwide unitary business.
- B. Dividends received by IBM in 1975 from its subsidiary, IBM World Trade Corporation, are includable in its apportionable income and are subject to taxation

by the State of Wisconsin within the intent and meaning of s. 71.07(1m), Wis. Stats.

- C. The dividends received by IBM from IBM World Trade Corporation are includable as "total sales" in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.
- D. During the period involved, IBM's business within Wisconsin was an integral part of its unitary business within the intent and meaning of s. 71.07(2), Wis. Stats.
- E. The investment department of IBM is not a "discrete business enterprise" but rather an integral part of IBM's unitary worldwide business.
- F. Investment income received by IBM during the period involved is includable in its apportionable income and is subject to taxation by the State of Wisconsin within the intent and meaning of s. 71.07(1m), Wis. Stats.
- G. The interest and proceeds from the sale of investments by IBM during the period involved are includable as "total sales" in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.
- H. The royalties received by IBM during the period involved constituted "mainstream" income and are includable as "total sales" in the sales factor of the apportionment formula within the intent and meaning of s. 71.07(2)(c), Wis. Stats.
- I. The Commission does not have the authority or jurisdiction to rule on the constitutional issues raised by IBM.

The taxpayer has appealed this decision to the Circuit Court. The department has not appealed this decision.

Wisconsin Department of Revenue vs. Lake Wisconsin Country Club (Court of Appeals, District IV, February 25, 1985). Lake Wisconsin Country Club appealed a judgment of the Circuit Court overturning part of a Tax Appeals Commission decision which determined that assessments for Lake Wisconsin's capital improvement fund were taxable income rather than nontaxable contributions to capital. (See WTB #37 for a

summary of the Circuit Court's decision.)

Prospective members of Lake Wisconsin Country Club must purchase a \$100 Certificate of Membership which is refunded when they withdraw, pay a nonrefundable initiation fee of \$100 and pay nonrefundable annual dues and assessments for capital improvements. The club contended that the assessments constitute contributions to capital and so do not fall within the statutory definition of income.

The Court of Appeals concluded that there is a reasonable distinction between contributions to capital and income, and that the Commission's conclusion that that distinction is embodied in s. 71.03(1), Wis. Stats., is a reasonable conclusion. The Court of Appeals therefore need not examine competing interpretations of s. 71.03(1). The judgment of the Circuit Court is reversed.

The department has appealed this decision to the Supreme Court.

Spacesaver Corporation vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, February 12, 1985). During the period under review, 1977 through 1981, Spacesaver Corporation was a Wisconsin corporation with its principal place of business in Fort Atkinson, Wisconsin. The sole issue for the Commission to determine is whether or not the travel and business meeting expenses for employees' wives were "ordinary and necessary" business expenses of the taxpayer and were deductible under s. 71.04(2)(a), Wis. Stats.

The taxpayer is involved in manufacturing, engineering and marketing high density shelving. The vast majority of sales of its product are made through franchised area contractors in the United States and Canada. The area contractors are independently owned companies, ranging from three to thirty people.

The taxpayer planned and hosted the annual sales conferences which were held either the last week of February or the first week of March. The annual sales meetings were typically held in Arizona and Southern California because the climate was conducive to the recreational activities the taxpayer had planned. The purposes of the annual sales meetings were to market the taxpayer's product, to introduce new products, and

to decide the theme for the next annual sales meeting.

The marketing, sales and customer service personnel attended the annual sales meetings, as well as the officers of the company, and on occasion a senior engineer and the company's legal counsel. The wives of the employees of Spacesaver started accompanying their husbands to the annual sales conferences in 1977.

The wives of the employees did not perform any administrative functions in the taxpayer's corporation; they were not shareholders and corporate officers of the corporation; they could not enter into contracts for the corporation, and they were not salespersons hired by the corporation. Additionally, the wives of the taxpayer's employees had no educational background or work experience in the areas of sales and marketing.

The taxpayer claims that the purpose of having the wives of its employees attend the annual sales conference was to motivate the area contractors' wives to motivate their husbands to sell the taxpayer's products and to promote a certain family image. The employees' wives also participated in a variety of activities such as assembling literature packets, assembling hardware displays, assisting in registration of participants, assisting in room reservations, acting as table hostesses, assisting in audiovisual presentations, and hosting ladies' programs.

The taxpayer's annual sales conference agendas for the years 1977 through 1981 had two separate programs, one for the business sessions and the other for the ladies' optional programs. A majority of the ladies' programs consisted of social and recreational activities.

The Commission concluded that a substantial percentage of the business activities for the employees' wives were social and recreational and the incidental services performed by the wives of the employees did not constitute a bona fide business purpose. The travel and business meeting expenses for employees' wives were not "ordinary and necessary" business expenses of the taxpayer and were not deductible under s. 71.04(2)(a), Wis. Stats.

The taxpayer has appealed this decision to the Circuit Court.

United States Steel Corporation vs. Wisconsin Department of Revenue

(Wisconsin Tax Appeals Commission, May 9, 1985). The taxpayer has raised a number of issues in this appeal. The first issue raised relates to the "unitary business/formula apportionment" concept of allocating income to Wisconsin for taxation purposes. It is the taxpayer's contention on the unitary issue that its transportation operation is not part of its unitary business in Wisconsin because this activity is carried out through subsidiaries which did no business in Wisconsin. In addition, the taxpayer is contending that three of its divisions, USS Realty Development (Realty), Sterling Park Development Division (Sterling Park) and the New York Investment Division (Investment Division), were not part of its unitary business in Wisconsin.

The taxpayer raises the following issues in addition to the above-stated contention on the unitary issue:

- A. Whether the department's method of determining apportionable income relating to its mining operations was arbitrary, in violation of the principle of the Wisconsin statutory three factor approach to apportionment, and/or in violation of the statutory pattern in s. 71.07, Wis. Stats., for determining apportionable income by shifting further emphasis in the formula to sales and away from property and payroll.
- B. Whether the department erred in including the taxpayer's intangible income in apportionable income.
- C. Whether all intangible proceeds from the sales, exchanges and redemptions of intangible assets should be included in the taxpayer's gross receipts for the purpose of calculating the denominator of the sales factor on the taxpayer's 1975 return.
- D. Whether the property, payroll and sales of the taxpayer's dividend paying subsidiaries should have been included in the denominators of the property, payroll and sales factors for purposes of calculating intangible income apportionable to Wisconsin.
- E. Whether Wisconsin's double weighted sales factor results in attributing to Wisconsin income

out of all appropriate proportion to the activities of the taxpayer in Wisconsin; results in multiple state taxation or results in attributing to Wisconsin, for taxation, income on Wisconsin destination sales which has already been taxed in the state where the manufacturing was performed; and/or results in a discrimination against interstate commerce.

- F. Whether the increase in the relative tax burdens on the taxpayer from the law changes incorporating destination sales, double weighted sales and intangible income into the apportionment calculation constitutes a burden on interstate commerce, and/or whether this increased burden has any rational relationship to the activities of the taxpayer in Wisconsin.

United States Steel Corporation is a Delaware corporation, with its main corporate headquarters in Pittsburgh and New York. It has commercial domicile in Pennsylvania. The taxpayer is a multi-state, multi-national corporation doing business in all but one of the United States and numerous foreign countries.

There are five major segments comprising the taxpayer's domestic operations; each segment is made up of several divisions. The five major segments are as follows: manufacture and sale of steel, fabricating and engineering, chemicals, transportation, and cement.

In addition to the above segments, the taxpayer has other miscellaneous operations, including Realty, Sterling Park, and the Investment Division. These operations are conducted as divisions of the taxpayer and are not subsidiary corporations.

The taxpayer owns the following subsidiaries: twelve railroad subsidiaries, Orinco Mining Company, U.S. Steel International, United States Steel International Sales Co. (DISC), Intupersa, Navigen Company, and Navios Corporation.

The taxpayer is a stockholder with less than a controlling interest in the following dividend paying corporations: Ashco, Inc.; Oglebay Norton Company; Rinker Materials Co., Inc.; Structural Dynamics Research Corporation; and Altos Hornos de Vizcaya, S.A.

The five divisions of United States Steel Corporation operating in Wisconsin during the relevant period were (a) USS Division - production and sales of steel; (b) USS Supply Division - warehouses for sale of steel products; (c) USS Chemicals Division - manufacture of various industrial chemicals; (d) Universal Atlas Division - production and sale of cement products; and (e) USS Agricultural Chemicals Division - manufacture of various nitrogen phosphatic fertilizer products.

The taxpayer is not asserting that its income relating to the activities of four of its major segments (manufacture and sale of steel; fabrication and engineering; chemicals; and cement) is not subject to apportionment in Wisconsin in that each of these divisions had activities in Wisconsin during the years at issue.

Each division of the taxpayer is run as a separate profit unit, operating under the principle of "functional profitability independence". Each division has a separate set of books and records and a separate profit and loss statement. Each division is headed by an executive officer, hired and fired by the taxpayer's top level management. Each division determines how best to accomplish its goal of making a profit, with each unit having responsibility for getting a rate of return competitive with what outside businesses in the same line are earning.

Each division has its own sales, advertising, personnel, accounting, etc., departments. However, the division may rely on the taxpayer's central office to provide assistance in purchasing, accounting, personnel, legal matters, tax problems, etc. There is no requirement that the divisions utilize these services (they may go outside), and the divisions are charged for these services at market rates. These charges are taken against the division's profit and loss statement. Intra-company transactions are conducted at arm's length.

Certain services of the central office benefit the entire company, e.g., lobbying on environmental or labor matters, public relations, pension and employee insurance plans, corporate-wide self-insured coverage, labor negotiations, transportation planning, safety practices, planning for future facilities, economic studies, centralized and uniform accounting system, research and development,

central computer system, and advertising of a corporate image type. The taxpayer's central tax department is responsible for preparation of tax returns, state and federal. Each division is responsible for preparation of its own financial statements, which are submitted to the central office for consolidation for Securities and Exchange Commission (SEC) reporting and the annual report. On occasion, the taxpayer's employees are transferred between divisions for further training. The steel and raw materials divisions are coordinated to a great extent through the central office. The taxpayer has a vice-president of Accounting-Other Divisions whose responsibility is to work with divisions other than steel and raw materials to make sure that the taxpayer has the coordination and uniformity necessary to carry out its programs and policies.

If a division is in need of funds for expansion, the head of the division would look to the taxpayer's treasurer, and advances made to a division in excess of its budget would be subject to the discretion of top management.

The head of each division is responsible for preparation on an annual basis of a forecast of profits and losses, a budget and expected rate of return, plus a projection for the next three years, which is reviewed with the next higher level of management. These budgets and forecasts are submitted to the central accounting office for preparation of a company-wide projection, which is approved by the taxpayer's Corporate Policy Committee.

United States Steel Corporation's Board of Directors establishes the overall policies for the taxpayer and approves certain activities, e.g., filings with the SEC, the annual report, major expenditures of the corporation and its dividend policy.

The Corporate Policy Committee is a committee of the Board of Directors whose principal function is carrying out certain policies designated by the Board. It also acts as the primary approval group before going to the Board, and in some cases, the Board has delegated to this committee authority for approval of certain financial matters.

The Corporate Management Committee is a committee of the Board of Directors whose principal functions

are to review the profit and loss results of the divisions, and to review the operating situations of each division. Through this committee, each division keeps top management advised of the status of its business, reporting its results and where it stands in relation to its expectations for the year, and discussing the problems it might be having.

All excess cash of the divisions not needed for day-to-day operations is turned over to the Investment Division, where it is commingled with other business receipts and invested at the discretion of the New York investment staff. Once these funds are commingled, it is impossible to trace the source of the funds.

If funds are needed by the taxpayer's management for expansion, capital acquisitions or acquisitions of new businesses, needed funds are obtained either through borrowing, the corporate treasury, or sales of stock. The decision as to the source of financing is made by top management with approval of the Corporate Policy Committee.

The Investment Division has been in existence since at least the 1930s. Its offices are located in the taxpayer's New York headquarters. This division is under the supervision of the corporate treasurer. Although because of the nature of this operation it has had little need of the taxpayer's central services, the Investment Division operates in relation to the taxpayer's central office in a similar manner to the other divisions.

The main responsibility of the Investment Division is the management and investment of the cash of the taxpayer not needed for the day-to-day operations. The Investment Division is a sizable contributor to the taxpayer's income; in fact, the top money making division of the taxpayer in 1975. The Investment Division is one of the taxpayer's regular business functions.

The Investment Division invests the taxpayer's excess cash in short-term investments (less than 1½ years). These short-term investments are primarily in Treasury bills, notes and bonds; bankers acceptances and bankers participation certificates; certificates of deposits from various banks; commercial paper; and Canadian time deposits. Most of these short-term investments are negotiable instruments and are readily

traded and sold by the division. In 1975, the net income from intangibles earned through investments by the Investment Division was \$303,871,292.

The Investment Division had one \$20,000 certificate of deposit in Wisconsin, which was in the North Milwaukee State Bank, from which the taxpayer derived \$1,100 annual interest income. Other than this certificate of deposit, the Investment Division had no activity in Wisconsin; no securities kept in Wisconsin; no other bank accounts in Wisconsin; and no funds transferred for use in Wisconsin.

The Investment Division provides needed cash flow to other divisions of United States Steel Corporation. Normally, the funds can be made available on short notice for use by other divisions or by the taxpayer for acquisitions. When the Investment Division is called upon to provide cash for another corporate purpose, it is for a specific purpose, such as working capital or a loan to a division, as specified through the Pittsburgh office. The Investment Division does provide cash for loans to subsidiaries which are interest bearing notes, usually tied to the prime rate.

Realty was created in 1969 with an initial capital investment from the taxpayer. The head of this division reports to the vice-president of Realty and Finance. The purpose of Realty is to develop and manage corporate property to the best financial advantage, for corporate use and otherwise. It is construction oriented, having constructed shopping centers, industrial parks, warehouses and recreational facilities (e.g., theme hotels for Disney World). Realty constructs warehouses for lease to the taxpayer at market rental rates. On a few occasions, Realty has taken over facilities abandoned by the taxpayer.

Realty operates in relation to the taxpayer's central office in a similar manner to the other divisions. Realty has its own accounting department, financial statements, and management. Realty uses outside engineers because it employs people from the community in which it is operating. Realty does not use the taxpayer's central research and development facilities, engineering department, advertising, labor services or legal counsel (although on a few occasions, it has used the legal services,

paying for the service). Realty does have charges included in the Deductions listed on its Operating Statements for 1972-1975 for services provided by other administrative groups of the taxpayer. Realty has used the taxpayer's products in its construction activities. Realty usually obtains financing by borrowing on the outside but has sought financial assistance from the taxpayer. Requests for additional funding are made by Realty's management through the appropriate channels within the taxpayer. The decision is made by the taxpayer's management whether to finance through the taxpayer or go outside.

Realty's excess earnings flow to the taxpayer, which takes control over these funds for use within the discretion of the taxpayer's management.

Realty's accounting personnel are located in the taxpayer's Pittsburgh office building. Other employes of Realty are located throughout the United States. The paychecks are from the USS Realty Division payroll account.

Sterling Park was responsible for a housing development in Sterling Park, Virginia, consisting of single- and multi-family housing which were sold to the general public. It also developed and maintains a shopping center in the area. Prior to 1972, Sterling Park was a subsidiary of the taxpayer and was then changed into a division. It remains a very small division of United States Steel Corporation. Sterling Park operates in relation to the taxpayer's central office in a similar manner to the other divisions. The head of Sterling Park reports to the vice-president of Realty and Finance.

This division developed a warehouse for lease to the taxpayer's products division in Birmingham, Alabama, which was leased on the basis of commercial prices.

Neither Realty nor Sterling Park owns any land in Wisconsin and neither has any operations in Wisconsin.

United States Steel Corporation owns twelve domestic railroad subsidiaries. The taxpayer did not organize any of these railroad companies but acquired existing companies around 1901, when the corporation was organized. These twelve subsidiaries constitute one of the largest carrier systems in the United States