No. 06 1413 APR 20 2007

In The

Supreme Court of the United States

MEADWESTVACO CORPORATION,
successor in interest to THE MEAD CORPORATION,

Petitioner,

v.

ILLINOIS DEPARTMENT OF REVENUE, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, AND TREASURER OF THE STATE OF ILLINOIS,

Respondents.

On Petition For A Writ Of Certiorari To The Appellate Court Of Illinois

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Is the attempt by Illinois to tax the approximately $1 billion gain realized by Petitioner when it sold its investment in Lexis/Nexis in 1994 (which it acquired in 1968 for $6 million and which functioned for 26 years as an independent, nonunitary business) in direct conflict with the decisions of the Court in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico,* 458 U.S. 354 (1982) and *ASARCO Inc. v. Idaho State Tax Commission,* 458 U.S. 307 (1982) and the Due Process and Commerce Clauses of the United States Constitution?

RULE 29.6 STATEMENT

Petitioner, The Mead Corporation, was a publicly held company with no parent company or publicly held company owning more than 10% of the Company's stock during the year ended December 31, 1994, the tax period involved in the dispute. As of January 29, 2002, MeadWestvaco Corporation was formed. From January 29, 2002 through December 31, 2002, MeadWestvaco Corporation functioned as a holding company with two assets – all of the stock of The Mead Corporation and all of the stock of Westvaco Corporation. On December 19, 2002, MW Custom Papers, Inc. was incorporated. On December 31, 2002, The Mead Corporation was merged into MW Custom Papers, Inc. Later on December 31, 2002 MW Custom Papers, Inc. was converted into MW Custom Papers, LLC. After this conversion, the majority of the operations and assets previously owned by The Mead Corporation and then contained within MW Custom Papers, LLC were transferred to MeadWestvaco Corporation. MeadWestvaco Corporation is the successor in interest to The Mead Corporation. MeadWestvaco Corporation is a publicly held company with no parent company or publicly held company owning more than 10% of MeadWestvaco Corporation's stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully seeks this Court's review of the January 12, 2007 opinion of the Appellate Court of Illinois, First Judicial District, Sixth Division and the January 24, 2007 Denial of the Supreme Court of Illinois of the Petition for Leave to Appeal.

OPINIONS BELOW

The Denial of the Supreme Court of Illinois of the Petition for Leave to Appeal (Petition Appendix ("App.") 41a), dated January 24, 2007, is reported at 862 N.E.2d 235. The opinion of the Appellate Court of Illinois, First Judicial District, Sixth Division (App. 1a-22a), dated January 12, 2007, is reported at 861 N.E.2d 1131. The order of the Appellate Court of Illinois, First Judicial District, granting the Respondents' motion to publish a Rule 23 order as a precedential decision and withdrawing the Rule 23 order issued on November 3, 2006 (App. 23a-24a), dated January 3, 2007, is not reported. The Memorandum Decision, Judgment and Order of the Circuit Court of Cook County, Illinois (App. 28a-40a) filed on March 18, 2003, is not reported. The Final Judgment Order of the Circuit Court of Cook County, Illinois (App. 25a-27a) entered on March 25, 2003, was not reported.

JURISDICTION

The opinion of the Appellate Court of Illinois, First Judicial District, Sixth Division (App. 1a-22a), was rendered on January 12, 2007. The Denial of the Supreme Court of Illinois of the Petition for Leave to Appeal (App.

41a), was issued on January 24, 2007. The jurisdiction of this Court rests upon 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS INVOLVED

The United States Constitution provides: "The Congress shall have the Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3 (the Commerce Clause).

The Fourteenth Amendment to the United States Constitution provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law." U.S. Const. amend. XIV, § 1 (the Due Process Clause).

INTRODUCTION

This Petition presents the question whether Illinois can violate the principles set forth in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico,* 458 U.S. 354 (1982) and *ASARCO Inc. v. Idaho State Tax Commission,* 458 U.S. 307 (1982) and the Due Process and Commerce Clauses of the United States Constitution, by ignoring the factors articulated by this Court in determining whether an asset serves an operational function such that income from the sale of that asset can be subjected to tax by a non-domiciliary state. Furthermore, and again in direct contravention of the principles articulated by this Court, the factors relied upon by Illinois in reaching its determination would almost always in today's business world lead to a conclusion that an operational relationship exists where one business owns another. Consequently, if the Illinois decision is allowed to stand it will eviscerate the operational test articulated by this Court and result in virtually all income being subject to apportionment.

Petitioner acquired Data Corporation, which became Mead Data Central, in 1968 for $6 million. One of the technologies included in this acquisition was an experimental full-text information retrieval technology which, for the first time, applied computers to legal research and eventually became the Lexis/Nexis information service (this business will be referred to as "Lexis/Nexis").

Petitioner was, and is, in the business of producing and selling forest products, including paper and school supplies. Lexis/Nexis was in the electronic publishing business.

Lexis/Nexis did not receive its big break until the 1970s when this Court became a customer, leading to courts at every level becoming customers, which inevitably led to law firms, law schools and the entire legal profession becoming customers. Lexis/Nexis grew from a small legal database into the world's premier provider of online legal information.

The controversy in this matter stems from Petitioner's gain from the liquidation of its investment in this completely separate business, Lexis/Nexis, in 1994 (the "gain") and Respondents' taxation of the gain. It is Petitioner's position that, as a non-domiciliary of Illinois, Illinois cannot tax the gain because Petitioner's investment in Lexis/Nexis served an investment as opposed to an operational function in accordance with this Court's decisions in *Allied-Signal*, *Woolworth* and *ASARCO*.

As concluded by the trial court, Lexis/Nexis did not engage in a unitary business with Petitioner. Specifically, the trial court found that Petitioner and Lexis/Nexis "were not functionally integrated, there was no centralization of management and no significant economies of scale between the two businesses." App. 39a. Despite the fact that Petitioner and Lexis/Nexis were in two distinct businesses, the trial court went on to find, and the appellate court concurred, without foundation, that Petitioner's investment in Lexis/Nexis served an operational rather than investment function.

The factors relied upon by the appellate court as indicative of Lexis/Nexis serving Petitioner in an operational rather than investment function start with the fact that Petitioner owned 100% of Lexis/Nexis. However, this Court has held that income received by a non-domiciliary corporation from wholly owned subsidiaries was not apportionable to New Mexico where there did not exist a unitary relationship between the parent and the subsidiaries. *F.W. Woolworth Co. v. Taxation & Revenue Dep't of N.M.,* 458 U.S. 354, 370 (1982).

The remainder of the factors relied upon by the appellate court all stem from this first factor, *i.e.*, the remaining factors all reflect an ordinary relationship between a company and a 100% owned business. Such factors were: (1) Petitioner's capital investment in the early years of Lexis/Nexis; (2) Petitioner's receipt of the benefit of certain tax advantages; (3) Petitioner's investment of Lexis/Nexis' excess cash (for the benefit of Lexis/Nexis); (4) Petitioner's approval of major debt and major capital expenditures; (5) Petitioner's ability to change Lexis/Nexis from a division to a subsidiary; and (6) Petitioner's inclusion of Lexis/Nexis in describing the company's business in its annual reports and Forms 10-K.

These factors, however, exist in virtually every situation where one business owns another. If allowed to stand, reliance by Illinois on these factors would render this Court's holding setting forth the operational requirement in *Allied-Signal* meaningless. It would mean that all income received by non-domiciliary corporations from subsidiaries or divisions would be subject to apportionment. This is precisely what New Jersey argued for in *Allied-Signal*. This Court responded that the unitary business principle has existed since the beginning of the twentieth century, that it is workable in practice, and that to overrule it at this late date would make it unworkable in practice. Illinois cannot be allowed to circumvent this Court's holding in *Allied-Signal*.

STATEMENT OF THE CASE

As the appellate court recognized, the facts in this matter are "essentially undisputed." App. 2a.

A. Petitioner's Business

At all times relevant hereto, Petitioner was a corporation incorporated under the laws of Ohio that maintained its commercial domicile in Dayton, Ohio.

Petitioner was, and is, in the business of producing and selling forest products, including paper, packaging and school and office supplies.

In 1968, Petitioner acquired Data Corporation because it was interested in its ink jet printing technology. Data Corporation also had two other technologies, one of which was a full-text experimental information retrieval technology which was the predecessor of Lexis/Nexis. Lexis/Nexis developed the information retrieval technology, in a project with the Ohio and Missouri Bar Associations, into a service that would assist in researching law. This project lasted until 1972, when it was decided to develop this service on a national basis. Lexis was launched in 1973.

Lexis/Nexis received a big break in the 1970s when this Court became a customer. Courts at every level soon became customers, which inevitably led to law firms, law schools and the rest of the profession becoming customers. Nexis, a news and information service aimed at the financial market, was launched in approximately 1980.

Lexis/Nexis had its own building in Miamisburg, Ohio. Petitioner was located at its corporate headquarters in downtown Dayton, Ohio. Lexis/Nexis maintained its own facilities that were separate from the facilities maintained by Petitioner. There were no shared facilities between Petitioner and Lexis/Nexis.

Lexis/Nexis was responsible for all of its own personnel matters. Bonuses for Lexis/Nexis personnel were based upon the performance of Lexis/Nexis measured against its business plan. There were many years when Lexis/Nexis employees received bonuses while Petitioner's employees did not.

There were no shared departments between Petitioner and Lexis/Nexis. For example, Lexis/Nexis maintained the following departments, all of which were separate from Petitioner: accounting; internal audit; internal legal; credit and collection; human resources; real estate; purchasing; and marketing.

While Lexis/Nexis could have invested its own excess funds, Petitioner invested cash for Lexis/Nexis. However, the funds and the investment returned on those funds accrued specifically to Lexis/Nexis.

Petitioner exercised very little control over the capital acquisitions of Lexis/Nexis. Lexis/Nexis made its own purchases based upon its business plan. As would any investor in a company, Petitioner's board of directors reviewed and approved major capital expenditures by Lexis/Nexis, changes to Lexis/Nexis' legal structure and other large, nonrecurring transactions. Petitioner also made some capital contributions to Lexis/Nexis.

While the legal relationship between Petitioner and Lexis/Nexis changed several times between a division and a subsidiary, this did not affect the operations of Lexis/Nexis. Indeed, most people at Lexis/Nexis were not even aware of any changes.

To Petitioner, Lexis/Nexis was simply an investment. Petitioner therefore let the company run itself. Once a year, Lexis/Nexis management would present a business plan to Petitioner and that was the extent of Petitioner's involvement in the operations of Lexis/Nexis.

The Illinois Department of Revenue's auditor conceded that Petitioner and Lexis/Nexis were not in the same line of business or vertically integrated. Furthermore, he conceded that there was no functional integration between Petitioner and Lexis/Nexis, *nor was there any operational relationship between the businesses*. Simply stated, Illinois' own auditor acknowledged that Petitioner was a passive investor in Lexis/Nexis.

On December 2, 1994, Petitioner announced the completion of the sale of Lexis/Nexis for approximately $1.5 billion. Petitioner is contesting the actions of Illinois in seeking to tax the $1,056,001,948.00 gain from that sale reported by Petitioner as nonapportionable income on its Illinois return for the tax year 1994.

B. Proceedings Below

The Illinois Department of Revenue issued two notices of deficiency to Petitioner asserting that, among other issues that are not the subject of this Petition, Petitioner was to apportion the gain from the sale of Lexis/Nexis to Illinois. Petitioner filed this action in the Circuit Court of Cook County Illinois asserting, as relevant to this Petition, that Petitioner did not have a unitary relationship with Lexis/Nexis, nor did Petitioner's investment in and disposition of Lexis/Nexis serve an operational, as opposed to an investment, function.

During the trial before the Circuit Court of Cook County, several expert witnesses in tax policy and one expert witness in economics testified and submitted their reports detailing their findings. Professor Walter Hellerstein, renowned in the state and local tax community, testified and provided a report as an expert witness in state tax policy. App. 48a-58a. With regard to any operational relationship that might have existed between Petitioner and Lexis/Nexis, Professor Hellerstein opined in his report:

> In summary, because the relationship between Mead and MDC involved no meaningful functional integration, centralized management, or economies of scale; because there was no significant flow of value between Mead and MDC; and because neither Mead nor MDC served an operational function in each other's business, Illinois lacks the power to include the gain that Mead (a nondomiciliary corporation) earned from its disposition of MDC.

App. 57a. (Mead being Petitioner and MDC being Lexis/Nexis.)

Professor Richard D. Pomp, also renowned in the state and local tax community, testified and provided a report as an expert witness in state tax policy. App. 59a-77a. With regard to any operational relationship that might have existed between Petitioner and Lexis/Nexis, Professor Pomp opined in his report:

> Based upon the above facts and applying the governing principles of state tax policy, my opinion is that Mead and Lexis/Nexis were separate businesses. Lexis/Nexis did not contribute to Mead's unitary paper business, nor was Mead's unitary paper business dependent upon Lexis/Nexis. Accordingly, I conclude that from a policy prospective, Lexis/Nexis is not part of Mead's unitary paper business so that for that reason no nexus exists between Illinois and the gain on the liquidation of Mead's ownership of

> Lexis/Nexis to justify the Department's apportionment of the gain.

App. 71a. (Mead being Petitioner.)

Professor Ferdinand P. Schoettle, also renowned in the state and local tax community, testified and provided a report as an expert witness in economics. App. 78a-103a. With regard to any operational relationship that might have existed between Petitioner and Lexis/Nexis, Professor Schoettle opined in his report:

> As to the relationship between Mead and Lexis-Nexis, based upon my investigations I concluded that operational integration between Mead and Lexis-Nexis was virtually zero. Mead kept Lexis-Nexis as a separate business, an investment in a very different business than its own. That separateness was the reason Mead sold Lexis-Nexis. Mead had neither publishing nor computer expertise nor any other line function which it could integrate with Lexis-Nexis. Given these conditions, Lexis-Nexis was truly a "stand alone" company.

App. 93a. (Mead being Petitioner.)

The Circuit Court of Cook County found that Petitioner and Lexis/Nexis "were not functionally integrated, there was no centralization of management and no significant economies of scale between the two businesses." App. 39a. Based upon those findings the Circuit Court of Cook County concluded that, as a matter of law, Mead and Lexis/Nexis were not unitary. App. 39a. The Circuit Court of Cook County then found that the gain from Petitioner's sale of Lexis/Nexis was apportionable by the State of Illinois because "Mead's investment in Lexis/Nexis did serve an operational purpose." App. 38a. Petitioner then filed an appeal with the Appellate Court of Illinois, First Judicial District, seeking reversal of the determination of the Circuit Court of Cook County.

The Appellate Court of Illinois, First Judicial District, concluded that Lexis/Nexis served an operational function for Petitioner.[1] App. 11a.

The Appellate Court of Illinois, First Judicial District, originally set forth these conclusions in an unpublished, non-precedential Rule 23 Order. Respondents then filed a Motion to Publish Rule 23 Order as Precedential Decision on November 14, 2006. App. 42a-47a. In this motion Respondents urged the Court to consider the importance of its decision as follows:

> *The decision provides such crucial guidance on a recurring issue* because it sets forth specific factors – such as on-going capital support, approval of major capital expenditures, manipulation of business organizations, and retaining benefits and control of excess cash – on which the Department, courts and taxpayers can rely in determining when a business unit qualifies as an operational asset and thus when the gain realized from its sale is constitutionally apportionable. *In addition, the decision is significant* because it approved of specific evidence on which the Department and courts can rely in making this determination – such as annual reports and federal 10-K statements – and disapproved of other evidence – the testimony of

[1] It did "not address the Department's claim of error as to the [Circuit Court's] 'lack of unitary business' finding." App. 11a.

> experts who offer opinions on matters of law – in deciding whether a business asset serves an operational function.

App. 45a (emphasis added).

Petitioner filed a Petition for Leave to Appeal with the Supreme Court of Illinois on December 8, 2006 with regard to the Appellate Court, First Judicial District's unpublished, non-precedential Rule 23 Order. The opinion of the Appellate Court of Illinois, First Judicial District (the precedential opinion issued in response to Respondent's motion), was issued on January 12, 2007 ("Illinois Decision"). App. 1a-22a. The Petition for Leave to Appeal was denied by the Supreme Court of Illinois on January 24, 2007. App. 41a.

REASONS FOR GRANTING THE PETITION

I. WITHOUT FURTHER REVIEW, THE ILLINOIS DECISION WILL EFFECTIVELY OVERTURN THE OPERATIONAL TEST SET FORTH IN *ALLIED-SIGNAL*

In *Allied-Signal* this Court held that even if two businesses operate on a non-unitary basis, a non-domiciliary state may still apportion the income from the disposal of one business if that business served an operational rather than an investment function. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 787 (1992). Furthermore, this Court discussed the differences between an asset with an operational purpose and an asset with an investment purpose. The focal point of this Court's analysis for the finding of an operational relationship has been whether the asset was utilized directly in the selling company's business, or was utilized as a short-term investment to fund the day-to-day operations of the selling company.

In this case, the trial court held that Petitioner and Lexis/Nexis were *not* unitary. Then, contrary to this Court's precedent, and without foundation, the trial court held and the appellate court affirmed the finding that Petitioner's investment in Lexis/Nexis was "operational."

The inquiry should not have ended with a determination that Lexis/Nexis was 100% owned by Petitioner nor should it have considered the other factors directly flowing from the 100% ownership (*i.e.*, Petitioner's capital investment in the early years of Lexis/Nexis, Petitioner's receipt of the benefit of certain tax advantages, Petitioner's investment of Lexis/Nexis' excess cash (for the benefit of Lexis/Nexis), Petitioner's approval of major debt and major capital expenditures, Petitioner's ability to change Lexis/Nexis from a division to a subsidiary and Petitioner's inclusion of Lexis/Nexis in describing the company's business in annual reports and Forms 10-K). Not only has this Court never even implied that any of these factors are to be considered in reaching a determination on the operational nature of an asset, but this Court has held that many of these factors are not indicative of whether a certain item of income may be apportioned to a non-domiciliary state.

The Illinois Decision improperly points to the fact that Petitioner owned 100% of Lexis/Nexis. In *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354, 356-57 (1982), however, this Court found that Woolworth and its subsidiaries were not part of a unitary business, even where three of the subsidiaries were wholly owned. Moreover, in the context of a unitary business and in finding that the income received by Woolworth from the subsidiaries was not apportionable, the Court held that the mere potential to operate a subsidiary as part of a unitary business is insufficient for allowing the apportionment of income by a non-domiciliary state. *Id.* at 362 ("the *potential* to operate a company as part of a unitary business is not dispositive when, looking at 'the "underlying economic realities of a unitary business,'" the dividend income from the subsidiaries *in fact* is '[derived] from "unrelated business activity" which constitutes a "discrete business enterprise"'" (citations omitted)); *see also ASARCO Inc. v. Idaho State Tax Comm'n,* 458 U.S. 307, 323 (1982) ("Although ASARCO has the control potential to manage [the subsidiary], no claim is made that it has done so.").

The Illinois Decision improperly points to Petitioner's capital investment in the early years of Lexis/Nexis. *Woolworth*, 458 U.S. at 366 n.14 (where previous capital contributions did not lead to the apportionment of income by New Mexico).

The Illinois Decision also points to Petitioner's receipt of certain tax advantages, Petitioner's investment of Lexis/Nexis' excess cash (for the benefit of Lexis/Nexis), Petitioner's ability to change Lexis/Nexis from a division to a subsidiary and Petitioner's inclusion of Lexis/Nexis in describing the company's business in annual reports and Forms 10-K as bases for finding an operational relationship. These factors, however, will be present in any relationship between a parent company and a 100% owned business. Therefore the inescapable result of the Illinois Decision is that in Illinois, and in any other state that decides to follow the holding, the operational requirement of *Allied-Signal* no longer exists.

Furthermore, this Court has held that for the continued vitality of the unitary principle, it cannot be that all income earned by a corporation is apportionable income:

> [t]he business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently all of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business."

ASARCO, 458 U.S. at 326 (emphasis and citation omitted).

To allow the Illinois Decision to stand would be a violation of this principle in that in every situation where a parent owned 100% of a subsidiary or a division, all income from that business would be classified as apportionable income, regardless of the factual circumstances.

With regard to Petitioner's investment of excess cash on behalf of Lexis/Nexis, this Court in *Woolworth* noted that considering this commingling of funds to be determinative of the issue of the existence of a unitary relationship "subverts the unitary-business limitation. *All* dividend income – irrespective of whether it is generated by a 'discrete business enterprise,' – would become part of a unitary business if the test were whether the corporation commingled dividends from other corporations, whether subsidiaries or not." 458 U.S. at 364 n.11 (citation omitted). Furthermore, with regard to all of these issues this Court noted that consolidated accounting and consolidated statements did not lead to a conclusion that there existed a unitary relationship. *Id.* at 369 n.22. *See also Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992) (in holding that a gain was not apportionable, this Court ignored descriptions of business activities in annual reports that the Supreme Court of New Jersey had relied upon in reaching the opposite conclusion).

The Illinois Decision also relied upon the fact that Petitioner continued to approve major capital expenditures. This action, however, amounts to nothing more than actions any good investor would take with regard to an investment. *Woolworth*, 458 U.S. at 369 (in concluding a unitary business did not exist the Court found that "[e]xcept for the type of occasional oversight – with respect to capital structure, major debt, and dividends – that any parent gives to an investment in a subsidiary, there is little or no integration of the business activities or centralization of the management").

The Illinois Decision did not address the two determinative focal points of this Court's previous discussions of the operational test – whether the asset was utilized directly in the selling company's business, or whether the asset was utilized as a short-term investment to fund the day-to-day operations of the selling company. *E.g.*, *Allied-Signal,* 504 U.S. at 789-90 ("Nor can it be maintained that Bendix's shares of ASARCO stock, which it held for over two years, amounted to a short-term investment of working capital analogous to a bank account or certificate of deposit."); *Corn Prods. Refining Co. v. Commissioner*, 350 U.S. 46, 50 (1955) (corn futures were vitally important to a corn products business as a guarantee against increases in the prices of raw corn).

Several other cases discuss an operational versus investment function in the context of determining the apportionability of income to a non-domiciliary state. The focus of all of these discussions is whether the asset was used in the same line of business as the company that sold it or whether the asset was analogous to working capital. None of the factors relied upon in the Illinois Decision are factors to be considered in deciding whether an asset serves an operational or investment function. *See Woolworth*, 458 U.S. at 370 ("In this case the parent company's operations are not interrelated with those of its subsidiaries so that one's 'stable' operation is important to the other's 'full utilization' of capacity." (citations omitted)); *Allied-Signal*, 504 U.S. at 789 (explains the holding in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) by saying that a unitary relationship is shown where the management role of the parent "is grounded in its own operational expertise and operational strategy").

Petitioner's ownership of Lexis/Nexis, which lasted almost 26 years, served an investment function. Lexis/Nexis was acquired as an investment, and its management was separate from Petitioner's. Like Bendix's ownership of ASARCO, Petitioner's ownership of Lexis/Nexis did not amount to "a short-term investment of working capital." *Allied-Signal,* 504 U.S. at 790. Furthermore, unlike the facts in *Container Corp.* and *Corn Products*, Petitioner and Lexis/Nexis were in two completely separate and independent lines of business.

As noted by Illinois in its Motion to Publish Rule 23 Order as Precedential Decision before the Appellate Court of Illinois:

> The decision provides such crucial guidance on a recurring issue because it sets forth specific factors – such as on-going capital support, approval of major capital expenditures, manipulation of business organizations, and retaining benefits and control of excess cash – on which the Department, courts and taxpayers can rely in determining when a business unit qualifies as an operational asset and thus when the gain realized from its sale is constitutionally apportionable. In addition, the decision is significant because it approved of specific evidence on which the Department and courts can rely in making this determination – such as annual reports and federal 10-K statements – and disapproved of other evidence – the testimony of experts who offer opinions on matters of law – in deciding whether a business asset serves an operational function.

App. 45a.

Petitioner could not agree more that this incorrect decision will have a major effect on tax administration not only in Illinois, but in every state. The detrimental effect of this decision will impact every multi-state taxpayer. This Court's intervention is required to ensure that multi-state taxpayers and state taxing authorities alike receive a correct and uniform analysis in the determination of whether an asset serves an operational function or an investment function.

To let the Illinois Decision stand would be to decide that in any situation where a non-domiciliary business owns 100% of a subsidiary or division, all income from such subsidiary or division is apportionable by Illinois. This would render the operational requirement of *Allied-Signal* meaningless.

II. WITHOUT FURTHER REVIEW, THE ILLINOIS DECISION, WHICH DECIDES AN IMPORTANT FEDERAL QUESTION, WILL STAND IN CONFLICT WITH DECISIONS OF OTHER STATE COURTS OF LAST RESORT

The Supreme Court of Minnesota dealt with the issue of whether an asset served an operational or investment function as follows:

> *Allied-Signal* stated that an assessment of whether an intangible asset served an operational function must focus "on the objective characteristics of the asset's use and its relation to the taxpayer and its activities in the taxing state." The Court gave us two examples of how an intangible might serve an operational function: a short term investment analogous to a bank account or certificate of deposit, or, under its decision in *Corn Products Refining Co. v. Commissioner*, a long-term investment in commodity futures that ensures a certain supply of a necessary product at a fixed price.
>
> As we discussed above, however, there is no evidence that Hercules treated its investment in Himont as a repository for working capital like a bank account or certificate of deposit. Nor did Hercules hold its Himont stock as a hedge against a fluctuating supply of polypropylene.

Hercules Inc. v. Commissioner of Revenue, 575 N.W.2d 111, 117 (Minn. 1998) (citations omitted).

The state's highest court in Maryland, the Court of Appeals, reached the same conclusion based upon a similar analysis in a case involving the same taxpayer and the gain from the sale of the same intangible asset. *Hercules Inc. v. Comptroller of Treasury*, 716 A.2d 276 (Md. 1998).

Neither of the courts of last resort in Minnesota or Maryland relied upon any of the factors relied upon in the Illinois Decision. While the Illinois Decision focuses solely on the potential control (*i.e.*, the 100% ownership of Lexis/Nexis by Petitioner and the factors flowing from such ownership) to support the conclusion that Lexis/Nexis served an operational function for Petitioner, the Court of Appeals of Maryland specifically rejected an argument made by the state regarding ownership and explained that pursuant to *Woolworth* the test for apportionability of the gain "was not the *potential* of unitary control, but rather the actual, in fact unitariness or separateness of the subsidiary enterprises." *Hercules*, 716 A.2d at 281. The Illinois Decision is in direct conflict with the decision of the Court of Appeals of Maryland in *Hercules*.

The Supreme Court of Alaska in *Alaska Department of Revenue v. OSG Bulk Ships, Inc.*, 961 P.2d 399 (Alaska 1998), reviewed the conclusion of a hearing officer that an asset had served an operational function. The hearing officer had based that conclusion on his finding (for which he relied heavily upon the statements in the company's annual reports) that the company's "'investment decisions were obviously aimed at building its financial strength overall.'" *Id.* at 413-14. The Supreme Court of Alaska found that "the hearing officer's definition of 'operational income' would swallow the distinction between operational and investment income," in that all business decisions are made with the goal of profitability. *Id.* at 414. Indeed, the court noted that this Court had specifically rejected New Jersey's argument in *Allied-Signal* that any distinction between operational and investment income was artificial. *Id.* The Supreme Court of Alaska reversed the determination of the hearing officer, but remanded the matter for further proceedings with the instructions that the income from the asset could be apportioned by Alaska only if the asset were part of the company's unitary business, or the asset was a short term investment used to fund the day-to-day operations of the company that was similar to a bank account. *Id.* Again, the Illinois Decision, relying upon factors such as Petitioner's capital investment in Lexis/Nexis, its receipts of certain tax advantages, its approval of major debt and capital expenditures and the inclusion of Lexis/Nexis in its annual reports and Forms 10-K, is in direct conflict with this decision of the Supreme Court of Alaska.

Several other state courts of last resort have reached decisions similar to those of Alaska, Maryland and Minnesota. *Pennzoil Co. v. Department of Revenue*, 33 P.3d 314, 318 (Or. 2001) (In finding an operational relationship the Supreme Court of Oregon found: "The acquisition of oil reserves is related – indeed it is vitally important – to the continued blending and distribution of motor oil in Oregon."), *cert. denied*, 535 U.S. 927 (2002); *Hoechst Celanese Corp. v. Franchise Tax Bd.*, 22 P.3d 324, 345 (Cal.) (In finding a pension plan and trust used to retain employees and attract new employees was related operationally to the taxpayer's business the Supreme Court of California stated: "Although the United States Supreme Court has not clearly differentiated operational and investment functions, it has stated that an asset serves an operational function if it helps the taxpayer 'make better use . . . of [its] existing business-related resources.'" (citation omitted)), *cert. denied*, 534 U.S. 1040 (2001).

Thus the state courts of last resort that have dealt with the issue of determining whether an asset served an operational or investment function, have asked the questions – is the asset directly related to the business of the company that disposed of the asset, or is the asset a short-term investment similar to working capital. These questions are consistent with the decisions of this Court. Illinois now seeks to ignore these factors and to, instead, focus on other factors, most of which are not recognized as relevant to a determination of whether or not income is apportionable.

The Illinois Decision is in direct conflict with the decisions of the courts of last resort of other states and, if allowed to stand, will have a major effect on tax administration not only in Illinois, but in every state that imposes an income tax. This Court's intervention is required to ensure that multi-state taxpayers and state taxing authorities alike receive a correct and uniform analysis in the determination of whether an asset serves an operational or investment function.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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Dated: April 20, 2007

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