A TAXING WAR ON STICKY-FINGERED STATES

A major checkpoint in choosing plant locations is whether the state of your choice practices something called unitary taxation.

PRESIDENT REAGAN had hoped to score a minor triumph at the London economic summit by announcing a compromise on the so-called worldwide unitary taxes being extracted from multinational corporations by 12 U.S. states. But a high-powered presidential working group on unitary taxes disbanded in May with the issue far from resolved. Chaired by Treasury Secretary Donald T. Regan, the group included the governors of California, Illinois, and Utah, as well as the chief executives of Exxon, IBM, Ford, Pfizer, and Safeway.

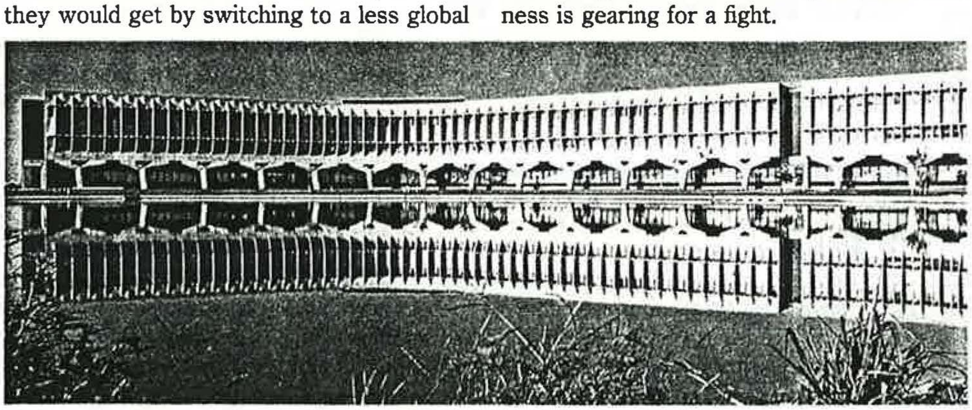
The issue is nettlesome, though the name is misleading: the unitary tax is not a tax, but an accounting formula that a state can use to assess the taxable income of corporations with operations beyond the state's boundaries. A state using the unitary method takes into account a corporation's worldwide earnings in assessing its taxable assets and operations within the state's boundaries. A typical unitary formula might divide the company's sales, payroll, and property values in the state by their worldwide equivalents to arrive at a percentage of the corporation's income that was earned within the state. But multinational companies claim that the formula can be terribly unfair—if, for example, a greedy state overestimated the portion of a corporation's worldwide income that it could lay claim to.

The states using the worldwide unitary method collect $750 million more a year than they would get by switching to a less global form of accounting, such as a straightforward levy on in-state operations. California alone gets some $500 million a year extra through this method.

Reagan's unitary-tax committee was able to agree only that states should not tax income that arises from business done beyond "the water's edge"—meaning the world outside the U.S. Left unresolved was the question of whether states may tax dividends paid to American corporations by their overseas subsidiaries. Predictably, the states want to tax those dividends, while U.S. multinationals want them left alone.

Another unresolved dilemma: how to treat U.S.-based companies that do 80% or more of their business abroad. Should they be treated like any other corporation with foreign interests? Says one business lobbyist who has monitored unitary tax moves: "Essentially nothing has been resolved at the federal level."

The battle has shifted to the states. California's Republican Governor George Deukmejian has proposed giving companies a choice between the worldwide unitary method and a water's edge approach that would include taxing all foreign-source dividends. Foreign corporations, which do not have the problem of repatriating dividends to the U.S., would come out ahead by choosing the water's edge method. U.S. multinationals would get stuck either way. No legislative action is expected before next year, and business is gearing for a fight.



Upset by Florida's unitary tax, *IBM said it wouldn't enlarge this Boca Raton plant.*

The biggest battle has been staged in Florida, where one of the players is IBM. With considerable fanfare, the company announced this spring that it would scuttle plans for investment in Florida because of the unitary tax. IBM put up for sale 2,000 acres it had purchased in northern Florida. Other companies made similar decisions, business lobbyists say.

Just before the legislative season ended in June, Governor Bob Graham called in business representatives and told them he would support repeal of worldwide unitary accounting if they came up with other business taxes to replace the revenues it brings in. As FORTUNE went to press, legislators said repeal looked likely.

Multinationals will keep the pressure on. Three delegations of Japanese businessmen are touring the U.S., as they put it not very subtly, "to study the investment climate." One is led by the chairman of C. Itoh & Co., a large Japanese trading company; another by a Nissan Motor executive; and a third by Akio Morita, the chairman of Sony. They'll visit four states with worldwide unitary tax laws—and more than a dozen without. The message is clear. **—Peter W. Bernstein**

BIG BETS ON THE HILL

Business is spreading money to influence important House and Senate races.

WHILE TV CAMERAS pan on presidential primaries and Ronald Reagan, business focuses much of its energies and money on the congressional races. The stakes are large: the political tilt of the House, control of the Senate, and what President Whoever will be able to do legislatively in 1985.

Oddsmakers are betting that changes in the House will be small. If a Democrat is elected President, he'll probably pick up at least five seats in the House, giving him a strong base in that body. If Reagan wins—the most likely outcome at the moment—he should bring in enough Republicans to give him a gain of five to ten House seats after losing 26 in 1982. That would restore at least