Broadening the States' Power to Tax Foreign Multinational Corporations: Barclays Bank v. Franchise Tax Board

Robert Charles Griffitts

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NOTES

BROADENING THE STATES’ POWER TO TAX FOREIGN MULTINATIONAL CORPORATIONS:
BARCLAYS BANK V. FRANCHISE TAX BOARD

A jurisdiction’s taxing behavior significantly impacts a variety of business decisions, including the location of a company’s investments, the type of business form a new enterprise should assume, optimal methods

   This Note employs several terms that require somewhat narrow definitions to avoid confusion. The terms “U.S. multinational” and “domestic multinational” refer to a corporation that is incorporated, or based in the United States, and has foreign subsidiaries or affiliates. The term “foreign corporation” or “foreign multinational” describes an entity chartered in a country other than the United States, but whose operations extend into different countries, including, perhaps, the United States. In literature and practice, other definitions are commonly used to describe corporations engaged in operations in more than one country. See id. at 10-11. For instance, the term “multinational enterprise” or “MNE” is commonly used as a synonym for multinational corporation. See id. The United Nations often uses the term “transnational corporation” or “TNC.” See id. at 11. The concept of a multinational corporation is often further categorized as either a “global company,” which integrates its operations from various countries and generally targets a product to a global market segment, or a “multidomestic company,” which conducts each country’s operations independently. See id. Because this Note focuses on taxation issues, use of such precise terminology is not required.

2. Studies of the effect tax policies have on corporate investment behavior indicate that higher rates deter foreign direct investment. See Cletus C. Coughlin et al., State Characteristics and the Location of Foreign Direct Investment Within the United States, 73 Rev. Econ. & Stat. 675, 682 (1991) (noting that state government taxation has an effect on foreign direct investment). Accordingly, tax incentives often are used to attract foreign investment. See id. at 678. A recent phase-down of U.S. tax incentives provided to multinational firms in Puerto Rico illustrate this impact. See Puerto Rico: Post Section 936, Bus. Latin Am., June 6, 1994, at 4. In response, many businesses are preparing to reduce or close their operations on the island. See id.

3. See Robert W. Hamilton, Corporations Including Partnerships and Limited Partnerships 131 (5th ed. 1994). Federal income tax laws are often a corporation’s primary consideration in deciding its business form. See id. This is due to the various treatments different business forms are subject to under tax laws. See id. The Tax Reform Act of 1986, for example, lowered the maximum individual tax rate below the maximum corporate tax rate, thereby providing a strong incentive for many corporations to elect S corporation status. See M. Allen Wilson & Edith S. Williford, S Corporation: The New Corporate Tax Planning Weapon, Mgmt. Accr., Sept. 1987, at 46. For a discussion of S corporations and the selection of business forms in general, see Hamilton, supra, at 128-
of financing,⁴ and methods of pricing transactions between units of the organization.⁵ Further, the rapid globalization of the world economy is leading to the adoption of uniform laws that attempt to alleviate the many complexities and inconsistencies associated with international transactions.⁶ The United States and all other major developed nations have embraced one uniform system of taxation to calculate the tax liability of foreign-owned corporations operating within their borders.⁷ Under this uniformly accepted system of taxation, known as the arm’s length

⁴See also Marcia Parker, *Oil and Gas MLPs on Ropes*, PENSIONS & INVESTMENT AGE, Sept. 19, 1988, at 17 (discussing tax incentives for oil and gas companies to restructure from master limited partnerships into corporations).⁵The tax policies of the jurisdictions in which a corporation operates strongly influence the corporation’s capital structure. See Victor Brudney & William W. Bratton, *Corporate Finance* 463 (4th ed. 1993). Managers of public corporations commonly must determine the optimal ratio between the value of the company’s debt and equity. See id. at 448. Because debt and equity are treated differently by federal tax laws, managers wishing to maximize the value of the firm must determine this optimal ratio. See id. at 449. For a detailed discussion of optimizing corporate capital structures and the corresponding influence of taxes, see id. at 448-86.⁶The mechanisms and prices at which various units of a corporation internally transfer goods and services, commonly referred to as intrafirm pricing, is also influenced by taxes. See generally Sol Picciotto, *International Taxation and Intrafirm Pricing in Transnational Corporate Groups*, 17 ACCT. ORGANIZATIONS & SOCI’Y 759 (1992). To minimize total tax liability, corporations often manipulate intrafirm pricing by shifting profits between units of the organization from high-tax to low-tax jurisdictions. See id. at 770. Therefore, the comparative tax policies of jurisdictions in which a corporation operates directly impact the corporation’s intrafirm pricing practices. See id. For more discussion on intrafirm pricing, manipulation, and a hypothetical example see infra note 38.⁷See Daniels, supra note 1, at 18. Due to increased interdependency among countries, a greater degree of consistency and uniformity is required to assure an efficient flow of goods and services. See id.; see also infra note 40 (discussing the policy reasons for adhering to a uniform international tax standard).


⁷See Paul J. Hartman, *Federal Limitations on State & Local Taxation*, §§ 9:16-17, at 521-23 (1981) (discussing the arm’s length method); Picciotto, supra note 5, at 763-73 (discussing the history and prevalence of the arm’s length method); see also Jacob Mertens, Jr., *12 MERTENS LAW OF FEDERAL INCOME TAXATION* § 451 (Supp. 1995) (discussing the arm’s length method in intercorporate transactions); infra note 8 (providing an overview of the arm’s length method).
method, a taxing jurisdiction calculates a corporation's tax liability based on that corporation's earnings within the jurisdiction's borders. Thus, an arm's length jurisdiction calculates a business's tax liability based on the reported earnings appearing in its accounting records.

An alternative method of taxation is unitary taxation. This system, also called formula apportionment, allows a taxing jurisdiction to con-
sider a corporation's total earnings, including income derived from outside the taxing jurisdiction, in calculating its tax liability. By applying a formula based on objective factors designed to reflect a fair estimation of that corporation's intrajurisdictional activities, the jurisdiction essentially apportions the corporation's total, multi-jurisdictional income between that jurisdiction and the others in which the corporation operates.

In 1966, California implemented a version of unitary taxation called worldwide combined reporting (WWCR). This method extended the

Barclays Bank Int'l, Ltd. v. Franchise Tax Bd., 829 P.2d 279, 282 (Cal. 1992) (same); see also infra notes 41-52 and accompanying text (discussing unitary taxation).

11. See HARTMAN, supra note 7, § 9:18, at 523-24. Under formula apportionment, also known as the unitary method, taxes are apportioned by a formula with variables based on objective measurements of the corporation's activities both inside and outside the state. See id. Generally, apportionment is based on the proportion between the average value of the factors in the state to the average value of the factors of the enterprise as a whole. See id. California's tax, for instance, is based on the popular three factor formula that considers a corporation's property values, payroll expenses, and sales figures. See CAL. REV. & TAX. CODE §§ 25105-25137 (West 1992 & Supp. 1996); infra note 14 (discussing California's WWCR formula); see also Henry R. Anderson & D. Dale Bandy, Understanding the Unitary Tax, MGMT. ACCT., Sept. 1985, at 35-43 (providing a thorough introduction and comprehensive hypothetical example of unitary taxation).

The difficulty in establishing an internationally accepted mechanism for administering a unitary tax against multinational corporations made the idea largely unfeasible. See Piccio-otto, supra note 5, at 786-88. The idea was revived in the late 1960s by American states, which used the concept as an alternative method when tax administrators believed that a corporation's income calculated under the arm's length system was inadequate. See id. at 785. Formula apportionment gained popularity, and eventually every state with a corporate income tax adopted the method. See HARTMAN, supra note 7, § 9:18, at 523.

12. See Barclays Bank v. Franchise Tax Bd., 114 S. Ct 2268, 2272 (1994) (stating that apportionment occurs "between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction") (citing Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 165 (1983)). Of the 45 states that have corporate income taxes, all use a formula to apportion income between the states in which the corporation operates. See Review of Unitary Method of Taxation: Hearings on S. 1113 and S. 1974 Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance, 99th Cong. 4 (1986) [hereinafter Review of Unitary Taxation]; HARTMAN, supra note 7, § 9:18, at 523. For a general discussion of the unitary method and California's WWCR method, see infra notes 14 and 141 and accompanying text.


14. See Barclays, 114 S. Ct. at 2271-72. Like unitary taxation, the WWCR method of income allocation considers a subsidiary's earnings as well as the earnings of any related businesses, irrespective of those business locations, or what proportion of their operations are actually conducted within the taxing state. See id. at 2272-73. California's WWCR method uses a three-factor formula based on the subsidiary's property, payroll, and sales in
unitary method by apportioning a corporation’s earnings based on a formula designed to capture that corporation’s worldwide income.\(^{15}\) The WWCR method immediately met with fervent international objection and criticism.\(^ {16}\)

the state to determine what proportion of the earnings of the overall entity it may tax. See id. at 2273; see also infra note 44 (discussing why these three factors are generally used). For the tax statutes at issue, see Cal. Rev. & Tax. Code §§ 25105-25137 (West 1992 & Supp. 1996). Originally, all factors were weighted equally. See Barclays, 114 S. Ct. at 2273. Thus, if a subsidiary had four percent of its payroll, eight percent of its sales, and nine percent of its property located within the state, California would take the average – seven percent – and tax that percentage of the business's worldwide income. See Cal. Rev. & Tax. Code § 25128 (West 1992 & Supp. 1996) (containing the three-part formula); see also Anderson & Bandy, supra note 11, at 36-37 (providing a more elaborate hypothetical example). In 1993, California modified the formula by giving the sales factor double the weight of the property and payroll factors. See Cal. Gen. Assembly Comm. on Ways & Means, Report on S.B. 1176, Aug. 25, 1993. Accordingly, the sales factor is weighted one-half, and the property and payroll factors each are weighted one-quarter. See id. The change was expected to result in net tax revenue gains of $15 million in 1993-94. See id. Additionally, this approach shifts a portion of the tax burden from local producers who sell products outside the state to out-of-state businesses that sell products in the taxing state. This encourages out-of-state businesses to relocate in the taxing state. See Thomas C. Pearson, Note, State Taxation of Foreign Source Income Through Worldwide Combined Reporting, 17 Vand. J. Transnat'l L. 95, 112 (1984).


15. See Barclays, 114 S. Ct. at 2273; see also supra note 14 (discussing the structure of WWCR).

16. As outlined in Barclays's brief, the California statute induced diplomatic notes from around the world, delayed treaty negotiations, and engendered strong opposition from the French, Danish, Italian, and German governments, including direct protestations from heads of state to the President. Brief for Petitioner at 6, Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268 (1994) (No. 92-1384). For instance, in a letter to the Department of State, Ambassador of Italy Paolo Pansa Cedronio wrote that, “unless the same basic rules for calculating taxable profits are followed generally by the main trading nations it will be impossible to achieve the essential objective of providing a consistent and coherent international tax framework for trade and investment.” Letter from Paola P. Cedronio, Ambassador of Italy, to the Department of State (Mar. 19, 1980), in Advisory Commission on Intergovernmental Relations, State Taxation of Multinational Corporations, at 10 (1983). Ambassador Cedronio further stressed, “The unitary tax basis can give rise to obviously inequable [sic] tax liabilities.” Id.; see also International Taxation: Unhappy Returns, Economist, Apr. 2, 1994, at 74 (“California's taxmen face a renewed assault by Britain and 19 other countries on a controversial tax the state has levied... on foreign companies with operations there.”); Rick Wartzman, California Tax Dispute Forces Clinton to Choose Between Vote-Rich State and Trading Partners, Wall St. J., Aug. 19, 1993, at A12 (“Some of America's most important economic allies are threatening an all-out tax war with the U.S. unless California restructures its corporate tax system.”); infra note 53 (discussing some foreign investment consequences of WWCR).
In *Barclays Bank v. Franchise Tax Board*, the United States Supreme Court determined the constitutionality of WWCR as applied to domestic

17. 114 S. Ct. 2268 (1994). The suit arose when two member corporations of the Barclays Group, based in the United Kingdom, alleged in a California state court that California had inappropriately considered the income of the entire Barclays Group in computing the taxes owed by the two corporations. See *id.* at 2274. The two refund-seeking corporations were two of more than 220 member corporations of the Barclays Group. See *id.* The first, Barclays Bank of California (Barcal), conducted business solely in California, and was a wholly owned subsidiary of the second petitioning corporation, Barclays Bank International Limited (BBI), which operated in more than 33 nations and territories. See *id.* The petitioner, Barclays Bank PLC, was the successor in interest to the tax refund for both corporations, and the Court used “Barclays” to refer to both the petitioner, Barclays Bank PLC, and the taxpayers, BBI and Barcal. See *id.* at 2275 n.7. The Superior Court of California invalidated the WWCR method, and the Franchise Tax Board of California (FTBC) appealed. See *Barclays Bank Int'l v. Franchise Tax Bd.*, 275 Cal. Rptr. 626 (1990).

On appeal, the FTBC first argued that there was evidence of congressional intent to allow states to utilize the WWCR method. See *id.* at 634. The FTBC relied on several factors in arguing that Congress had intended to allow states to use WWCR in apportioning taxes of foreign corporations, including the absence of federal legislation prohibiting states from using WWCR, Congress's failure to address state taxes in federal income tax treaties with foreign countries, and its rejection of article 9(4) of the U.S.-U.K. Tax Treaty, Convention for the Avoidance of Double Taxation, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668, which was the executive branch's only attempt to prohibit states' use of WWCR. See *Barclays*, 275 Cal. Rptr. at 634.

The FTBC argued that Congress's failure to address the issue demonstrated the federal government's reluctance to interfere with a state's taxing power. See *id.* The California Court of Appeal, however, considered congressional inaction on the issue insufficient evidence that Congress approved of the use of WWCR against foreign multinationals. See *id.* at 636. The court of appeal concluded that there was insufficient evidence that the federal government had acquiesced on the issue of unitary taxation for several reasons. See *id.* at 634-36. None of the tax treaties, except for the U.S.-U.K. Tax Treaty, addressed unitary taxation at the state level. See *id.* Further, most of the treaties to which the FTBC refers predate the problems WWCR created. See *id.* at 635.

Although the court agreed with the FTBC that WWCR did not inherently lead to multiple taxation, it reasoned that the risk of retaliation against overseas United States businesses was too great. See *id.* at 637-38. Relying on *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), the court concluded that no constitutionally significant difference existed between domestic and foreign multinationals with respect to issues of double taxation, claiming that in neither case was double taxation inevitable. See *Barclays*, 275 Cal. Rptr. at 637; see also *infra* notes 94-106 and accompanying text (discussing *Container* in detail). The court was concerned, however, with the “sharp, frequent, and incessant” international protests that had occurred over the course of several years. *Barclays*, 275 Cal. Rptr. at 638. It noted Britain's retaliatory legislation withdrawing tax advantages for U.S. multinationals doing business in a unitary tax state. See *id.* The court stressed the fact that every industrialized western nation protested the use of WWCR at the state level. See *id.* For those reasons, the court of appeal struck down the California tax. See *id.* at 645-46.

The California Supreme Court, in a unanimous decision, reversed the court of appeal, and reestablished the constitutionality of California's taxing system. See *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd.*, 829 P.2d 279, 300 (Cal. 1992). The California Supreme Court recognized that the U.S. Supreme Court left the issue in *Barclays* unanswered in *Container*, a case where a domestic multinational, as opposed to a foreign multinational, challenged the constitutionality of California's WWCR method; thus, the court found it
subsidiaries of foreign multinationals. In *Barclays*, the Supreme Court upheld California's aggressive unitary system of taxation, concluding that was not bound by *Container*. See *id.* at 281. The California Supreme Court indicated, however, that its reversal was based on a "path illuminated" by several recent Supreme Court opinions, including *Container*. Id.

First, the California Supreme Court considered Barclays's claim that the California tax was inherently inequitable when applied to foreign multinationals. See *id.* Barclays argued that the tax was unfairly apportioned, and therefore, violated the interstate Commerce Clause as established in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). See *id.* at 2277-79; see also infra notes 72-80 and accompanying text (discussing *Complete Auto*).

Barclays argued that formula apportionment is inherently inequitable when applied to foreign multinationals because it distorts tax liability by ignoring the fact that the values of the components of the three factors in the formula—property, payroll, and sales—tend to be significantly higher in California than in the other jurisdictions in which the multinational operates. See *Barclays*, 829 P.2d at 286. In rejecting this argument, the court refused to distinguish between a tax upon a domestic multinational, such as that challenged and upheld in *Container*, and a tax upon a foreign multinational, such as that at issue in *Barclays*. See *id.*; cf. *Container*, 463 U.S. at 180-84 (upholding California's WWCR method against a U.S. multinational corporation). Conceding that California's tax was not necessarily perfect, the court found no evidence that the WWCR method presented any greater inherent risks of error than the alternate arm's length method. See *Barclays*, 829 P.2d at 286.

Next, the California Supreme Court examined Barclays's central contention that the tax impeded the federal government's ability to act uniformly on a foreign commerce issue. See *id.* at 286-99. The court reiterated several recent U.S. Supreme Court decisions which, in the California Supreme Court's determination, required Congress to clearly and explicitly indicate its intention that states not be allowed to utilize the WWCR method before such a tax is preempted by the federal government. See *id.* at 287-95 (citing *Wardair Can. Inc. v. Florida Dep't of Revenue*, 477 U.S. 1, 9 (1986)) (providing that governmental silence will not trigger a dormant Commerce Clause analysis when Congress, through its silence, has acquiesced on the controversial issue, thereby validating it); *Container*, 463 U.S. at 194 (stating that a federal directive must be "clear" before it will preempt a state tax); *Mobil Oil v. Commissioner of Taxes*, 445 U.S. 425, 448 (1980) (stating that the Court will not infer, absent an explicit congressional directive, that foreign income must receive identical treatment from the states as it receives from the federal government); see also infra notes 94-106 and accompanying text (discussing *Container* in detail); infra notes 107-117 and accompanying text (discussing *Wardair* in detail).

Failing to find clear and explicit directives prohibiting states from utilizing the WWCR method, the California Supreme Court found that Barclays failed to demonstrate a violation of the foreign Commerce Clause, and upheld California's WWCR method of taxation as applied to foreign multinationals. See *Barclays*, 829 P.2d at 293-95.
the risk of double taxation\(^\text{18}\) was no greater than the risk associated with other alternatives reasonably available to California.\(^\text{19}\)

The Court also held that California’s taxing scheme did not violate the interstate or foreign Commerce Clauses.\(^\text{20}\) The Court held that Barclays had failed to demonstrate a violation of the interstate Commerce Clause because it failed to prove that its business activities lacked a sufficient nexus with the state, that the tax discriminated against interstate commerce, that the tax was not fairly apportioned, or that the tax was unrelated to services provided by the state.\(^\text{21}\) Justice Ginsburg, writing for the majority, found that Barclays had failed to establish any of these four elements and concluded that California’s tax did not violate the interstate Commerce Clause.\(^\text{22}\)

In analyzing petitioner Barclays’s contention that the tax violated the foreign Commerce Clause, the Court applied two additional factors that had been established specifically to determine the constitutionality of taxes involving foreign commerce.\(^\text{23}\) First, the Court noted that a state’s attempt to tax foreign commerce must not result in double taxation.\(^\text{24}\)

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18. According to the Supreme Court, double taxation occurs when a tax places on a multi-jurisdictional corporation “burdens of such a nature as to be capable . . . of being imposed or added to with equal right by every state which the commerce touches . . . so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce.” Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 255-56 (1938) (citations omitted). In Western Live Stock, the Court examined a state tax that appellants contended resulted in multiple taxation, thereby creating an unconstitutional burden on interstate commerce. See id. at 252. At issue was a New Mexico tax that reached income appellants had earned by selling advertising space to customers outside the state. See id. at 252-53. The Court noted the “peculiarly local” nature of the publishing business, despite its interstate circulation. See id. at 258. Therefore, the tax was upheld because it was “not one which in form or substance can be repeated by other states in such manner as to lay an added burden on [appellant’s business].” See id. at 260; see also J.D. Adams Mfg. v. Storen, 304 U.S. 307, 311-12 (1938) (stating that a state tax applied to receipts from interstate sales is unconstitutional if it may be taxed “to the fullest extent” by different states at various stages of the production process, such as manufacturing and sales stages).

19. See Barclays, 114 S. Ct. at 2281; see also infra note 101 (discussing why the alternative arm’s length method also may result in double taxation).

20. See Barclays, 114 S. Ct. at 2278.

21. See id. at 2276-79. The Court relied on its earlier decision in Complete Auto, which delineated these four factors, to determine whether a state tax violates the interstate Commerce Clause. See id. at 2276; see also infra notes 72-80 and accompanying text (discussing the Complete Auto factors).

22. See Barclays, 114 S. Ct. at 2271, 2276-78.

23. See id. at 2276; Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979). In Japan Line, the Court demanded that a state tax meet two additional criteria if it taxed instrumentalities of foreign commerce. Id. at 446-51; see infra notes 81-93 and accompanying text (discussing the Japan Line requirements in detail).

24. See Barclays, 114 S. Ct. at 2279-81; see also supra note 18 (discussing the factors that characterize double taxation).
Second, the scheme may not impede the federal government's ability to speak with "one voice" on issues specifically reserved to the federal government.25 Although the majority acknowledged that the tax could result in the double taxation of a multinational's earnings, it concluded that double taxation was neither inherent in the taxing method, nor were there alternatives reasonably available to California that did not result in double taxation.26 With regard to the one voice doctrine, the majority concluded that California's tax did not interfere with the federal government's ability to regulate an area reserved exclusively for the federal government under the Commerce Clause.27 The Court, therefore, concluded that California's tax did not violate any interstate or foreign Commerce Clause conditions.28

In three separate opinions, the remaining Justices disapproved of the Court's analysis.29 Justices Blackmun and Scalia expressed concern with the majority's analysis of the federal uniformity issue, but nevertheless concurred in the majority's judgment.30 Justices O'Connor and Thomas concurred in the judgment in part, and dissented in part.31 Their dissent focused on the majority's analysis of the double taxation issue, arguing that the effects of California's tax are aggravated when it falls on a foreign multinational, as in Barclays.32

To begin, this Note examines two currently accepted methods of tax apportionment: the arm's length method and the unitary method. This Note then discusses the role of the Commerce Clause in shaping state taxation issues, followed by an examination of California's "water's-
edge” alternative and the political pressures that forced California lawmakers to provide corporations with a less aggressive tax system. Next, this Note tracks the Supreme Court’s reasoning by examining the impact of the Commerce Clause, and a line of related cases that guided the Court’s decision in Barclays Bank PLC v. Franchise Tax Board. After analyzing the various opinions in Barclays, this Note examines how that decision changes Commerce Clause analysis of state taxation issues. Finally, this Note argues that Barclays was correctly decided because the undesired effects of WWCR had already been eliminated by California’s water’s-edge alternative, which generally limits a corporation’s tax exposure to income generated within the United States.

I. The Development of the Double Taxation Shield for Multinational Corporations

A. Methods of Allocating Income

Before a state can compute the tax liability of a corporation operating in more than one jurisdiction, it must determine precisely how much of that business’s income is attributable to activities within its borders.33 There are two generally accepted methods of income apportionment for tax purposes. The first, and most prominent, is the arm’s length method.34 This concept is embodied in the first and fourth Complete Auto factors, which require that the tax have a “sufficient nexus” with the state, and that the tax be related to services the state provided. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 277-78 (1977); see infra notes 72-80 and accompanying text (discussing the Complete Auto test), and specifically note 79 (discussing the difference between the first and fourth Complete Auto factors).

33. This well-established principle is rooted in state tax statutes as evidenced by the ubiquitous qualifying clause “within the state.” For instance, an Alabama statute provides for an “excise tax on every person . . . who sells . . . to any person, firm, corporation, club or association within the State of Alabama any beer.” Ala. Code § 28-3-190 (1975 & Supp. 1995) (emphasis added). Similarly, a Colorado statute provides that in computing taxes on personal property, the state may consider “the length of time such item may be operated in intrastate or interstate commerce within the state of Colorado.” Colo. Rev. Stat. Ann. § 42-3-107(4) (West 1993 & Supp. 1995) (emphasis added). The Supreme Court reiterated this principle in ASARCO Inc. v. Idaho State Tax Comm’n, 458 U.S. 307 (1982), noting that a state may tax value earned only within its borders. ASARCO, 458 U.S. at 315. Similarly, in Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940), the Court stated that the controlling question is “whether the state has given anything for which it can ask return.” Id. at 444.

This concept is embodied in the first and fourth Complete Auto factors, which require that the tax have a “sufficient nexus” with the state, and that the tax be related to services the state provided. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 277-78 (1977); see infra notes 72-80 and accompanying text (discussing the Complete Auto test), and specifically note 79 (discussing the difference between the first and fourth Complete Auto factors).

34. See HARTMAN, supra note 7, §§ 9:16-9:19, at 521-24. Additionally, a third method known as the specific allocation method, assigns net income to a specific geographical location. See id. § 9:19, at 524. It is generally used when taxing real property. See id. For instance, if a company received rental income from various properties located in several states, those states using the specific allocation method would base their taxes on the income derived directly from each property within the state. See Wasson & Weigand, supra note 8, at 46. This method, however, has limited applicability because it generally is applied to non-operating sources of net income such as interest, dividends, and capital gains. See id. (stating that states have largely abandoned the specific-allocation method in the
method, sometimes referred to as separate accounting. The second is the unitary method, also known as formula apportionment.

1. Arm's Length Method

The arm's length method treats every business unit as a distinct entity, separate from its parent corporation and any of its other affiliated businesses located outside the taxing jurisdiction. Therefore, a corporation's earnings, as reflected in its accounting records, is generally the figure used to determine the corporation's tax liability.

context of interstate or international commerce because it is "almost useless" in allocating revenue and cost among states that want a "piece of the tax-revenue pie").

35. See HARTMAN, supra note 7, § 9:17, at 522-23; see also supra note 8 (discussing the adoption of the arm's length method).

36. See HARTMAN, supra note 7, § 9:18, at 523-24; see also supra note 11 (discussing the unitary taxation method).

37. See Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 185 (1983). The arm's length method treats different corporations, even those closely affiliated, as separate and independent entities engaging in transactions at arm's length. See id. Under this principle, corporations only are taxed by the jurisdiction in which they operate, and such tax is based on the income reflected in the corporation's accounting records. See id.; see also HARTMAN, supra note 7, § 9:17, at 522-23 (providing an overview of the arm's length method).

38. See Container, 463 U.S. at 185. Critics emphasize the possibilities of manipulating transfer prices to reduce a company's overall tax liability, thereby depriving relatively high-tax jurisdictions of their fair share of taxes. See Picciotto, supra note 5, at 759 (stating that the term "transfer pricing" commonly implies or signifies the manipulation of prices, usually to evade regulation, in particular to minimize liability to profits taxation); Wasson & Weigand, supra note 8, at 46 (stating that, ideally, the separate accounting method would be sufficient. The opportunity to "cook the books" by manipulating transfer prices, however, makes the approach inadequate). A congressional study showed that, by inflating the price of goods purchased from their foreign parent, 36 multinationals with more than $35 billion in sales in the U.S. in 1986 paid little or no income tax. See Picciotto, supra note 5, at 773.

Hypothetically, assume a U.S. multinational corporation (parent) with a subsidiary in Brazil (subsidiary) manufactures widgets in the U.S. at a production cost of five dollars per unit. Desiring to sell them in Brazil, the U.S. multinational may either sell them to an independent Brazilian distributor, or sell them to its subsidiary. Assume that the distributor and the subsidiary intend to sell the widgets on the Brazilian market for ten dollars per unit, and that the tax on widgets in Brazil is 25%, while the U.S. tax on widgets is 50%. Normally, the widgets would be sold to the distributor for eight dollars per unit, or three dollars profit per unit. The parent would prefer, however, to "sell" the widgets to its subsidiary at the lowest possible price. Therefore, by selling the widgets at six dollars, for instance, the subsidiary will be taxed on the four dollars per unit profit at the lower tax rate (25%), while the parent will be taxed on only one dollar of profit per unit at the higher tax rate (50%). The result is a lowering of the multinational's global tax liability, while depriving both the parent's state of incorporation and the federal government of their fair share of taxes.

To diminish the incentive for corporations to shift income from high-tax to low-tax jurisdictions, this method requires that intercorporate transfers of value (e.g. goods and services) be priced as if the transactions were being conducted between unrelated business units at market prices, or at arm's length. See id. at 766-67. For this reason, each taxing
The arm's length method is used by the United States federal government, and is the accepted method in every tax treaty to which the United States is a signatory. Moreover, it is recognized as the international standard, and every major developed nation uses the arm's length method to compute the tax liability of foreign-owned businesses operating within their borders.

2. Unitary Taxation Method and WWCR

Unlike the arm's length method, unitary taxation allows states to examine factors other than a corporation's intrajurisdictional activities to determine tax liability. The unitary method assumes that income flows not from a single entity located within the state, but rather from the business as a whole. Accordingly, the state first defines the larger corporate jurisdiction generally has retained the right to examine intercorporate transfers to determine if they were indeed priced at arm's length. See id.; CAL. REV. & TAX. CODE § 25104 (West 1992) (providing that the FTBC is empowered to "adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net income earned by said corporation or corporations from business done in this State").


40. See Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268, 2273 (1994). According to petitioner Barclays:

Strong policy reasons underlie the use of a single standard. For international business, the use of an agreed upon standard: (i) mitigates the possibility of unrelied multiple taxation by reducing the number of nations that claim the right to tax the same income; (ii) gives predictability for planning; and (iii) harmonizes tax compliance requirements. From the standpoint of nations, the use of a single standard is even more important: it sets the boundaries of a nation's claim to tax income, it protects that nation's commerce and trade by delineating the rules under which its nationals are taxed abroad, and it provides a consistent and uniform framework to discuss and resolve difficult and sensitive issues of international taxation.


41. See HARTMAN, supra note 7, § 9:18, at 523. California's three-factor formula, for instance, requires the state to measure the corporation's payroll, sales, and property values within the state. See CAL. REV. & TAX. CODE § 25128 (West 1992 & Supp. 1996); see also infra note 44 (discussing why these factors generally are used in apportionment formulas). Ironically, since a corporation's in-state income is not a variable in the formula, such income is not a factor in tax apportionment.

42. See Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980). Over 70 years ago in Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924), the Court aptly demonstrated the rationale behind unitary taxation. See id. at 282. There, the Court examined the operations of a British corporation that distributed its product in the United States through offices in New York and Chicago. See id. at 278-79. Although the corporation, as a whole, earned over two million dollars, none of its income was subject to a federal income tax. See id. at 279. New York levied a tax of $826 based on the value of
structure of which the in-state corporation is a part, and then determines its tax liability based on the ratio between the corporation's in-state activities and the corporation's activities as a whole. A commonly provided justification for unitary taxation is the difficulty of ascertaining

the corporation's assets in the state. See id. at 279-80. The corporation argued that the tax was not based on net income earned in New York, but rather on income generated by business outside of the United States. See id. at 280. The Court upheld the tax, stating that "profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York . . . resulting in no profits until [the process] ends in sales." Id. at 282.

43. See Barclays Bank Int'l, Ltd. v. Franchise Tax Bd., 829 P.2d 279, 282 (Cal. 1992), aff'd sub nom. Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268 (1994). Courts have defined the concept of a unitary business in several ways. In Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920), the Supreme Court held that a unitary business is characterized by a series of transactions beginning with manufacture in one state, and resulting in sales in another state. See id. at 120; Bass, 266 U.S. at 282 (upholding a unitary tax since "the process of manufacturing result[s] in no profits until it ends in sales"). Later, the California Supreme Court established three guiding factors indicating the existence of a unitary business: "(1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation." Butler Bros. v. McColgan, 111 P.2d 334, 341 (Cal. 1941), aff'd, 315 U.S. 501 (1942). More recently, in a series of cases, the Supreme Court established that "[t]he entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas [sic] utilizing in-state aspects of interstate affairs." Mobil Oil, 445 U.S. at 436 (citing Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 460 (1959)). To do so, there must be a "minimal connection" between the state and the interstate activities, and a "rational relationship" between the income apportioned to the state and the intrastate value of the corporation. Id. at 436-37. The Court further stated that this "nexus" requirement is satisfied if the "corporation avails itself of the 'substantial privilege of carrying on business' within the State." Id. at 437 (quoting Wisconsin v. J. C. Penney Co., 311 U.S. 435, 444-45 (1940)).

In Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980), the Court applied the factors established in Mobil Oil and upheld Wisconsin's tax against Exxon's entire operations, even though the only functional operations Exxon conducted within Wisconsin were its marketing operations. See id. at 219-20. In ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982), however, the Court held that Idaho's definition of a unitary business would "destroy the concept" because it required a unitary business to have nothing more than a common purpose. Id. at 326. There, Idaho attempted to tax a portion of the dividends of five subsidiaries of ASARCO. See id. at 309-10. Although the subsidiaries contributed to the profits of ASARCO, the Court held that they were discrete businesses with no connection to ASARCO's activities in Idaho. See id. at 328.

44. See HARTMAN, supra note 7, § 9:18, at 523. The most popular type of unitary taxation formula used by states is the three-factor formula. See Wasson & Weigand, supra note 8, at 47. The three factors most commonly used are payroll, sales, and property, because they are deemed the primary measures of a corporation's activity. See HARTMAN, supra note 7, § 9:18, at 523-24 (noting that these three factors are considered the largest generators of income); Anderson & Bandy, supra note 11, at 36.
precisely how much of a multi-jurisdictional corporation's income is attributable to the state under the traditional arm's length method.45

California's controversial tax at issue in Barclays was an aggressive derivative of the unitary method that sought to capture the worldwide income of corporations operating in California.46 This system was based on a three-factor formula, consisting of a corporation's property,47 payroll,48

45. See Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 192 (1983) ( likening the allocation process to "slicing a shadow"); Underwood Typewriter, 254 U.S. at 120-21 (recognizing the "impossibility" of accurately allocating the precise income a corporation earned within the state); Hartman, supra note 7, § 9:17, at 522 (stating that the arm's length method "has strict limitations," and that "income from the operations within each State cannot accurately be attributed to a given State by the separate accounting [or arm's length] method"); Frank M. Keesling, A Current Look at the Combined Report and Uniformity in Allocation Practices, 42 J. Tax'n 106, 107 (1975) (stating that the arm's length method "endeavors to treat separately what is, in fact, inseparable"). In Container, Justice Brennan argued that due to a lack of a centralized authority capable of ensuring consistent application of a taxation method, absolute consistency in apportioning income among various taxing jurisdictions using the arm's length method would be "too much to ask." Container, 463 U.S. at 192. He conceded that, at the federal level, inter-governmental negotiations often may mitigate differences in the application of the arm's length method by other nations. See id. at 192-93 n.31. In support of his contention that inconsistencies in the method as applied by the states cannot be mitigated, he noted that states are not in a position to negotiate with other governments, and that the federal government is not equipped with the mechanisms necessary to negotiate issues of double taxation on behalf of the states. See id.

46. See Brief for Petitioner at 4, Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268 (1994) (No. 92-1384). The WWCR method considers not only income of the corporation located in California, but also income of any related corporations part of the unitary group irrespective of whether they operate in the United States. See id. For a discussion of other states utilizing a WWCR method, see supra note 14.

47. The use of a property factor typically is justified in that it represents the investment of capital. See Miller, supra note 13, at 134. Rented property, and property used free of charge, is considered in the property factor on the basis that there is no difference in the productivity between rented property and owned property. See id. Further, failing to consider the value of rented property would result in apportionment distortions between jurisdictions. See id. For instance, assume a corporation has identical operations in states X and Y except that the manufacturing plant is owned in state X and leased in state Y. Severe distortions would result if rental property was not considered because one hundred percent of the property would be apportioned to state X, and zero percent to state Y. See id.; Cal. Rev. & Tax. Code §§ 25129-25131 (West 1992 & Supp. 1996) (containing provisions for calculating the property factor). Owned property is valued at original cost. See id. § 25130. Rented property is valued at eight times the net annual rental rate, a figure that must be reduced by any rental income received from subrental to another party. See id.

48. The use of a corporation's payroll expenses is justified on the basis that they represent the value of the human contribution to the enterprise. See Miller, supra note 13, at 135. It generally is accepted that, in the United States, salary levels properly measure contribution of human capital to profitability, and is thus not a controversial issue. See id.; see also Cal. Rev. & Tax. Code §§ 25132-25133 (West 1992) (containing the provisions for calculating the payroll factor).
and sales figures within the state. Essentially, the state taxed a share of a multinational's worldwide income equal to the proportion between the property, payroll, and sales figures of the California corporation, with the property, payroll, and sales figures of the larger corporate group. Thus, California determined a corporation's state tax liability based on the worldwide income of all affiliated businesses.

B. An Alternative to WWCR: The "Water's-Edge" Election

In response to intense international and domestic pressure, California modified its tax code in 1986 allowing corporations to "opt out" of re-

49. The sales factor is based on the value of property sold in California. See CAL. REV. & TAX. CODE § 25135(a)(1) (West Supp. 1996). Use of the sales factor is necessary to ensure that an appropriate share of income is allocated to the state in which the products are sold, and similarly to prevent an over-allocation of income to the state in which the products are manufactured. See Miller, supra note 13, at 135. California's tax code also contains what is commonly known as the "throwback rule," which dictates that if the sale of property is made to the federal government or to another jurisdiction which does not tax the sale, such sale may be apportioned to California. See CAL. REV. & TAX. CODE §§ 25135(a)(2) (1995) (West Supp. 1996); CAL. REV. & TAX. CODE §§ 25135-25136 (West 1992 & Supp. 1996) (containing the provisions for calculating the sales factor).

50. See CAL. REV. & TAX. CODE § 25128 (West 1992 & Supp. 1996). For California's statutory provisions relating to the three-factor unitary formula, see CAL. REV. & TAX. CODE § 25128 (West 1992 & Supp. 1996) (providing the formula); id. §§ 25129, 25130, 25131 (providing the property factor); id. §§ 25132, 25133 (providing the payroll factor); id. §§ 25134, 25135, 25136 (providing the sales factor). Finally, § 25137, "Apportionment by franchise tax board," provides that the taxpayer may petition the Franchise Tax Board to use the arm's length method, or modify the formula, if apportionment is not fair and representative. See supra notes 47-49 (discussing these provisions in detail).

51. See HARTMAN, supra note 7, § 9:18, at 523-24. For a hypothetical application of California's three-factor formula, see supra note 14; see also supra note 43 (discussing the factors which determine whether a business is unitary).


53. The Reagan administration proposed legislation that would exert pressure on California to abandon WWCR and adopt a water's-edge alternative. The Tax Heard 'Round the World, FORBES, May 5, 1986, at 14. The heavy financial costs of retaining WWCR became evident when foreign corporations indicated their reluctance to invest in any state using WWCR. For instance, on the day that Indiana Governor Robert Orr promised that his state would abandon its unitary tax system, Sony announced that it would invest $20 million for a laser-disc plant in the state. See Wasson & Weigand, supra note 8, at 45. Similarly, after Oregon abandoned its WWCR tax system, Fujitsu announced plans to build a plant in the state. See id. California had hoped that the Fujitsu plant would be built in their state, and there were indications that Fujitsu preferred California to Oregon. See id. California's WWCR method, however, was a "factor big enough to tip the decision
porting the worldwide income of their corporate group. Termed the “water’s-edge” election, this option permitted certain multinationals to elect to report only the income of certain “affiliated entities.” The 1986 amendment, however, failed to alleviate the intense debate and retaliatory threats waged against California’s tax system, because the original version of the water’s-edge alternative required the corporation to pay a large fee, and granted the Franchise Tax Board of California (FTBC) in Oregon’s favor.” See supra note 16 (discussing international criticism of California’s WWCR taxation method).


54. Pursuant to California Senate Bill 85, 1986 Cal. Stat. 660, which took effect in 1988, qualified corporations could elect to be taxed only on income of certain specified affiliated entities. See infra note 55 (discussing which affiliated entities are considered in income calculation).

55. See Cal. Rev. & Tax. Code § 25110(a) (West 1992 & Supp. 1996). A qualified taxpayer that makes a water’s-edge election must report income from only certain affiliated entities. See id. Generally, a “qualified taxpayer” is any bank or corporation which consents to the taking of depositions from key corporate individuals, agrees to accept subpoenas duces tecum, and agrees that any dividends received by the corporation from certain affiliated entities are business income. See id. § 25110(b)(2); see also id. § 25110(a)(2) (requiring corporations to report income from affiliated domestic international sales corporations and foreign sales corporations as defined in the Internal Revenue Code); id. § 25110(a)(3) (requiring corporations to report income from any affiliated corporation whose combined average payroll, sales, and property factors within the United States is 20% or more); id. § 25110(a)(4) (requiring corporations to report income from affiliated banks and corporations incorporated in the United States, except corporations making an election pursuant to §§ 931-936 of the Internal Revenue Code that have at least 50% of their voting stock owned or controlled, directly or indirectly, by the same interests); id. § 25110(a)(6) (requiring corporations to report income from affiliated export trade corporations as described in the Internal Revenue Code); id. § 25110(a)(8) (requiring corporations to report income from any affiliated bank or corporation that the Internal Revenue Code defines as a “controlled foreign corporation”). For any bank or corporation that does not meet any of these enumerated types of entities, id. § 25110(a)(4) provides that the income of such bank or corporation with “income derived from or attributable to sources within the United States” as determined by federal income tax laws shall be included and such income “shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.” Id.


57. The annual fee was equal to .03% of the sum of the corporation’s payroll, sales, and property within California. See Politi & Karl, supra note 53, at 1085.
discretion to disregard a corporation's election to use the alternative. In 1993, continuing political controversy both at home and abroad prompted California to modify the water's-edge alternative by negating the fee requirement and revoking the possibility of disregard. Corporations were granted the option of reporting only income of certain affiliated businesses within the water's edge boundaries of the United States, instead of subjecting their entire world income to taxation under the traditional WWCR method.

C. The Commerce Clause and State Taxation Authority

The federal government historically has placed few constraints on the states' power to tax. The Commerce Clause, however, has long been construed to restrict any state activity that excessively interferes with in-
terstate and international commerce.62 By operation of the Supremacy Clause, any state law that directly conflicts with federal law will be preempted.63 Further, through the negative implication doctrine, or "dormant" Commerce Clause, the Court also will invalidate state activity that regulates in an area reserved for control by Congress.64 Accordingly, any

62. See U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States"). The Commerce Clause has been called "one of the most significant provisions in the Constitution in welding the confederation into a viable Nation." HARTMAN, supra note 7, § 2:17, at 7-8 (Supp. 1991). Congress's plenary power of commerce can be traced to the trade wars that plagued the states before Congress was granted its general power over commerce. See id. The Constitutional Convention in 1787 represented a unification of the belief that the federal government needed the power to regulate commerce among the States and with foreign nations. See id. § 2:2, at 15. The Constitutional Convention led to the replacement of the Articles of Confederation with the Federal Constitution. See id. The activities and motivations behind the Convention are depicted by Albert J. Beveridge:

The senseless and selfish nagging at trade in which the States indulged, after peace was declared, produced a brood of civil [abuses]. The States passed tariff laws against one another as well as against foreign nations; and, indeed, as far as commerce was concerned, each State treated the others as foreign nations. There were retaliations, discriminations, and every manner of trade restrictions and impediments which local ingenuity and selfishness could devise. . . . Merchants and commercial bodies were at their wits' end to carry on business and petitioned for a general power over commerce.


63. See U.S. CONST. art. VI, cl. 2 ("[T]he Laws of the United States . . . shall be the supreme Law of the Land"). When a congressional regulation of commerce directly conflicts with a state regulation, the Supremacy Clause clearly controls, and the "only remaining issues might be the scope of federal power and the application of the federal law to the challenged state regulation." LOCKHART, supra note 62, at 287. Most preemption issues arise, however, when a federal law that does deal explicitly with its effect upon state regulation is challenged or preempted by federal law. See id. The resolution of such cases "depend[s] largely on widely variant considerations, including the unique terms, history and objectives of the federal legislation." See id.

See, e.g., Houston, E. & W. Ry. Co. v. United States, 234 U.S. 342, 353 (1914) (holding that Congress has the power to regulate intrastate commerce in an effort to unburden the flow of interstate commerce); Champion v. Ames, 188 U.S. 321 (1903) (holding that Congress may prohibit the transportation of lottery tickets across state lines because such transport constitutes interstate commerce); Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 196 (1824) (stating that Congress may "prescribe the rule by which commerce is to be governed"). For discussion of the Supremacy Clause and federal preemption of state law, see LAWRENCE TRIBE, AMERICAN CONSTITUTIONAL LAW §§ 6:25-6:27, at 479-501 (2d ed. 1988).

64. The dormant Commerce Clause is a judicially created mechanism limiting the powers of the states by creating an area of free trade where Congress has failed to exercise its commerce power. See Tribe, supra note 63, §§ 6:2-6:3, at 403-06 (discussing early interpretations of the Commerce Clause). The dormant Commerce Clause is a self-executing concept. See id. § 6:2, at 403. Even in the absence of congressional action specifically preempting state authority, the judiciary will determine whether a particular state action threatens the values that the Commerce Clause was intended to protect. See id.
activity, including taxation, that unduly burdens interstate or international commerce will be struck down.\(^{65}\)

1. Interstate Commerce Clause Implications

Since deciding the first unitary taxation case nearly 100 years ago,\(^{66}\) the Supreme Court has developed an analysis to determine the constitutionality of state taxation statutes, both in the interstate and foreign commerce context.\(^{67}\) The constitutionality of unitary apportionment was upheld nearly twenty-five years later in Underwood Typewriter Co. v. Chamberlain.\(^{68}\) The Underwood Court examined a Connecticut tax that, through formula apportionment (or the unitary method), sought to reach

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\(^{65}\) See Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 447 (1978) (holding that a Wisconsin law, requiring that trucks longer than fifty five feet operating on its highways obtain a permit, violates the dormant Commerce Clause); Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 443 (1960) (reiterating the rule that a state statute regulating a legitimate local interest and only incidentally affecting interstate commerce will be upheld unless the burden imposed is excessive in relation to the benefits derived); H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 535 (1949) (stating that in situations where Congress has not acted, the Court has “advanced the solidarity and prosperity of this Nation by the meaning it has given to these great silences of the Constitution”); cf. Southern Pac. Co. v. Arizona, 325 U.S. 761, 767 (1945) (stating that absent conflicting legislation by Congress, there is a “residuum of power” in the state to legislate matters of local concern which affect interstate commerce or, to a limited extent, regulate it); South Carolina State Highway Dep’t v. Barnwell Bros., Inc., 303 U.S. 177, 184-85 (1938) (stating that absent congressional action, states are free to regulate matters which are local in character so long as the means of regulation are reasonably adapted to the end sought). For a thorough discussion of Commerce Clause limitations on state taxing power, see Developments in the Law—Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev 953, 956-72 (1962).

\(^{66}\) See supra note 64 (providing examples of state laws that have been struck down under the dormant Commerce Clause).

\(^{67}\) See Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897). In Adams Express, the Court upheld an ad valorem state tax which apportioned the income of railroads and utilities based on the value of the interstate system as a whole. See id. at 229; see also infra note 83 (defining an ad valorem tax). At issue was whether the state could constitutionally tax telegraph, telephone, and express companies based on the value of the entire interstate system, or whether the state was limited to taxing the value of tangible property within the state. See Adams Express, 165 U.S. at 196-204. In upholding the tax, the Court stated that the actual value of the tangible property used within the state's borders was not an accurate reflection of the true value of the utility within the state. See id. at 221.

\(^{68}\) See infra notes 72-117 and accompanying text (discussing the development of the Supreme Court's state taxation analysis).

\(^{69}\) 254 U.S. 113 (1920). Although Underwood was the first case addressing the concept of unitary taxation, the Court in Adams Express faced a concept known as the “unit rule” which taxed railroads and utilities operating within its borders based on the entire interstate system. Adams Express, 165 U.S. at 220-29.
income of a corporation earned outside of the state's borders. The Court, finding the tax did not interfere with interstate commerce, justified Connecticut's law by recognizing the "impossibility" of accurately apportioning the corporation's income based on its in-state activities. The difficulties of accurately ascertaining how much of a corporation's income a state may tax was a primary concern in Underwood, and has served as a basis for upholding more recent unitary taxation statutes.

In Complete Auto Transit, Inc. v. Brady, the Court faced an issue similar to that previously considered in Underwood. Complete Auto claimed that a Mississippi tax levied against its transportation activities violated the Commerce Clause. The Court established a four-part test to determine when a state tax on interstate activities would survive Commerce Clause scrutiny. First, a corporation's activities must have a suf-

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69. See Underwood, 254 U.S. at 118. The Underwood Typewriter Company produced, sold, repaired, and rented typewriters and related products. See id. 118-19. Headquartered in New York, the company manufactured its products in Connecticut, and maintained branch offices in other states. See id. at 119. Connecticut computed the corporation's state taxes by reference to its federal tax liability, thus basing its state tax liability on income earned from its operations throughout the United States. See id. at 117-18. Using this method, Connecticut attributed 47% of Underwood's overall earnings to intrastate activities. See id. at 119.

70. Id. at 120-21 ("The legislature, in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.").

71. See supra note 45 (discussing the difficulty of accurately apportioning income of multi-jurisdictional corporations).


73. See supra notes 68-71 and accompanying text (discussing Underwood).

74. See Complete Auto, 430 U.S. at 277. Appellant was a Michigan corporation that transported vehicles arriving by rail in Mississippi to dealers within the state. See id. at 276. It challenged the constitutionality of a Mississippi sales tax levied against its transportation activities, which resulted in approximately $165,000 in taxes over a four year period. See id. at 277 (providing the tax assessment calculations). Appellant argued that the tax violated the Commerce Clause because its transportation activities were "but one part" of movements in interstate commerce. Id. In support of its position, the corporation relied on prior Court decisions declaring that a state tax on the "privilege" of engaging in an activity in the state may not be levied against an activity that is part of interstate commerce. See id. at 278; see also Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 610 (1951) (reiterating that any state tax imposed directly on interstate commerce was per se unconstitutional, a principle which became known as the Spector rule); Freeman v. Hewitt, 329 U.S. 249, 253 (1946) (concluding that denying a state the ability to tax interstate commerce does not cripple a state's ability to perform its local function). The state relied heavily upon a line of cases holding that the Commerce Clause was not intended to "relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing the business." Complete Auto, 430 U.S. at 279 (quoting Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938)).

75. See Complete Auto, 430 U.S. at 277-78; see also infra notes 129-35 and accompanying text (discussing and applying this four-part test in Barclays).
ficient nexus with the state. Second, the tax must not discriminate against interstate commerce. Third, the tax may not be unfairly apportioned. Finally, the tax must be related to services provided by the state. The Court upheld the tax without considering the merits of the nexus requirement is intended to “limit the reach of state taxing authority” to ensure that state taxation does not unnecessarily burden interstate commerce. Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992); see Goldberg v. Sweet, 488 U.S. 252, 263 (1989) (expressing doubt that states may tax a telephone call based solely on that call’s electronic signal passing through the state, but noting that states in which a call is originated, terminated, or billed do have a sufficient nexus to tax the call); National Geographic Soc’y v. California Bd. Of Equalization, 430 U.S. 551, 556 (1977) (requiring more than the “slightest presence” for a sufficient nexus); United Air Lines, Inc. v. Mahin, 410 U.S. 623, 631-32 (1973) (holding that a state has a sufficient nexus to tax aviation fuel stored in the state and consumed in interstate flights, but not to tax an airline based solely on its flights over the state); National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 758 (1967) (holding that receipt of mail is not a sufficient nexus).

According to the Court in Container, the requirement that a state tax not discriminate against interstate commerce, however, has generally not required more than that the tax be fairly apportioned. Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 171 (1983).

To demonstrate unfair apportionment, the taxpayer has the burden of proving that there is no “rational relationship between the income attributed to the State and the intrastate values of the enterprise.” Container, 463 U.S. at 180 (quoting Mobil Oil Corp. v. Commissioner, 445 U.S. 425, 437 (1980)). The company can achieve this burden by showing that the statute is “out of all appropriate proportion” to the business transacted by the company in that state. Hans Rees’ Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931). Additionally, the Container Court indicated that an “obvious” component of a fair tax is a principle it referred to as “internal consistency.” Container, 463 U.S. at 169. This concept requires that if every jurisdiction were to apply the tax, it would result in no more than all of the unitary business’s income being taxed. See id. In other words, a “fair” tax may not result in double taxation. See supra note 18 (discussing what characterizes double taxation).

In distinguishing the first from the fourth factor:

The Court read the fourth and final prong of the Complete Auto Transit test, the requirement that the tax be fairly related to the beneficial services provided by the state, as requiring only that the measure of the tax be reasonably related to the extent of contact with the taxing state. Thus the fair relation test became little more than a gloss on the nexus requirement.

The Court never reached the substance of Complete Auto’s claim because Complete Auto failed to allege any objections to Mississippi’s tax other than that it was imposed upon the “privilege” of engaging in interstate commerce. Complete Auto, 430 U.S. at 278. The Court noted that it was confronted with a situation similar to that in Spector, a case which the Court simultaneously overruled. See id. at 287-89.
case because Complete Auto failed to allege that the tax violated any of these four requirements.  

2. Extension of the Unitary Taxation Concept Beyond National Boundaries

In *Japan Line Ltd. v. County of Los Angeles*, the Court extended the Complete Auto test to taxation disputes involving foreign commerce. In *Japan Line*, the Court specifically addressed the constitutionality of a California *ad valorem* property tax levied on Japanese-owned cargo containers temporarily located within the state. In defining the bounds of state taxation of foreign entities, the Court adopted the Complete Auto test as a threshold inquiry. The Court then noted two additional criteria to be examined when states seek to tax instrumentalities of foreign commerce. First, the tax must not inevitably result in international double taxation. The Complete Auto Court dismissed the blanket prohibition against any tax levied on an activity that is part of interstate commerce, claiming such a rule "has no relationship to economic realities," and adopted the four-prong Complete Auto test. Complete Auto, 340 U.S. at 279; see also supra note 74 (discussing the Spector rule).


The Complete Auto Court dismissed the blanket prohibition against any tax levied on an activity that is part of interstate commerce, claiming such a rule "has no relationship to economic realities," and adopted the four-prong Complete Auto test. Complete Auto, 340 U.S. at 279; see also supra note 74 (discussing the Spector rule).


82. See supra notes 72-79 and accompanying text (discussing the Complete Auto four-part test and the case itself); infra notes 129-35 and accompanying text (applying Complete Auto in Barclays).

83. Duties are categorized as either "*ad valorem*" or "specific." *BLACK'S LAW DICTIONARY* 51 (6th ed. 1990). *Ad valorem* literally means "according to value," and describes a tax that is calculated based on a percentage of the property's value. *Id.* A "specific" duty is one that imposes a fixed tax on each unit, irrespective of that unit's value. *Id.*

84. See Japan Line, 441 U.S. at 437. In Japan Line, six Japanese shipping companies challenged a California property tax imposed on their shipping containers temporarily located within the state. See *id.* at 436. Their operations were exclusively in foreign commerce, and the containers were in constant transit except for time spent during repair or awaiting loading or unloading of cargo. See *id.* Further, the containers were subject to and were actually taxed in Japan. See *id.* The county of Los Angeles levied a property tax of over $550,000 for the containers' presence over the course of three years. See *id.* at 437.

85. See *id.* at 444-45; see also supra notes 72-79 and accompanying text (discussing the Complete Auto four-part test); infra notes 129-35 and accompanying text (applying the Complete Auto four-part test).

86. See Japan Line, 441 U.S. at 446. The Court previously had recognized that the Constitution more broadly prohibits the taxation of foreign commerce than interstate commerce. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2370
taxation. The Court found that the California tax failed both criteria. First, the tax resulted in double taxation because the cargo containers were taxed in Japan and then again in California. Second, California's tax also violated the one voice doctrine because it contravened an articulated federal policy to remove obstacles to the utilization of containers as instrumentalities of foreign commerce. Therefore,

(1992). Therefore, in Japan Line, the Court required “a more extensive constitutional inquiry” when examining Congress’s ability to regulate foreign commerce as opposed to interstate commerce. Japan Line, 441 U.S. at 446.

87. See Japan Line, 441 U.S. at 466; see also supra note 18 (discussing the factors that characterize double taxation).

88. See Japan Line, 441 U.S. at 448. The Court held that when examining a state tax levied upon foreign commerce, in addition to addressing the Complete Auto requirements, a court must also examine, “first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from ‘speaking with one voice when regulating commercial relations with foreign governments.’” Id. at 451.

The one voice doctrine, which is now a well-established requisite of state taxation of foreign entities, was first articulated in Michelin Tire. Michelin Tire v. Wages, 423 U.S. 276, 285 (1976) (stating that the Framers granted power to levy import duties solely to the federal government, partially because “the Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power”).

89. See Japan Line, 441 U.S. at 451-57.

90. See id. at 451-52. The Court stated that, to prevent double taxation, taxes must be apportioned among taxing jurisdictions in such a way that, in aggregate, the instrumentality of interstate commerce is not being taxed on more than its full value. See id. at 447. The corollary to this principle is that no jurisdiction may tax the instrumentality on its full value. See id. However, when such a taxing jurisdiction is a foreign sovereign with the right to levy a tax on the full value of the instrumentalities of commerce, and actually levies such a tax, any additional tax a state imposes would inevitably lead to double taxation. See id. Therefore, because the Japanese containers upon which the property tax was levied were taxed fully in Japan, California’s tax resulted in double taxation. See id. at 452.

In several subsequent cases, the Court addressed the constitutional impact of property taxes, as in Japan Line, which are allocated to a single situs, and income taxes, which are commonly apportioned to various jurisdictions. See Exxon Corp. v. Department of Revenue, 447 U.S. 207, 228-29 (1980) (allowing states to tax “situs” income, such as the income earned from oil exploration and production that is conducted in other states); see also Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443-46 (1980) (holding that dividend income need not be allocated to a single situs, but may be apportioned among the States).

91. See Japan Line, 441 U.S. at 452. The Court recognized that the desired uniform treatment of containers engaged exclusively in foreign commerce is evidenced by the Customs Convention on Containers to which the U.S. and Japan are members. See Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301, 304 (stating that containers that are temporarily located within a taxing jurisdiction are admitted “free of import duties and import taxes”). California’s tax was struck down because of the likelihood of retaliation by
although California's tax survived Complete Auto scrutiny, it's double taxation of instrumentalities of foreign commerce and interference with the government's ability to speak with one voice rendered it unconstitutional.

D. Container v. Franchise Tax Board: Barclays's "Domestic" Counterpart

Four years after Japan Line was decided, the Court in Container Corp. of America v. Franchise Tax Board addressed the constitutionality of WWCR as applied to U.S. multinationals with foreign subsidiaries. In Japan especially since other states had already begun to enact similar tax statutes. See Japan Line, 441 U.S. at 453. Such behavior, if left unchecked, "obviously, would make 'speaking with one voice' impossible." Id.

The Court noted that apportioned taxes could frustrate federal uniformity in several other ways. See id. at 450. First, international disputes over reconciliation could arise if states were allowed to impose apportioned taxes. See id. Second, foreign nations could retaliate in response to a tax creating "an asymmetry in the international tax structure," and such retaliation would be directed at all American businesses, not just those within the taxing state. Id. If more states engaged in such practice, the Court warned that the result would clearly violate the nation's ability to "speak[ ] with one voice." Id. at 451.

92. The Court accepted the state's stipulations that the Complete Auto factors were satisfied without engaging in any analysis. See Japan Line, 441 U.S. at 445. In response to the state's assertion that the Complete Auto factors had been satisfied, that Court noted that "[t]hese observations are not without force," and continued by assuming that, had the containers been instrumentalities of purely interstate commerce, Complete Auto would have applied and been satisfied. Id.

93. See id. at 453-54.

94. 463 U.S. 159 (1983). The Court in Container addressed the applicability of California's tax only on domestic corporations. The Court indicated, "we have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." Id. at 189 n.26. The constitutionality of a state tax levied on a foreign multinational expressly was left open, and was later addressed in Barclays Bank v. Franchise Tax Board, 114 S. Ct. 2268 (1994).

95. See Container, 463 U.S. at 189. Container Corporation of America manufactured paperboard packaging and controlled twenty foreign subsidiaries located in Latin America and Europe. See id. at 171. Container failed to include the income of its subsidiaries for three consecutive years, and filed suit after California levied additional taxes against Container upon considering its subsidiaries part of a unitary business. See id. at 174-75.

First, the Court addressed Container's assertions that the California Court of Appeal erred in classifying Container and its subsidiaries as part of a unitary business. See id. at 175-76; see also supra note 43 (discussing the factors which characterize a unitary business). After reciting the development of the unitary business concept, the Court examined Container's two arguments against its characterization as a unitary business. See Container, 463 U.S. at 175-79. Container argued that the state court erred in considering Container's "mere potential to control" its subsidiaries a dispositive factor. Id. at 177. The Court, however, believed that the state court's determination was based on the more concrete ground that Container dictated to its subsidiaries proper "standard[s] of professionalism, profitability, and ethical practices." Id. Container also attacked the propriety of the
its primary analysis, the Court addressed whether California’s taxing scheme survived foreign Commerce Clause scrutiny by meeting the additional requirements established in Japan Line.96

First, the Court qualified Japan Line’s first requirement that the tax not increase the risk of double taxation.97 It stressed that this requirement does not place an absolute prohibition on state taxation policies that result in double taxation in an international context.98 Instead, the Court must examine the context in which the double taxation occurs and the alternatives reasonably available to the state.99 The Court distinguished Container from Japan Line by finding that the double taxation in Container was not the inevitable result of California’s tax, in contrast with Japan Line, where the nature of the property tax rendered double tax-

state court’s presumption that corporations which are engaged in the same type of business are unitary. See id. The Court rejected this argument, noting its limited influence in the state court’s final determination, and stating that when one corporation invests in another in the same line of business, it is more likely that the two corporations will benefit through economies of scale, operational integration, or sharing of expertise. See id. The Court concluded that, in light of these various factors, the state court did not err in considering Container and its subsidiaries a unitary business. See id. at 179-80.

Next, the Court examined Container’s assertions that California’s tax was not fairly apportioned. See id. at 180-84. To demonstrate the lack of a rational relationship between the tax and the corporation’s intrastate value, the corporation must show that the statute is “out of all appropriate proportion to the business transacted in that State.” Id. at 180-81 (quoting Hans Rees’ Sons, Inc. v. North Carolina, 283 U.S. 123, 135 (1931)). Container first challenged the application of California’s tax on its worldwide income on the grounds that its foreign subsidiaries were more profitable. See id. at 181. It argued that because California’s tax did not consider the higher profitability of its foreign subsidiaries, and was based on objective factors unrelated to actual income, the true allocation of income between the parent and its subsidiaries was distorted. See id. Container also argued that the tax unduly increased income allocation to the state because it failed to recognize the fact that costs of production are significantly lower in foreign countries. See id. at 181-82. Because the three factors in California’s tax—property, payroll, and sales—are all factors that tend to be relatively higher in California than in other taxing jurisdictions where the corporations operate, the tax “unfairly inflates” the corporation’s tax liability to California. Id. at 182; see infra note 165 (discussing how WWCR inflates tax liability in jurisdictions where property, payroll, and sales values are relatively higher).

The Court answered both contentions by observing that Container’s statistics are based on the “misleading” premise that income is derived from a single, identifiable source, which is “precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort[ing] to formula apportionment in the first place.” Container, 463 U.S. at 181.

96. See id. at 185-97; see also supra notes 81-93, and accompanying text (discussing Japan Line’s requirements).
97. See Container, 463 U.S. at 185-93.
98. See id. at 189; cf. Japan Line Ltd v. County of Los Angeles, 441 U.S. 434, 446-48, 451 (1979) (holding that a tax which exposes foreign commerce to double taxation is unconstitutional).
tion unavoidable. Further, were California to adopt the alternative arm’s length method, the risk of double taxation would not have been eliminated.

In examining whether California’s tax violated Japan Line’s second requirement by interfering with the federal government’s ability to speak with one voice, the Court held that a state tax could violate this requirement in either of two ways. First, the tax must not “implicate[] foreign policy issues which must be left to the Federal Government.” Second, it must not violate a “clear federal directive.” Concluding that the risk of retaliation by foreign governments was not severe, and that the political branches more appropriately address foreign policy considerations, the Court held that California’s tax did not implicate foreign policy issues sufficiently severe to require overturning the tax. After examining var-

100. See id. at 187-88; see also supra note 90 (discussing the Court’s distinction between property taxes and income taxes).

101. Accordingly, the Court refused to require that California abandon its taxing method on the grounds that it results in double taxation, because the alternative arm’s length method, when applied inconsistently by different countries, could also result in double taxation. See Container, 463 U.S. at 193; see also infra note 189 (discussing how countries differ in the application of the arm’s length method). For a discussion of inconsistent applications of the arm’s length method, see Stanley S. Surrey, Reflections on the Allocation of Income and Expenses Among National Tax Jurisdictions, 10 Law & Pol’y Int’l Bus. 409 (1978).

102. Container, 463 U.S. at 194.

103. Id. In examining this issue, the Court noted that it is not sufficient if the “tax merely has foreign resonances but does not implicate foreign affairs.” Id.

104. Id.

105. See id. at 196. First, the Court noted that a tax may implicate foreign policy issues if it offends foreign trading partners and could lead them to “retaliate against the Nation as a whole.” Id. at 194. In addressing this issue, however, the Court recognized its incompetence in recognizing the political impact of U.S. actions on foreign nations. See id. Absent explicit action by Congress, in balancing the sovereign power of the states and the potential for foreign retaliation, the Court, at most, would develop objective standards based on observations of international trade and international relations. See id.

Based on three factors, the Court concluded that California’s tax would not justifiably lead to retaliation. See id. at 194-95. First, the tax did not create an automatic “asymmetry” in international taxation. Id.; see supra note 91 (discussing how California’s tax in Japan Line was struck down, partially because it created such an “asymmetry”); see also Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 452-54 (1979) (providing the Court’s reasoning for holding California’s tax violative of the one voice doctrine). Second, the tax ultimately fell on Container, a domestic corporation. See Container, 463 U.S. at 195. Third, since Container was amenable to taxation in California, irrespective of the method used, “the amount of tax it pays is much more the function of California’s tax rate than of its allocation method.” Id.

Additionally, the Court examined the possible existence of foreign policy implications other than the risk of retaliation. See id. at 195-97. Unlike Japan Line, the Executive Branch in Container failed to submit an amicus curiae brief in opposition to California’s tax. See id. at 195. Although not a dispositive factor, when combined with the Court’s other reasoning, the Executive Branch’s failure to submit a brief indicated in Container
ious tax treaties and tax statutes, the Court further concluded that there was not a clear federal directive sufficient to preempt California’s tax.\textsuperscript{106}

\textbf{E. Wardair Canada, Inc. v. Florida Department of Revenue: Narrowing the Dormant Commerce Clause}

In challenging the constitutionality of a state tax, a corporation may establish that the tax violates\textit{Japan Line}'s one voice requirement even if Congress has failed to speak.\textsuperscript{107} This concept, called the dormant Commerce Clause doctrine, is invoked when the federal government has not acted on a particular issue, and the judiciary must determine whether a state action unduly burdens the flow of commerce.\textsuperscript{108} In \textit{Wardair Canada, Inc. v. Florida Department of Revenue},\textsuperscript{109} the Court concluded that when Congress's silence is intentional, Congress has affirmatively indi-

that U.S. foreign policy was not threatened by California's tax. See \textit{id.} at 195-96. Accordingly, the Court emphasized that foreign policy issues are “much more the province of the Executive Branch and Congress than of this Court.” \textit{id.} at 196.

For a case argued in the previous term where the Executive Branch submitted an amicus curiae opposing WWCR, see Caterpillar Tractor Co. v. Lenckos, 417 N.E.2d 1343 (Ill. 1981). The Court disregarded this filing because “there has been no indication that the position taken by the Government in [that case] still represents its views, or that we should regard the brief in that case as applying to [Container].” \textit{Container}, 463 U.S. at 195 n.33.

\textsuperscript{106} See \textit{Container}, 463 U.S. at 196-97. In determining whether California's tax violated a clear federal directive, the Court examined whether Congress had manifested an intent to bar states from utilizing WWCR. See \textit{id.} First, there was no claim that the federal statutes preempted California's tax. See \textit{id.} at 196. Second, although many of the tax treaties to which the United States is a signatory require contracting nations to utilize the arm's length method in calculating tax liability of multinational corporations, there generally is no requirement that governments also use the arm's length method in taxing their own domestic corporations. See \textit{id.} Third, none of the tax treaties compel subnational units, such as states, to utilize the arm's length method. See \textit{id.} On this point, the Court noted that Congress had at least once declined to give its consent to a treaty provision which extended an arm's length requirement to the states. See \textit{id.} at 196. Fourth, the Court noted that Congress often has debated restricting the states' use of WWCR, but has not enacted such legislation. See \textit{id.} at 196-97 & 197 n.38. Because the Court could not find a clear federal directive, it rejected Container's contention that the federal government preempted California's tax. See \textit{id.} at 197; see also supra note 63 (discussing preemption and the Supremacy Clause).

\textsuperscript{107} See supra notes 81-93 and accompanying text (discussing the \textit{Japan Line} factors).

\textsuperscript{108} See supra note 64 and accompanying text (providing an overview of the dormant Commerce Clause).

\textsuperscript{109} 477 U.S. 1 (1986). Wardair Canada, Inc., a Canadian airline, conducted charter flights between the United States and Canada. See \textit{id.} at 3. The Florida tax statute under attack was amended in 1983 and provided that all airlines purchasing fuel in Florida would be liable for a flat five percent tax, regardless of whether the fuel was used for flights within Florida's borders. See \textit{id.} at 3-4. Prior to the 1983 amendments, the tax was based on a mileage proration formula, wherein taxes were assessed based on the ratio of the airline's Florida miles to its total worldwide miles. See \textit{id.} at 3.
icated its intent to acquiesce on that issue. Moreover, since Congress is considered to have affirmatively acted, the dormant Commerce Clause is inapplicable.

Wardair argued that Florida's tax on aviation fuel purchased within the state violated Japan Line's one voice requirement. Wardair argued that the more than seventy bilateral aviation agreements demonstrated a federal policy to exempt instrumentalities of international air traffic from taxation. Wardair argued that none of the agreements explicitly prohibited state taxation of aviation fuel, so the Court should apply a dormant Commerce Clause analysis. The Court, however, declined to do so because it did not consider this silence to be of the type that triggers a dormant Commerce Clause analysis. In light of an apparent interna-

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110. See id. at 9.

111. See id. Since only congressional silence can trigger the dormant Commerce Clause, the Court will not apply the doctrine where there is evidence that Congress considered and specifically declined to regulate that area of commerce. See id. at 12-13. For additional discussion of Wardair, see HARTMAN, supra note 7, § 2:17, at 10-12 (Supp. 1991).

112. See Wardair, 447 U.S. at 3. Before making its primary analysis under Japan Line, the Court addressed Wardair's argument that the Federal Aviation Act preempted Florida's tax. See id. at 5-7. Wardair argued that Congress's extensive regulation of the aviation industry indicates that "it is the Federal Government that calls the tune [and] is the conductor of the music, deciding how it is to be played and who are the players." Id. at 5. Although recognizing that the federal government has regulated aviation extensively through "licensing, route services, rates and fares, tariffs, safety, and other aspects of air travel" the Court held that language in the Federal Aviation Act expressly permits states to tax aviation fuel. Id. at 6-7. The Court dismissed Wardair's claim that the Federal Aviation Act preempted Florida's tax, but did not consider this evidence dispositive, in that Congress may have intended this provision to apply only to state taxation of domestic, not foreign, carriers. See id. at 7.

Wardair conceded that Florida's tax satisfied the four-part Complete Auto test. See id. at 8-9; see also supra notes 72-79 and accompanying text (discussing the Complete Auto test). Wardair also recognized that Florida's tax did not result in international double taxation, as prohibited by Japan Line's first factor, because the sale of aviation fuel is a transaction that occurs only within a single taxing jurisdiction. See Wardair, 447 U.S. at 9. Wardair based its entire argument on Japan Line's second factor, claiming that the tax impaired the federal government's ability to speak with one voice. See id. at 9.

113. See Wardair, 447 U.S. at 9-10. Wardair claimed that Congress's "one voice" had spoken in bilateral agreements with over 70 countries, including the U.S.-Canadian Agreement. See id. See generally Nonscheduled Air Services Agreement, May 8, 1974, U.S.-Can., art. XII, 25 U.S.T. 787, 794. Wardair also relied on the Chicago Convention on International Civil Aviation, Dec. 7, 1944, T.I.A.S. No. 1591, to which 156 nations, including the United States, are signatories. See Wardair, 447 U.S. at 9-10. Wardair contended that these agreements strongly demonstrated a federal policy to eliminate all taxes on aviation fuel, and that such a "policy" represents the federal government's "one voice." Id. at 9.

114. See Wardair, 447 U.S. at 10.

115. See id. at 9. The Court found that these treaties were inadequate evidence to demonstrate that Florida's tax violated the one voice doctrine because none of them specifically denied Florida the power to assess the tax in controversy. See id. at 10-11. The Court noted that the failure of the treaties to mention political subdivisions of either coun-
tional intention to eliminate taxation of aviation fuel, the Court interpreted Congress's failure to specifically prohibit states from levying such a tax to be an unwillingness to do so. Because the Court considered Congress to have spoken, albeit through silence, it refused to apply a dormant Commerce Clause analysis in deciding whether Florida's tax violated Japan Line's one voice requirement.

II. Barclays Bank v. Franchise Tax Board: States May Subject Subsidiaries of Foreign Corporations to WWCR

In Barclays Bank v. Franchise Tax Board, the Supreme Court resolved an issue left open eleven years earlier in Container: the constitutionality of allowing a state to apply the WWCR method in assessing the tax liability of domestically-located subsidiaries of foreign corporations. The Court concluded that a state unitary tax based on income of foreign multinationals is not inherently violative of the foreign Commerce Clause.

In 1977, Barclays Bank was the parent company of over 220 corporations, only two of which were incorporated in the United States. It conducted ninety-eight percent of its business outside of the United States. Barclays sued California for a refund of its 1977 franchise taxes calculated under the WWCR method, claiming, among other things, that

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116. See id. at 11. Reiterating Japan Line's requirement that a state cannot impair the federal government's ability to speak with one voice when regulating foreign commerce, the Court stressed that "we never suggested . . . that the Foreign Commerce Clause insists that the Federal Government speak with any particular voice." Id. at 13. The Court concluded that the federal government cannot be deemed to have remained silent on this issue because more than 70 agreements entered into after the Chicago Convention indicate, by negative implication, that the United States has acquiesced on the issue of state taxation of fuel used by foreign airlines in international travel. See id. at 12. The Court concluded that the international agreements relied upon show that "in the context of this case we do not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis." Id. at 9.

117. See id. at 10.

118. See id. at 12-13. The Court emphasized that, "It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to reverse the policy that the Federal Government has elected to follow." Id. at 12.

119. See supra note 94 (discussing how the Container Court declined to address the constitutionality of WWCR as applied to foreign multinationals).

120. See Barclays, 114 S. Ct. at 2286.

121. See id. at 2274; supra note 17 (discussing Barclays's subsidiaries involved in the suit).

such a tax violated the foreign Commerce Clause. Barclays alleged specifically that California's tax system inherently led to double taxation, as prohibited by the first prong of Japan Line. Further, Barclays claimed that California's WWCR system frustrated the federal government's ability to speak with one voice on foreign issues, a violation of Japan Line's second requirement.

In a seven to two decision, the Court held that Barclays had failed to meet its burden of proof in demonstrating that California's tax scheme burdened foreign multinational corporations in violation of the foreign Commerce Clause. Although the majority recognized that WWCR could lead to double taxation, it concluded that WWCR does not inherently result in double taxation. Further, the Court held that a state's use of WWCR against foreign multinationals does not inhibit the federal government's ability to speak with one voice on foreign affairs issues.

A. The Majority Opinion: Extending Container to Foreign Multinationals

The Court began its analysis by examining Barclays's claim in light of the four requirements of Complete Auto. Concluding that the tax "easily" met three of the four elements, the Court examined Barclays's contention that the tax discriminated against interstate commerce.

123. See Barclays, 114 S. Ct. at 2274. For purposes of this litigation, Barclays conceded to being a unitary business. See id. at 2274-75. For a discussion of the principles of a unitary business, see supra note 43.

124. See Barclays, 114 S. Ct. at 2279-81; see also supra notes 81-93 and accompanying text (discussing the Japan Line requirements).

125. See id. at 2271, 2279-86.

126. See id. at 2279-81; see also infra notes 180-85 and accompanying text (discussing why no tax apportionment method will ever inherently result in double taxation).

127. See id. at 2281-85.

128. See supra notes 72-79 (discussing the four-part Complete Auto test).

129. Barclays, 114 S. Ct. at 2276. Complete Auto's nexus requirement was met by the California operations of both BBI and Barcal during the time period in question. See id. Also, Complete Auto's requirement that the tax be fairly apportioned was satisfied because Barclays failed to demonstrate that there was no "rational relationship between the income attributed to the State and the intrastate values of the enterprise," or that the taxes were "out of all appropriate proportion to the business transacted" by Barclays in California. Id. at 2277 (quoting Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 180-81 (1983)); see supra note 95 (discussing the Court's application of Complete Auto's fair apportionment criteria to Container). The Complete Auto criteria, which requires that the tax be related to services provided by the state, was also satisfied because California had given Barclays "protection, opportunities and benefits" for which the state was entitled to exact a return. Barclays, 114 S. Ct. at 2277 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940)).

130. See Barclays, 114 S. Ct. at 2277-79.
Barclays argued specifically that California’s tax required foreign corporations to convert their financial and accounting records for subsidiaries around the world into the language, currency, and accounting practices of the United States. The Court acknowledged that such compliance costs, if imposed disproportionately on foreign multinationals, could violate the Commerce Clause. The Court noted, however, that California law allowed Barclays to estimate the required information, if such data was not ascertainable from records kept in the ordinary course of business. Accordingly, the Court dismissed Barclays’s claim that California’s tax violated the interstate Commerce Clause and declared that the tax satisfied the Complete Auto criteria.

The Court next analyzed Barclays’s claim under Japan Line’s two additional requirements that the tax not increase the risk of double taxation, and that it not prevent the federal government from speaking with one voice.

To demonstrate that WWCRA inherently led to double taxation, Barclays argued that foreign multinationals typically conduct a greater proportion of their business outside of the United States than do U.S. multinational corporations. Accordingly, Barclays argued that foreign multinationals face significantly more exposure to risks of double taxation. Reiterating its position in Container, the Court refused to require California to abandon its unitary method on the grounds that it resulted in double taxation.
not the inevitable result of California's WWCR tax, and that the alternative arm's length method might also result in double taxation. Barclays thus failed to establish the first of Japan Line's two requirements.

The Court next examined whether federal legislation preempted California's tax, and whether it violated Japan Line's one voice requirement. In its preemption analysis, the Court examined proposed legislation of federal tax statutes and the U.S.-U.K. tax treaty. The Court noted that on various occasions Congress had examined WWCR, but failed to enact legislation specifically prohibiting states from utilizing the WWCR method. Further, the Court found significant Congress's refusal to ratify the original version of the U.S.-U.K. tax treaty, which would have prohibited states from using WWCR. Thus, the Court

“inevitab[ly] result” in double taxation, and second, the alternatives reasonably available to the state “could not eliminate the risk of double taxation.” Id. (quoting Container Corp. v. Franchise Tax Board, 463 U.S. 159, 188-91 (1983)).

See Barclays, 114 S. Ct. at 2280. The Court noted that the unitary taxation method and the arm's length method are “two distinct methods of allocating the income of a multinational enterprise. The arm's length approach divides the pie on the basis of formal accounting principles. The formula apportionment method divides the same pie on the basis of a mathematical generalization.” Id. at 2280 n.17 (quoting Container, 463 U.S. at 188). The Court stated that double taxation was not inevitable under either method, but rather dependent on the facts of each case. See id. at 2280.

See id. The Court reiterated its position in Container where the Court refused “to require California to give up on one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation.” Id. (quoting Container, 463 U.S. at 193); see supra note 101 (discussing the Court's reasoning in Container for concluding that double taxation was inevitable under the arm's length method).

See Barclays, 114 S. Ct. at 2279-81.

See id. at 2281.

See id. at 2283-85. The Court examined a variety of proposed bills which would have prohibited California from utilizing WWCR as challenged here. See id. at 2283-84. Some bills would have prohibited states from requiring inclusion of income of corporate affiliates earned substantially outside of the U.S. See id. at 2284. Another set of bills would have prohibited a state from taxing any income not subject to federal income tax. See id. The Court noted that none of these bills ever was enacted. See id. Barclays pointed out, however, that none of the bills introduced addressed solely the issue of WWCR as applied to foreign multinationals, and that there had never been a vote in either a congressional committee, or in either house of Congress on any of these bills. Brief for Petitioner at 9, Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268 (1994) (No. 92-1384).

See Barclays, 114 S. Ct. at 2283-84; see also id. at 2283-84 n.23 (providing a list of congressional studies of state taxation of multinational corporations).

See id. at 2284. The U.S.-U.K. tax treaty as originally proposed would have prohibited states from applying WWCR to U.K. corporations. See id. The treaty finally was ratified absent the provision which would have prevented states from using WWCR. See id.; see also id. at 2284 n.26 (providing language from the proposed and ratified versions of the treaty).
found no indications of congressional intent to bar states' use of WWCR, and held that California's tax was not preempted.148

In its one voice analysis, the Court first noted that Congress could "passively indicate" that a state tax did not interfere with the federal government's ability to speak with one voice.149 In concluding that Congress had, in fact, sufficiently indicated its approval of WWCR, the Court relied on negative inferences drawn from the legislative activity and from treaties on which the Court based its preemption analysis.150 Specifically, the Court found significant that, of the numerous bills that would have prohibited states from using WWCR, none had been enacted.151 The Court thus considered Congress's inaction an implicit approval of WWCR, and upheld the tax under Japan Line's one voice requirement.152

B. The Minority Opinions: Container Does Not Provide Adequate Protection From Double Taxation To Foreign Multinationals

Justice Blackmun, in a separate concurring opinion, expressed dissatisfaction over the majority's handling of the one voice issue.153 He stated that the Court should not have inferred Congress's permission to allow states to use the WWCR method from its failure to specifically prohibit it.154 He concurred in the judgment, however, concluding that the holding in Container was largely controlling in Barclays, and that California's tax did not impair the federal government's ability to speak with one voice.155

Justice Scalia, who concurred in part and concurred in the judgment, also expressed concern over the majority's assumption that Congress, through its inaction, approved of California's tax.156 Such assumptions, he argued, should only be drawn in particular circumstances, none of

148. See id. at 2284-85.
149. Id. at 2282-83. The Court noted this important premise as underlying Wardair and Container. See id.
150. See id. at 2283-85; see also supra notes 145-48 (providing the proposed legislature, congressional studies, and treaties on which the Court based its preemption analysis).
151. See Barclays, 114 S. Ct. at 2284-85.
152. See id.
153. See id. at 2286-87 (Blackmun, J., concurring).
154. See id. Justice Blackmun's reasoning is consistent with his dissent in Wardair, where he urged that the intent of the federal government should be "unmistakably clear" before a state regulation can be deemed permissible under the dormant Commerce Clause. Wardair Canada, Inc. v. Florida Dep't of Revenue, 477 U.S. 1, 18-19 (1986) (Blackmun, J., dissenting).
155. See Barclays, 114 S. Ct. at 2286-87 (Blackmun, J., concurring).
156. See id. at 2287 (Scalia, J., concurring in part and concurring in the judgment).
which were present in *Barclays*.

Justice Scalia thus found no foreign Commerce Clause violation.

Justice O'Connor, with whom Justice Thomas joined, concurred in the judgment in part and dissented in part. She reiterated her dissenter's position in *Container* and concluded that California's use of WWCR should have been struck down. She conceded that, because states and private parties have "justifiably relied" on the holding in *Container*, that holding should not be overruled. She found, however, that *Container* was not controlling because *Barclays* involved a foreign multinational corporation, a situation to which *Container* expressly did not extend.

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157. See *id.* Justice Scalia stated that the dormant Commerce Clause should be applied in only two situations: (1) if the state law facially discriminated against interstate or foreign commerce, and (2) if the state law being examined is indistinguishable from a type of law that the Court had previously held unconstitutional. See *id.* Since neither circumstance existed in *Barclays*, Justice Scalia conceded that the majority's analysis of the one voice issue will probably not differ much from Scalia's own approach in its consequences. See *id.*

158. See *id.*

159. See *id.* at 2287 (O'Connor & Thomas, JJ., concurring in the judgment in part and dissenting in part).

160. The dissenting opinion in *Container*, in which Justice O'Connor joined, challenged the majority's conclusions that California's tax passed constitutional muster under *Japan Line*'s two-prong test. See *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 197-205 (1983) (Burger, C.J., Powell & O'Connor, JJ., dissenting). The dissent argued that, contrary to the majority's conclusion, California's use of WWCR inherently led to double taxation because the formula always assigned a higher proportion of income to California where the property, payroll, and sales values were greater than the corresponding values in other jurisdictions in which the corporation operated. See *id.* at 198-201. The dissent noted that, although there were "a few" foreign countries where property, payroll, and sales figures were higher than California, *Container* did not conduct operations in these countries. See *id.* at 199 n.2. Accordingly, the dissent concluded that California's WWCR method inherently led to double taxation, and, under the first prong established in *Japan Line*, violated the foreign Commerce Clause. See *id.* at 198-99.

The *Container* dissent also argued that California's tax violated *Japan Line*'s second prong because it prevented the federal government from speaking with one voice in an area which should be left to the federal government. See *id.* at 201-02. Unlike the majority, the dissent attached significance to the filing of an amicus curiae brief in a previous case indicating Executive Branch opposition to the states' use of WWCR. See *id.* at 204; see also *supra* note 105 (discussing the Court's interpretation of the amicus curiae filing by the Executive Branch in *Chicago Bridge & Iron* Co. v. Caterpillar Tractor, 463 U.S. 1220 (1983)); *infra* note 185 (discussing *Chicago Bridge*). Because the Solicitor General failed to withdraw the memorandum, or indicate a contrary position, the dissent saw no reason to disregard the government's view in a case that raised "exactly the same issue." *Container*, 463 U.S. at 204. The dissent considered the Solicitor General's memorandum a sufficiently "clear federal directive," and concluded that California's tax impeded the federal government's ability to speak with one voice. *Id.* at 205 n.8.

161. See *Barclays*, 114 S. Ct. at 2290.

162. See *id.* at 2287.

163. See *id.*; see also *supra* note 94 (discussing how the issue presented in *Barclays* was expressly left open in *Container*). Justice O'Connor distinguished between a situation in which the double tax falls on a U.S. multinational, as in *Container*, and when the double
In justifying her conclusion that the WWCR violated the Commerce Clause, Justice O'Connor argued that double taxation was inherent in the WWCR method, and therefore, violated the first of Japan Line's requirements. Since California's formula was based on a corporation's sales, payroll, and property within the state, the formula assigned a higher proportion of income to states where property, payroll, and sales values were higher. Justice O'Connor concluded that because California was such a state, the formula extended to income that other countries had already taxed using accepted international standards.

A unitary tax may be appropriately applied to a U.S. multinational, even if income attributable to the corporation's foreign subsidiaries is taxed, because the corporation is already subject to taxation by the United States. Where the parent corporation is foreign, however, California ultimately will tax income attributable to foreign entities, even though the state may only tax income earned domestically. Thus, in Justice O'Connor's opinion, the facts in Container were sufficiently distinguishable from those in Barclays. See id. at 2290.

Interestingly, in her Barclays dissent, and contrary to her dissent in Container, Justice O'Connor conceded that the California tax did not violate Japan Line's one voice requirement. In Barclays, she expressed her reluctance to rely on briefs filed by officials of the Executive Branch due to the inconsistent positions taken by the Solicitor General in this case. Justice O'Connor further stressed that the power to regulate commerce is vested in Congress, not the judicial or executive branches. See id. Congressional reluctance to act on that issue, as discussed in the majority opinion, led Justice O'Connor to hold Japan Line's second requirement satisfied. See id. at 2287-88.

Justices O'Connor and Thomas argued that California's tax results in double taxation because the WWCR method is inconsistent with the taxing methods employed by other nations. In their view, California's three-factor formula apportions a higher proportion of income to jurisdictions where property, payroll, and sales figures are higher. Because these values will tend to be higher in California than in other taxing jurisdictions, the formula inherently leads to double taxation.

The majority contended that whether WWCR results in double taxation is dependent on the facts of each situation. Her conclusion that double taxation inevitably results, however, is qualified by her reasoning. She noted that California's tax apportions greater income to jurisdictions where property, payroll, and sales values are higher, and "to the extent that California is such a jurisdiction, (and it usually will be) the formula inherently leads to double taxation." Id. (emphasis added). Justice O'Connor is entirely correct in her conclusion that California's tax will result in double taxation when it is levied against a multinational operating in California, and other jurisdictions where property, payroll, and sales values are relatively higher.
III. THE SUPREME COURT CORRECTLY RESOLVED THE STATE WWCR ISSUE

A. The Danger of International Double Taxation Has Already Been Mitigated

Although the Court's decision was an apparent endorsement of double taxation of foreign multinationals, California's water's-edge alternative allowed the Court to uphold the tax without risking the possibility of continued double taxation of multinationals, while at the same time achieving several important objectives. First, the Court's decision ensured that California would not have to refund over one billion dollars of tax revenues it had collected under WWCR. Second, the Court demonstrated its unwillingness to interfere in conflicts that are largely political. By declining to strike down the tax absent an explicit indication of Congress's intent to bar states' use of WWCR, the Court reemphasized its view that judicial solutions are incompatible with political conflicts.

California's tax apportions greater income to jurisdictions where property, payroll, and sales values are higher relative to other jurisdictions.

The majority reasoned, however, that California's tax cannot be considered to inherently result in double taxation so long as there could be situations in which WWCR does not tax income already apportioned to another jurisdiction. See supra note 101 (discussing the *Container* majority's reasoning in upholding California's tax because it did not inherently result in double taxation); supra note 141 (discussing the *Barclays* majority's reasoning in upholding California's tax because it did not inherently result in double taxation); *infra* note 185 (discussing Chicago Bridge Iron, Co. v. Caterpillar Tractor, 463 U.S. 1220 (1983), a case where application of WWCR apportioned less income than did application of a formula that excluded foreign income or foreign apportionment factors).

Since the water's-edge alternative generally required multinationals to report only income attributable to sources within the United States, California's tax could not reach income attributable to other countries, thereby eliminating the risk of international double taxation. See supra notes 53-60 and accompanying text (discussing California's water's-edge alternative); *supra* note 55 (providing the types of income that will be considered under California's water's-edge alternative).

If the *Barclays* Court had upheld California's tax and simultaneously reversed *Container*, California officials indicated that the state could have been forced to refund as much as four billion dollars to corporations. See Brief for Respondent at 2 n.2, Barclays Bank v. Franchise Tax Bd., 114 S. Ct. 2268 (1994) (No. 92-1384); Paul M. Barrett, *Top Court Seems Skeptical of Challenges to California's Taxes on Multinationals*, WALL ST. J., Mar. 29, 1994, at A5. According to the Franchise Tax Board, Barclays's stake in this case was “relatively small.” See Brief for Respondent at 2 n.2, *Barclays* (No. 92-1384). Specifically at issue was $1,678 additional tax assessed to BBI, which was 12% more than reported, and $152,420 additional tax assessed to Barcal, about 28% more than reported. See *id*. As precedent, California has approximately one billion dollars in tax revenues at stake in this case. See *id*.

169. See *supra* note 16 (examining the international criticism in response to WWCR).

170. In *Container*, the Court noted:

This Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to
The *Barclays* decision clarified several recent Supreme Court decisions. Because *Barclays* involved state taxation of a foreign multinational, the Court left undisturbed the interstate Commerce Clause analysis propounded in *Complete Auto.*\(^{171}\) The decision, however, impacted the foreign Commerce Clause analysis established in *Japan Line.*\(^{172}\)

*Barclays* essentially eliminated foreign multinationals' constitutional protection under *Japan Line*'s first requirement.\(^ {173}\) In *Japan Line*, the Court indicated that a state tax creating "an enhanced risk of multiple taxation" could violate the Commerce Clause.\(^ {174}\) *Container*'s subsequent application of the *Japan Line* requirements created additional hurdles for domestic multinationals.\(^ {175}\) In *Container*, the Court held that to violate *Japan Line*'s double taxation requirement, the tax must inevitably lead to multiple taxation, and there must exist a reasonable alternative that is balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please.

Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 194 (1983); see infra note 196 (noting the Court's refusal to examine potential retaliation when determining the one voice issue).

The Court has long exercised discretion in reserving certain issues with foreign policy implications to the Executive and Congress. See Harisiades v. Shaughnessy, 342 U.S. 580, 588-89 (1952) ("[A]ny policy towards aliens is vitally and intricately interwoven with contemporaneous policies in regard to the conduct of foreign relations ... Such matters are so exclusively entrusted to the political branches of government as to be largely immune from judicial inquiry or interference."); cf. Baker v. Carr, 369 U.S. 186, 211 (1962) (stating that although certain foreign relations issues "defy judicial application, or involve the exercise of a discretion demonstrably committed to the executive or legislature ... it is error to suppose that every case or controversy which touches foreign relations lies beyond judicial cognizance").

171. See supra notes 72-79 and accompanying text (discussing the *Complete Auto* factors); supra notes 129-35 and accompanying text (discussing the Court's application of these factors in *Barclays*).

172. See supra notes 82-93 and accompanying text (discussing the *Japan Line* factors); supra notes 97-106 and accompanying text (discussing the Court's application of the *Japan Line* factors in *Container*); supra notes 138-52 and accompanying text (discussing the Court's application of the *Japan Line* factors in *Barclays*).

173. For a discussion of *Japan Line*'s first requirement that a state tax not result in double taxation, see supra notes 87-90 and accompanying text.

174. *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 446 (1979). While it is not readily apparent from the Court's opinion in *Japan Line* that a tax must "inevitably" lead to double taxation before it will be struck down, the *Container* Court subsequently interpreted *Japan Line* as standing for that proposition. Compare *Japan Line*, 441 U.S. at 446-47 (establishing the double taxation element) with *Container*, 463 U.S. at 187-88 (applying *Japan Line*'s double taxation element); see supra note 18 (discussing what constitutes double taxation).

certain not to result in multiple taxation.\textsuperscript{176} The \textit{Barclays} Court adopted these precepts in analyzing California's tax as applied to foreign multinationals.\textsuperscript{177} Barclays unquestionably would have met the \textit{Japan Line} double taxation element as originally established because, as the Court conceded in its analysis of the same tax in \textit{Container}, "multiple taxation in fact had occurred."\textsuperscript{178} Because the Court adopted \textit{Container}'s heightened standard, however, \textit{Japan Line}'s double taxation factor no longer provides relief to foreign multinationals.\textsuperscript{179}

First, no income apportionment method that satisfies \textit{Complete Auto} is likely to inevitably result in multiple taxation.\textsuperscript{180} One element of \textit{Complete Auto} requires that a state income tax on interstate commerce be fairly apportioned.\textsuperscript{181} Further, to be fairly apportioned, such a taxing method must be internally consistent: if applied by every jurisdiction, the tax would result in no more than all of the corporation's income being taxed.\textsuperscript{182} Because a state tax on foreign commerce must also satisfy \textit{Complete Auto},\textsuperscript{183} the tax similarly must be internally consistent with respect to the jurisdictions in which the multinational operates.\textsuperscript{184} It follows, then, that a state application of a taxing method that satisfies \textit{Complete Auto} will not violate \textit{Japan Line}'s first prong on the basis that it inevitably resulted in double taxation. As the Court indicated, whether California's tax results in double taxation depends solely upon the precise allocation methods employed by other jurisdictions in which the multinational operates.\textsuperscript{185}

\begin{footnotesize}

177. \textit{See} \textit{Barclays}, 114 S. Ct. at 2280-81. In adopting these conditions, the Court stated, "These considerations are not dispositively diminished when California's tax is applied to the components of foreign, as opposed to domestic, multinationals." \textit{Id.} at 2280; \textit{see supra} notes 138-143 and accompanying text (applying \textit{Japan Line}'s double taxation requirement in \textit{Barclays}).

178. \textit{Barclays}, 114 S. Ct. at 2280.

179. \textit{See infra} notes 186-189 and accompanying text (explaining why it is unlikely a corporation will likely never establish a violation of \textit{Japan Line}'s double taxation requirement).

180. \textit{See} \textit{Container}, 463 U.S. at 193 (requiring that the tax must "inevitably" lead to multiple taxation in order to violate \textit{Japan Line}'s first prong).

181. \textit{See supra} note 78 (discussing \textit{Complete Auto}'s requirement that a tax be fairly apportioned).


183. \textit{See} \textit{Japan Line Ltd. v. County of Los Angeles}, 441 U.S. 434, 446 (1979); \textit{see also supra} note 95 (discussing the application of \textit{Complete Auto} in \textit{Container}); \textit{supra} notes 130-135 (discussing the application of \textit{Complete Auto} in \textit{Barclays}).

184. In \textit{Barclays}, the Court noted that "if applied by every jurisdiction, 'California's method 'would result in no more than all of the unitary business' income being taxed." \textit{Barclays}, 114 S. Ct. at 2277 (quoting \textit{Container}, 463 U.S. at 169).

185. \textit{Container}, 463 U.S. at 188 ("Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is
Second, there exist no alternatives that are certain not to result in double taxation. The internationally accepted arm's length method may result in double taxation even though its reach is clearly defined by each country's borders. Absent an international organization capable of harmonizing the rules under which each taxing jurisdiction administers its arm's length system, the possibility of double taxation exists. Such an international policy coordination is unlikely given that many countries have developed elaborate tax regulations to prevent manipulation of income under the arm's length method. Absent consistent taxing among countries, there cannot exist a method that is certain to avoid double taxation.

Barclays also altered foreign Commerce Clause analysis in the context of multinational corporations under Japan Line's second prong: that the tax not impede the federal government's ability to speak with one voice. In Japan Line, the Court applied a dormant Commerce Clause analysis to the one voice issue. The combined effect of Wardair and Barclays, however, made less likely the application of such an analysis to issues involving state income taxation of foreign multinationals. Specifically, the Court stated that Congress may now "passively indicate" that a state tax does not violate the one voice requirement.

\[\text{References:}\]
- See Container, 463 U.S. at 188 n.25.
- See supra notes 37-40 and accompanying text (discussing apportionment under the arm's length method).
- See Container, 463 U.S. at 192. The Court noted that, although many countries use the arm's length method making their "basic approach to the task . . . quite similar," a central coordinating authority is likely necessary for absolute consistency in income allocation. Id.
- Although the arm's length system is the internationally accepted standard, "neither the international studies and reports, nor the development of national practice and rules, have succeeded in establishing agreed common criteria, still less common rules. The apparent widespread agreement on the arm's length approach has contrasted starkly with the indeterminacy about the actual content of the arm's length rules." Picciotto, supra note 5, at 773.
- See supra notes 144-52 and accompanying text (discussing Japan Line's one voice application in Barclays).
- See supra notes 109-17 and accompanying text (discussing how Wardair narrowed application of the dormant Commerce Clause by interpreting congressional silence in certain circumstances as an affirmative statement).
clays, for instance, the Court considered Congress to have approved of WWCR simply because it failed to enact any of the numerous bills prohibiting the method.\textsuperscript{194} As application of the dormant Commerce Clause requires congressional silence, any congressional indication approving the tax will preclude a dormant Commerce Clause inquiry.\textsuperscript{195} Most importantly, because \textit{Japan Line}'s one voice analysis is conducted under the dormant Commerce Clause, multinationals are less likely to show that a state tax violated the federal government's ability to speak with one voice.\textsuperscript{196}

\textbf{C. Although an Apparent Blow to Multinationals, Barclays's Practical Impact Will Be Minimal}

In \textit{Barclays}, the Court granted states permission to tax multinationals even though some income would be subjected to double taxation, a practice which the Court previously indicated it would not tolerate.\textsuperscript{197} However, long before \textit{Barclays} was decided, domestic and international politics had eroded that decision's potential impact. First, widespread international criticism and threats of retaliation prompted California to provide an alternative to multinationals who chose not to be taxed on their worldwide income.\textsuperscript{198} The ensuing water's-edge legislation alleviated multinationals' exposure to double taxation since it provided them

\textsuperscript{194} See id. at 2283-84.
\textsuperscript{195} See id.

\textsuperscript{196} See supra notes 81-93 and accompanying text (discussing the \textit{Japan Line} factors). In \textit{Barclays}, the Court indicated that it would no longer examine the possibility or threat of retaliatory action by other governments when examining the constitutionality of a state tax. \textit{Barclays}, 114 S. Ct. 2285. Prior to \textit{Barclays}, the Court indicated its willingness to strike down a state tax if it implicated foreign policy issues. In \textit{Japan Line}, the Court considered international disputes and the possibility of retaliation as sufficient to strike down a state tax under \textit{Japan Line}'s one voice requirement. \textit{Japan Line}, 441 U.S. at 450-51. Similarly, \textit{Container} indicated that "a state tax at variance with federal policy" will violate the one voice standard if it implicates foreign affairs. \textit{Container Corp. v. Franchise Tax Bd.}, 463 U.S. 159, 194 (1993). The \textit{Barclays} Court, however, explicitly withdrew its willingness to determine foreign policy implications stating that "Barclays' . . . argument that California's worldwide combined reporting requirement is unconstitutional because it is likely to provoke retaliatory action by foreign governments is directed to the wrong forum." \textit{Barclays}, 114 S. Ct. at 2285 (footnote omitted). The Court reiterated that "[foreign policy] nuances . . . are much more the province of the Executive Branch and Congress than of this Court," and that the Court's intervention would not be warranted unless the foreign policy of the United States is "seriously threatened." \textit{Id.} at 2284 (quoting \textit{Container}, 463 U.S. at 196).

\textsuperscript{197} See supra notes 83-93 and accompanying text (discussing the Court's unwillingness to uphold a tax which created an "enhanced risk" of multiple taxation).

\textsuperscript{198} See supra note 16 (discussing the critical international response provoked by California's tax).
the option of being taxed on income earned only in the United States.\textsuperscript{199} Second, the immense criticism California faced made it apparent to other states using WWCR that lost foreign investment caused by continued application of this taxation method would harm their local economies.\textsuperscript{200} Currently, all states that retain WWCR offer some form of water’s-edge alternative.\textsuperscript{201} Despite Barclays’s approval of California’s tax, these political developments have rendered WWCR an unlikely source of future international controversy.

IV. Conclusion

In Barclays Bank PLC v. Franchise Tax Board, the Court finally resolved an issue that for many years had been at the heart of extensive international controversy. By allowing states to use WWCR in assessing the tax liabilities of foreign-owned subsidiaries, the Court confirmed its reluctance to intervene in political issues that are more appropriately left to Congress. Further, although the Court upheld California’s tax, and removed elements of constitutional protection previously afforded foreign multinationals, such corporations are no longer exposed to the threat of double taxation that existed prior to the enactment of water’s-edge legislation. By wisely refusing to heed to a threat that no longer existed, the Court appropriately returned the mechanisms for resolution of this political issue to the political arena.

Robert Charles Griffitts

\textsuperscript{199} See supra notes 53-60 and accompanying text (discussing California’s water’s-edge legislation).

\textsuperscript{200} See supra note 53 (discussing the potentially detrimental impact of WWCR on state economies).

\textsuperscript{201} See supra note 53 (providing the citations of various states’ water’s-edge legislation).