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INTERNATIONAL DOUBLE TAXATION, THE FOREIGN PARENT CASE: *BARCLAYS BANK V. FRANCHISE TAX BD. OF CALIFORNIA*

I. INTRODUCTION

The United States Constitution grants the power to regulate foreign and interstate commerce to Congress,¹ and the Import-Export Clause provides that “no State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it’s [sic] inspection Laws. . . .”² Yet, the Supreme Court has held that state governments have a legitimate right to collect taxes for the services they provide to corporations conducting business within the states’ borders.³ However, state governments cannot tax value earned outside their borders.⁴

At issue is the methodology that the states may use to divide the income of the corporation so that value earned outside of the state’s borders is not taxed. The Federal Government endorses the arm’s length method which is also used by the international community.⁵ This method treats each corporation, even those closely affiliated, as independent entities dealing at arm’s length, and treats the transactions between the affiliates as reflecting fair market value.⁶

The States insist this method is inherently flawed and have developed the apportionment method.⁷ This method is based upon the theory that there are

1. U.S. CONST. art. I, § 8, cl. 3. The Commerce Clause provides that “the Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States.” *Id.*

2. U.S. CONST. art. I, § 10, cl. 2.

3. Dep’t. of Revenue, *Wash. v. Ass’n of Wash. Stevedoring Cos.*, 435 U.S. 734, 750 (1978); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *General Motors Corp. v. Washington*, 377 U.S. 436 (1964); *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Memphis Gas Co. v. Stone*, 335 U.S. 80 (1948); *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444-45 (1940).

4. *ASARCO Inc. v. Idaho State Tax Comm’n*, 458 U.S. 307, 315 (1982); *See also Connecticut General Life Ins. Co. v. Johnson*, 303 U.S. 77, 80-81 (1938).

5. Brief of Petitioner at 4, *Barclays Bank PLC v. Franchise Tax Bd. of California*, ___ U.S. ___, 114 S. Ct. 2268 (1994) (No. 92-1384).

6. *Barclays Bank Int’l, Ltd. v. Franchise Tax Bd.*, 829 P.2d 279, 282 (Cal. 1992).

7. *Id.* at 282-83.

These critics cite several shortcomings in the AL/SA method: comparative distortions in measuring income, and a resulting overtaxation or undertaxation; administrative complexity generated by the

many intrinsic flows of value between the affiliates of a corporation that cannot be measured.⁸ For example, California's method aggregates the profit of affiliated corporations, even those outside the state's jurisdiction, with that of the entity that is conducting business within the state, and then apportions that income on the basis of a formula.⁹

California's method has been specifically supported by the courts. In 1983, the Supreme Court expressly upheld this method as constitutional when applied to a domestic parent corporation with foreign subsidiaries.¹⁰ However, the Court specifically declined to decide whether this method would pass constitutional scrutiny if applied to a domestic corporation with a foreign parent or a foreign corporation with either a foreign parent or foreign subsidiaries.¹¹ In June 1994, the Supreme Court faced this very question and rendered its answer in *Barclays Bank v. Franchise Tax Bd. of California*.¹² The majority concluded that Barclays' objection to the California method was directed to the "wrong forum."¹³ The Court relied on its analysis in prior decisions and underscored its position that Congress may passively indicate that a state may take a particular course of action.¹⁴

This casenote will provide a basic understanding of the state and federal methods used to apportion a corporation's income for tax purposes in part II. Part III will then explore in detail the most relevant underpinnings of the Court's jurisprudence in the *Barclays Bank* decision. Finally, parts IV and V will provide an analytical framework in which to define the Court's decision in *Barclays Bank* and will look at the impact the decision will have on multinational corporations and the United States.

II. THE CENTER OF THE CONTROVERSY

A. State vs. Federal Requirements

There are essentially two methods by which sovereigns may tax the income of a multijurisdictional corporation.¹⁵ They are the arm's length/separate accounting (AL/SA) method, and the unitary business/formula apportionment method. The United States, the United Kingdom, and most other nations of the

need to analyze thousands of intercorporate transactions; and the common absence of uncontrolled comparable prices by which to verify the value of intercorporate "arms length" transactions.

Id.

8. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164-65 (1983).

9. *Barclays Bank Int'l, Ltd.*, 829 P.2d at 282 n.2. See *infra* note 47 for California's three-factor variant of formula apportionment.

10. *Container Corp. of Am.*, 463 U.S. at 184.

11. *Id.* at 189, n.26.

12. *Barclays Bank PLC v. Franchise Tax Bd.*, ___ U.S. ___, 114 S. Ct. 2268 (1994), *aff'g* 10 Cal. App. 4th 1742 (Cal. Ct. App. 1992).

13. *Id.* at 2285-86 (stating that it was Congress, not the judiciary, who should determine federal policy concerning the state's method of taxation).

14. *Id.* at 2282-83. See generally *Itel Containers Int'l Corp. v. Huddleston*, ___ U.S. ___, 113 S. Ct. 1095 (1993); *Wardair Canada, Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986); *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

15. *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd.*, 829 P.2d 279, 282 (Cal. 1992).

world have adopted the AL/SA method.¹⁶ AL/SA treats each corporation as an independent entity dealing at arm's length with its affiliates.¹⁷ The internal accounting records of the corporation determine the income attributable to that jurisdiction.¹⁸ In contrast, most states have adopted the unitary business/formula apportionment method.¹⁹ Some states, such as California, have adopted a variant of the formula apportionment method called the worldwide combined reporting method (WWCR).²⁰ WWCR aggregates the income of all entities that form a part of a unitary business, regardless of the jurisdiction in which they do business, then determines the taxing jurisdiction's share according to a formula.²¹

The fundamental difference between the AL/SA approach and the unitary business formula, or more specifically the WWCR, is their basic assumption. The AL/SA method recognizes that costs, values, and profits can vary significantly among countries.²² The WWCR method is based on the assumption that there is an unquantifiable transfer of value that takes place among the affiliates of a corporation.²³

The State Department acknowledged that the WWCR has provoked intense criticism from foreign sovereigns.²⁴ On one hand, the United States, through its treaties, is bound to follow the AL/SA method. While conversely, the individual states may impose a completely different method of computing a foreign corporation's tax liability for state tax purposes.

B. What is a Unitary Business?

The foundation of a state's apportionment method is defining the various affiliates of a corporation as unitary. If a state's tax board deems the various affiliated corporations to be part of a unitary group, then the affiliates' income is apportioned to the taxing jurisdiction and includes the income of those affiliates operating wholly outside the jurisdiction.²⁵ The rationale of the unitary business concept is that a multijurisdictional corporation benefits from contributions to income resulting from integration, centralization of management, and economies of scale.²⁶ Cases defining what constitutes a "unitary business"

16. Brief of Petitioner at 4, *Barclays Bank PLC v. Franchise Tax Bd. of California*, ___ U.S. ___, 114 S. Ct. 2268 (1994) (No. 92-1384).

17. *Barclays Bank Int'l, Ltd.*, 829 P.2d at 282.

18. *Container Corp. of Am.*, 463 U.S. at 185.

19. *Barclays Bank Int'l, Ltd.*, 829 P.2d at 282-83.

20. *Id.* The three-factor model uses a mathematical formula based upon an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall. For the formula *see infra* note 47.

21. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 165 (1983).

22. Brief of Petitioner at 5, *Barclays Bank PLC v. Franchise Tax Bd. of California*, ___ U.S. ___, 114 S. Ct. 2268 (1994) (No. 92-1384).

23. *See generally* *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 317 (1982); *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438-42 (1980).

24. Brief of Petitioner at 7, *Barclays Bank PLC* (No. 92-1384).

25. *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd.*, 10 Cal. App. 4th 1742, 1748 (Cal. Ct. App. 1992).

26. *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd.*, 829 P.2d 279, 282 (Cal. 1992).

are riddled with various definitions, and the Supreme Court has refused to apply a "bright-line" test.²⁷

*Butler Bros. v. McColgan*²⁸ was the first case decided by the Supreme Court that addressed the issue of whether separate entities of a corporation were sufficiently related to form a unitary business.²⁹ In *Butler Bros.*, the taxpayer was an Illinois corporation which operated wholesale distributing houses in seven states including California.³⁰ Each house *inter alia* maintained its own sales force, served its own sales territory, and kept its own accounting records.³¹ However, the corporation maintained a central buying division, and the affiliates absorbed the actual cost of operating this division.³²

The California house filed its tax return showing a net loss of \$82,851.³³ However, California imposed a franchise tax on an apportionment basis taking into account the profits earned by the affiliated houses.³⁴ *Butler Bros.* contended the houses were in fact separate, and the California tax should not include these affiliated houses.³⁵ The Court dismissed this argument, pointing out that there existed unity of ownership and management.³⁶ In reaching this conclusion, the Court emphasized that the existence of the centralized buying division alone provided evidence of integration.³⁷ Accordingly, the Court held that California could appropriate its tax from the total unitary income on an apportionment basis.³⁸

Along the same line, the Supreme Court has concluded that a unitary business exists when there is some exchange of value beyond the mere flow of funds arising out of passive investment.³⁹ Therefore, a corporation must provide evidence that the activities of the affiliate are a part of a distinct and discrete enterprise to prove that it is not part of a unitary business.⁴⁰

27. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 178 (1983). The Court refused to adopt the corporation's argument that would have restricted the unitary test to a "flow of goods." *Id.*

28. 315 U.S. 501 (1942).

29. *Id.*, The unitary business concept was first applied to a foreign corporation in *Bass, Ratcliff & Gretton, Ltd. v. Tax Comm'n*, 266 U.S. 271 (1924).

30. *Butler Bros.*, 315 U.S. at 504. The branch office in California maintained its own inventory, had its own sales force, serviced only its own territory, and kept separate accounting records. However, the cost of operating the Illinois office was absorbed by all branches. Moreover, the Illinois office purchased all inventory and directed its shipment to the branch offices. *Id.*

31. *Id.*

32. *Id.*

33. *Id.* at 505.

34. *Butler Bros. v. McColgan*, 315 U.S. 501, 505 (1942).

35. *Id.* at 504-06.

36. *Id.* at 508.

37. *Id.*

38. *Id.* at 509.

39. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 166 (1983). This flow of value may be in the form of contribution to income between the entities. "[A] relevant question in the unitary business inquiry is whether contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale." *Id.* at 179 (quoting *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354, 364 (1982) (quoting *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438 (1980))).

40. *Mobil Oil Corp.*, 445 U.S. at 439-40.

The most recent enumeration of what constitutes a unitary business was enunciated in *Allied Signal, Inc. v. Director, Div. of Taxation*.⁴¹ The Court provided that the distinguishing characteristics of a unitary business are functional integration, centralization of management, and economies of scale.⁴² Similarly, the Court has classified affiliates as unitary if their business exhibits: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management division; and (3) unity of use of its centralized executive force and general system of operation.⁴³

It is apparent that the Court has varied in its determination of "unitary," and thus, states may use their own definition of what constitutes a unitary business. The Supreme Court has stated that it will not review every state court determination *de novo*.⁴⁴ Rather, if the state court applied the appropriate standards and its conclusion "was within the realm of permissible judgment," the Supreme Court will defer to the state court's determination.⁴⁵

For a higher court to overturn the state court's determination, the corporation must show by "clear and cogent" evidence that the state's determination was erroneous.⁴⁶ Thus, this is an area that is highly fact intensive. It can also be deduced that the very underpinning of a state's use of formula apportionment is defining a business as unitary. As a result, the importance of this preliminary issue cannot be overemphasized.

C. What is Formula Apportionment?

After concluding that affiliated corporations are unitary, the state may then apportion the income of all affiliated corporations, and then they may tax this apportioned income. The formula apportionment method is based on a mathematical equation designed to approximate taxable income of a multijurisdictional corporation.⁴⁷ The Supreme Court held that the fundamental basis of

41. *Allied-Signal, Inc. v. Director, Div. of Taxation*, ___ U.S. ___, 112 S. Ct. 2251 (1992).

42. *Id.* at 2264; *See also Container Corp. of Am.*, 463 U.S. at 179 (quoting *F.W. Woolworth Co.*, 458 U.S. at 364 (quoting *Mobil Oil Corp.*, 445 U.S. at 438)).

43. *Butler Bros. v. McCollgan*, 315 U.S. 501 (1941).

44. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 176 (1983); *compare ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982) (subsidiaries determined to be passive investments); *with F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354 (1982) (Court denied state's attempt to include all income because subsidiaries each operated a discrete business enterprise).

45. *Container Corp. of Am.*, 463 U.S. at 176 (citing *Norton v. Dep't of Revenue*, 340 U.S. 534 (1951)).

46. *Norfolk Western R. Co. v. North Carolina ex rel. Maxwell*, 297 U.S. 682, 688 (1936); *see also Allied-Signal, Inc. v. Director, Div. of Taxation*, ___ U.S. ___, 112 S. Ct. 2251, 2260 (1992); *Container Corp. of Am.*, 463 U.S. at 475; *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 221-22 (1980); *Butler Bros.*, 315 U.S. at 507.

47. California uses a three factor apportionment variant of formula apportionment and the taxable income would be calculated as follows:

In-state	In-state	In-state		
Property	+ Payroll	+ Sales		
Total	Total	Total	Total	Income
Property	Payroll	Sales	x Corporate	= Taxable
	3		Income	by the state

Barclays Bank Int'l, Ltd. v. Franchise Tax Bd., 829 P.2d 279, 282 n.2. (Cal. 1992).

state taxation is that "a state may not tax value earned outside its borders."⁴⁸ Theoretically, if all jurisdictions were to impose the same apportionment method, the states would tax no more than all of the unitary business' income.⁴⁹ However, when a corporation does business in different jurisdictions, providing accurate territorial allocations of taxable income to the state is a complex matter.⁵⁰ As a result, the Court has held that states may use various methods to calculate the value earned inside its borders.⁵¹

Methods of formula apportionment are problematic and can lead to gross distortions of income. Therefore, if the taxpayer can prove by "clear and cogent evidence" that the state is taxing income out of the appropriate proportion, or has "led to a grossly distorted result," then the Court will overrule the application of the apportionment formula.⁵² In *Container Corp.*, the Court recognized that the three-factor formula apportionment scheme used by California has an inherent margin of error.⁵³ Nevertheless, the Court reasoned the error was within an acceptable "substantial margin of error" inherent in any method of attributing income among the components of a unitary business.⁵⁴

As noted above, states such as California apply the WWCR variant of formula apportionment.⁵⁵ Under this alternative, the state includes the affiliate's income earned outside the state.⁵⁶ The host state apportions the total income of the unitary group by a three-factor formula.⁵⁷ The three factors consider property, payroll, and sales for the group in the host state as a fraction of the total worldwide property, payroll, and sales.⁵⁸ The unitary group's total income is multiplied by this fraction, producing an apportioned amount of income taxable by the host state.⁵⁹ The Supreme Court in *Container Corp.* expressly upheld California's taxing scheme as applied to a domestic corporation. However, it expressly reserved the issue of whether worldwide combined reporting is constitutional when applied to a foreign taxpayer.

D. What is the Arm's Length Method?

The U.S. government and other national sovereigns use the arm's length method to divide the tax base. Moreover, the United States and its trading

48. *ASARCO Inc.*, 458 U.S. at 315.

49. *Barclays Bank PLC v. Franchise Tax Bd.*, ___ U.S. ___, 114 S. Ct. 2268, 2277 (1994) (quoting *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983)).

50. *Container Corp. of Am.*, 463 U.S. at 164. See *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438 (1980); *Butler Bros. v. McColgan*, 315 U.S. 501, 507-09 (1941); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920).

51. *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 445 (1940).

52. *Container Corp. of Am.*, 463 U.S. at 170 (quoting *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 326); see also *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978).

53. *Container Corp. of Am.*, 463 U.S. at 184.

54. *Id.* See also *Moorman Mfg. Co.*, 437 U.S. at 272-73; *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939); *Underwood Typewriter Co.*, 254 U.S. at 120-21.

55. *Barclays Bank PLC v. Franchise Tax Bd.*, ___ U.S. ___, 114 S. Ct. 2268, 2272 (1994).

56. *Barclays Bank Int'l, Ltd. v. Franchise Tax Board*, 829 P.2d 279, 282 (Cal. 1992).

57. *Id.* at 282.

58. *Id.*

59. *Barclays Bank PLC*, 114 S. Ct. at 2272. See *supra* note 46.

partners use this method in all bilateral tax treaties and in their internal tax laws.⁶⁰ Under the arm's length or separate accounting method, the sovereign treats each corporate affiliate as a separate entity to determine income tax liability.⁶¹ When a corporation does business outside the United States, the United States as the host country taxes only the income earned within its borders by that corporation.⁶² The host country does not tax income earned by the corporation in other countries, nor does it tax income earned by affiliated corporations in other countries.⁶³ However, the Court has noted that a corporation could possibly divert income to other jurisdictions with lower tax rates by using creative accounting techniques.⁶⁴ To safeguard against such manipulation, the corporation must conduct its business between the affiliated groups on an "arm's length" basis, where the true market value of such transactions are reported.⁶⁵ If all transactions between the affiliates are conducted on an "arm's length" basis, then the host state may tax only the income reflected on the corporation's own books.⁶⁶

E. The Pros and Cons of the State and Federal Methods

Corporations have argued that the WWCR method increases the total apportionable income amount compared to the arm's length method.⁶⁷ For example, if the property values and wages in the jurisdiction outside the host state are lower than that of the taxing jurisdiction, then the income of the jurisdiction outside the state is higher.⁶⁸ The taxing jurisdiction in effect receives a windfall. This windfall is due to a disproportionately large amount of income being apportioned to the taxing state. As noted by the Supreme Court in *Container Corp.*, the WWCR method resulted in a fourteen percent difference in the taxable income above the amount that it would have been had the corporation used the arm's length method.⁶⁹

Conversely, States argue that the arm's length method fails to account for contributions to income that result from "functional integration, centralization of management, and economies of scale."⁷⁰ Moreover, they argue that separate accounting is subject to manipulation and imprecision which often ignores or misrepresents the many subtle and unquantifiable transfers of value that take place among the components of a single worldwide enterprise.⁷¹ With respect to contentions of distortion which compare WWCR results with profit or loss

60. Brief of Petitioner at 4, *Barclays Bank PLC v. Franchise Tax Bd. of California*, ___ U.S. ___, 114 S. Ct. 2268 (1994) (No. 92-1384).

61. *Barclays Bank PLC v. Franchise Tax Bd.*, ___ U.S. ___, 114 S. Ct. 2268, 2273 (1994).

62. Brief of Petitioner at 4, *Barclays* (No. 92-1384).

63. *Id.* at 4.

64. *Barclays Bank PLC*, 114 S. Ct. at 2273.

65. *Id.*

66. *Id.*

67. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 181-82 (1983); *Barclays Bank PLC*, 114 S. Ct. at 2279.

68. *Id.*

69. *Container Corp. of Am.*, 463 U.S. at 184.

70. *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 438 (1980).

71. *Container Corp. of Am.*, 463 U.S. at 164-65.

determinations made under AL/SA, the Court has dismissed this argument reasoning that it is the basic theoretical weaknesses of AL/SA which justify resorting to formula apportionment in the first place.⁷²

III. THE PREVIOUS DECISIONS

A. *Japan Line, Ltd. v. County of Los Angeles*⁷³

When determining whether a state tax is constitutional under the Dormant Commerce Clause, the Court balances the need for the state to extract from interstate commerce a fair share of the government's expenses without unduly restricting the flow of interstate commerce.⁷⁴ The validity of a state tax, as applied to domestic corporations under the Commerce Clause, is determined according to a four-pronged test developed from *Complete Auto Transit, Inc. v. Brady*.⁷⁵ The tax on domestic corporations will be upheld if: (1) the tax is applied to activities that have a substantial nexus with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate or foreign commerce; and (4) the tax is fairly related to the service provided by the state.⁷⁶

The four-pronged test is not adequate in all cases. In *Japan Line*, six Japanese shipping companies operated vessels that carried large cargo shipping containers.⁷⁷ The ships, as well as the containers, were used exclusively in foreign commerce.⁷⁸ California sought to impose an *ad valorem* tax on any container present within the jurisdiction on a certain date each year.⁷⁹ However, the containers were already subject to property tax in Japan, and had in fact been taxed there.⁸⁰ If the containers at issue were instrumentalities of purely interstate commerce, the Court acknowledged *Complete Auto's* test would be sustained, and its Commerce Clause analysis would end.⁸¹ However, the containers were instrumentalities of foreign commerce, and therefore the Court held that it was necessary to apply two additional considerations notwithstanding the *Complete Auto* four prong test.⁸²

The Court began its analysis noting that nondomiciliary states do have a right to tax instrumentalities of commerce on an apportionment basis. However, even though apportioned, the tax must not create an "enhanced risk of international multiple taxation."⁸³ The Court recognized that when dealing with domestic interstate commerce, the Constitution requires each state to apportion

72. *Id.* at 181.

73. 441 U.S. 434 (1979).

74. *Id.* at 444.

75. 430 U.S. 274 (1977).

76. *Id.* at 279.

77. *Japan Line, Ltd.*, 441 U.S. at 436.

78. *Id.* at 436.

79. *Id.* at 437.

80. *Id.* at 436.

81. *Id.* at 445.

82. *Japan Line, Ltd.*, 441 U.S. at 445-46.

83. *Id.* at 446.

the tax fairly to substantially reduce the risk of multiple taxation.⁸⁴ But when dealing in foreign commerce, the Federal Government cannot guarantee relief from double taxation, even if taxes are fairly apportioned in the United States.⁸⁵ This result occurs because there is no single tribunal able to ensure that the total aggregate tax is applied only once to the instrumentalities' full value.⁸⁶ Because Japan had in fact taxed the containers at their full value, the Court found California's levy necessarily resulted in double taxation and violated the foreign Commerce Clause.⁸⁷ The Court rejected California's argument that the resulting multiple taxation had been created by Japan, stating that the tax:

must be evaluated in the realistic framework of the custom of nations. Japan has the right and the power to tax the appellant's containers at their full value; nothing could prevent it from doing so. . . [t]his Court is powerless to correct malapportionment of taxes imposed from abroad in foreign commerce.⁸⁸

The Court then addressed whether state tax impaired federal uniformity. A state tax must not impair federal uniformity or prevent "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments'."⁸⁹ The Court found that the imposition of the levy on cargo containers used exclusively in international traffic frustrated this uniformity.⁹⁰

First, the Court relied on the Customs Convention on Containers⁹¹ to establish the need for federal uniformity.⁹² The Court noted that Congress had not "preempted the field by affirmative regulation," but the Court found that where Congress had remained silent, the Court "under the commerce clause [is] the final arbiter of the competing demands of state and national interests."⁹³ Thus, a multinational agreement may reflect a national policy to remove impediments that disrupt the flow of international commerce. Second, since Japan did not tax American-owned containers, the Court noted the asymmetry created by the California tax. This asymmetry posed the risk of international retaliation upon American owned instrumentalities present in the foreign jurisdiction.⁹⁴ Finally, there was the possibility of subjecting foreign businesses to varying degrees of multiple taxation that would make "speaking with one

84. *Id.* at 446-48.

85. *Id.* The country of domicile may impose a tax on the full value of an instrumentality of commerce, and in the event that the state also seeks to apportion part of that value, then actual double taxation results. *Id.*

86. *Id.* at 447-48.

87. *Japan Line, Ltd.*, 441 U.S. at 451-52.

88. *Id.* at 454.

89. *Id.* at 451.

90. *Id.* at 452.

91. Customs Convention on Containers, May 18, 1956, U.S.-Japan, 20 U.S.T. 301, 304. The Customs Convention on Containers is a multinational agreement between the United States and Japan. The agreement provides for "temporary admission free of import duties and taxes and free of import prohibitions and restrictions" if the containers are used solely in foreign commerce and are subject to re-exportation. *Id.* at 304.

92. *Japan Line, Ltd.*, 441 U.S. at 452-53.

93. *Id.* at 454 (quoting *Southern Pacific Co. v. Arizona ex. rel. Sullivan*, 325 U.S. 761, 769 (1945)). *Accord* *Hughes v. Oklahoma* 441 U.S. 322, 326 (1979); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 328 (1977).

94. *Japan Line, Ltd.*, 441 U.S. at 453.

voice" impossible.⁹⁵ In summarizing the Court's analysis, where foreign commerce is concerned, "[e]ven a slight overlapping of a tax — a problem that might be deemed *de minimus* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned."⁹⁶

*B. Container Corp. of America v. Franchise Tax Board*⁹⁷

Container involved a Delaware corporation headquartered in Illinois. Container was a vertically integrated manufacturer of custom-ordered paperboard packaging doing part of its business in California.⁹⁸ It also controlled twenty subsidiaries in Latin America and Europe with ownership ranging from 66.7% to 100%.⁹⁹ Container had omitted all of its subsidiaries' payroll, property, and sales, claiming that they were passive investments rather than part of a unitary business.¹⁰⁰ The California Franchise Tax Board disagreed and treated Container Corp. and its subsidiaries as a unitary business applying the three-factor apportionment formula.¹⁰¹ The Franchise Tax Board's determination had increased Container's tax by 14%.¹⁰²

On appeal to the Supreme Court, Container initially argued that there had been no flow of goods, and therefore it was not a unitary business.¹⁰³ As noted previously, the taxpayer has the burden of coming forth with "clear and cogent evidence" that the state had taxed extraterritorial values.¹⁰⁴ Discounting Appellant's argument, the Court stated the prerequisite to finding a unitary business was not a flow of goods, but rather a "flow of value."¹⁰⁵

In determining whether a "flow of value" existed in the instant case, the essential inquiry was whether "contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale."¹⁰⁶ Here, the taxpayer assisted the subsidiaries in obtaining equipment and personnel, assisted in obtaining financing, provided technical assistance, and made use of the corporate executives.¹⁰⁷ Thus, looking to the facts taken as a whole, the Court concluded that the trial court's determination of a unitary business was "within the realm of permissible judgment."¹⁰⁸

Container then argued that California's taxing scheme violated the constitutional requirement of fair apportionment,¹⁰⁹ contending that the differences between the United States and other national economies distorted the

95. *Id.* at 450-55.

96. *Id.* at 456.

97. 463 U.S. 159 (1983).

98. *Id.* at 171.

99. *Id.*

100. *Id.* at 174-75.

101. *Container Corp. of Am.*, 463 U.S. at 174-75.

102. *Id.* at 184.

103. *Id.* at 178-80.

104. *Id.* at 175.

105. *Id.*

106. *Container Corp. of Am.*, 463 U.S. at 178-79 (quoting *Mobil Oil Corp.*, 445 U.S. at 438).

107. *Id.* at 172-73.

108. *Id.* at 180.

109. *Id.* at 181-88.

apportionment formula and misappropriated income to the taxing jurisdiction.¹¹⁰ Container attempted to support its argument by stating that its subsidiaries were significantly more profitable. Thus, if California were to rely on the indirect measures of income, (payroll, property, and sales) then this three-factor formula systematically distorted the true allocation of income between the separate entities.¹¹¹ The Court found this argument without merit and summarily dismissed it by stating, "the profit figures relied on by [Container] are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resorting to formula apportionment in the first place."¹¹²

Container then argued that because wages were lower in the jurisdictions outside California, the use of the formula unfairly inflated the amount of income apportioned to the United States operation.¹¹³ The Court dismissed this argument by noting that the three-factor formula used by California was "necessarily imperfect."¹¹⁴ The Court distinguished the amount of distortion caused in Container's case of 14%, and that of more than 250% in *Hans Rees' Sons, Inc.*, where the Court struck down that state's method of apportionment.¹¹⁵ Accordingly, the Court believed the fourteen percent distortion was "within the substantial margin of error in any method of attributing income among the components of a unitary business."¹¹⁶

Considering the additional requirements of the *Japan Line* test, Container argued that California's tax had violated the Foreign Commerce Clause by exposing it to an enhanced risk of multiple taxation.¹¹⁷ The Court began its analysis by recognizing four similarities between *Japan Line* and *Container Corp.*: 1) both taxpayers had been subjected to actual double taxation; 2) this double taxation stemmed from the differences in the taxing methods adopted by California and the foreign taxing jurisdiction; 3) the taxing schemes used by the foreign jurisdiction were consistent with those of international practice; and 4) that the Federal Government had expressed a preference for the arm's length method as opposed to the apportionment formula adopted by California.¹¹⁸ Notwithstanding these similarities, the Court determined that the unitary method applied by California passed constitutional scrutiny under the test reiterated in *Japan Line*.¹¹⁹ Distinguishing the facts involved in *Japan Line* from the facts involved in *Container*, the Court noted that *Japan Line* involved a property tax rather than an income tax.¹²⁰ Moreover, the existing double taxation was "not the inevitabl[e] result of the California taxing scheme."¹²¹

110. *Id.* at 181.

111. *Container Corp. of Am.*, 463 U.S. at 181.

112. *Id.*

113. *Id.* at 181-82.

114. *Id.* at 183.

115. *Id.* (citing *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931)).

116. *Container Corp. of Am.*, 463 U.S. at 184.

117. *Id.* at 185-88.

118. *Id.* at 186-90.

119. *Id.* at 189-92.

120. *Container Corp. of Am.*, 463 U.S. at 187-88.

121. *Id.* at 189.

In *Japan Line*, the Court stated the result of the property tax would necessarily result in double taxation, but here, the Court reasoned that double taxation on income would depend upon the facts of the case. The Court concluded that Foreign Commerce analysis must consider "the context in which the double taxation takes place and the alternatives reasonably available to the taxing State."¹²² Adopting the arm's length method would not necessarily eliminate double taxation.¹²³

In *Japan Line*, California could avoid double taxation by simply not taxing any property used exclusively in international commerce. The Court found this equitable because it reflected international practice and express federal policy.¹²⁴ However, in *Container Corp.* the income was in part domestic, and the Court believed it absurd to prohibit California from taxing the state's fair portion of the income earned within California's borders.¹²⁵ Even if California adopted some version of the arm's length approach, it would not necessarily eliminate double taxation. The Court remarked that the difference between a tax on income and a tax on tangible property suggests the different result reached in *Container*.¹²⁶ Instead of evaluating the apportionment formula on its own merits, the Court rationalized its decision as follows: "it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation, in favor of another allocation method that also sometimes results in double taxation."¹²⁷

Turning to the second prong of the *Japan Line* test, the Court reiterated that a tax "may [not] impair federal uniformity in an area where federal uniformity is essential and prevent the Federal Government from 'speaking with one voice' in international trade."¹²⁸ In conducting this analysis, the Court stated that it could not be inferred that the tax policies of the Federal Government mandate identical treatment by the states, unless there was some explicit directive from Congress.¹²⁹ Thus, the one voice standard will be violated if there are foreign policy issues that must be left to the Federal Government or if the state's taxing scheme violates a clear mandate from the Federal Government.¹³⁰

In addressing the issue of whether there was some 'clear mandate' from Congress, the Court emphasized "Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income."¹³¹ As a result of Congress' inaction, the Court reasoned that this taxing scheme was not

122. *Id.* at 190.

123. *Id.* at 192.

124. *Japan Line, Ltd.*, 441 U.S. at 444.

125. *Container Corp. of Am.*, 463 U.S. at 191.

126. *Id.* at 190. See also *Mobil Oil Corp.*, 445 U.S. at 444-46; *Exxon Corp.*, 447 U.S. at 228-29; cf. *Japan Line, Ltd.*, 441 U.S. at 447.

127. *Container Corp.*, 463 U.S. at 194; cf. *Moorman Mfg. Co.*, 437 U.S. at 278-90.

128. *Container Corp.*, 463 U.S. at 193-94 (quoting *Japan Line, Ltd.*, 441 U.S. at 448-53 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976))).

129. *Container Corp.*, 463 U.S. at 195 (quoting *Mobil Oil Corp.*, 445 U.S. at 448); See also *Japan Line, Ltd.* 441 U.S. at 456 n.20; *Michelin Tire Corp.*, 423 U.S. at 286.

130. *Container Corp.*, 463 U.S. at 194.

131. *Id.* at 196-97 (quoting *Mobil Oil Corp.*, 445 U.S. at 448).

fatally inconsistent with federal policy.¹³² Notwithstanding Congress' failure to legislate, the Court felt that it was incompetent to adjudicate in policy matters dealing with the threat of foreign retaliation. Nevertheless, it developed three general objective standards by which to balance these foreign policy issues.¹³³ The Court dismissed this threat of international retaliation noting: (1) the tax did not create "automatic asymmetry" in international taxation; (2) the tax was technically imposed on a domestic corporation rather than a foreign entity; (3) Container is a domestic corporation that is no doubt amenable to taxation in California; and (4) the tax at issue is more a function of California's tax rate than of its allocation method.¹³⁴ Accordingly, the Court upheld California's formula apportionment method as applied to domestic corporations with foreign subsidiaries.

C. *Wardair Canada, Inc., v. Florida Dep't of Revenue*¹³⁵

Wardair Canada, Inc. is a Canadian corporation which operated round-trip international airline charter flights between Canada and the United States.¹³⁶ During the years in issue, the Florida Department of Revenue assessed an excise tax on fuel purchased within the state, regardless of whether the airline consumed the fuel purchased in intrastate or interstate flights.¹³⁷ Wardair expended the fuel purchased in Florida exclusively in foreign commerce.¹³⁸ Wardair challenged, stating that the Dormant Commerce Clause precluded the tax, and that the tax had violated the "one voice standard" reiterated in *Japan Line*.¹³⁹ Additionally, Wardair maintained the state tax violated the Supremacy Clause of the Constitution.¹⁴⁰ It was Wardair's position that the Federal Government, through the Federal Aviation Act, had so pervasively occupied the field that the Act preempted all state regulation.¹⁴¹ However, the Court found Congress had: (1) expressly provided for the state's tax; (2) by "negative implication" expressed an intent *not* to preempt the field; and (3) not remained silent, and thus did not trigger Dormant Commerce Clause analysis or the application of the "one voice" standard.¹⁴²

The Court first addressed Wardair's Supremacy Clause challenge. The Supremacy Clause dictates that where there is an actual conflict between state and federal law, the state law must yield. In addition, Congress can legislate in an area so pervasively that the Court infers the Federal Government has chosen to "occupy the field," thus displacing any state law.

132. *Container Corp.*, 463 U.S. at 198.

133. *Id.* at 194-95.

134. *Id.* at 194-95.

135. 477 U.S. 1 (1986).

136. *Id.* at 3.

137. *Id.* at 4.

138. *Id.* at 3-4.

139. *Id.* at 4-5.

140. *Wardair Canada, Inc.*, 477 U.S. at 5-6.

141. *Id.* at 5.

142. *Id.* at 12-13.

In the instant case, the Court acknowledged Congress had, through the Federal Aviation Act, regulated extensively in the field of aviation.¹⁴³ While there was no actual conflict, Wardair argued this Act provided evidence Congress had regulated the field so pervasively as to preempt the state's regulation of aviation.¹⁴⁴ However, the Court emphasized that state law is not preempted "whenever there is *any* federal regulation of an area of law."¹⁴⁵ As now, where there is extensive regulation by Congress, the fundamental inquiry in Supremacy Clause analysis is "whether Congress intended to displace state law."¹⁴⁶ A viewing of section 1513 of the Federal Aviation Act provides that "sales or use taxes on the sale of goods or services" are permissible.¹⁴⁷ The Court found this language of the Federal Aviation Act dispositive, expressly allowing Florida to impose its excise tax on fuel.¹⁴⁸ Moreover, the Court inferred that Congress had considered the issue of state taxation of air commerce and by the language of section 1513, had not preempted state law.¹⁴⁹ Thus, not only had the Act not preempted the field, it had in fact expressly allowed the states to impose excise taxes on fuel.¹⁵⁰ It should be noted that the Court applies Dormant Commerce Clause analysis only where the Federal Government has not affirmatively acted. While the Court's finding that Congress had expressly permitted the Florida tax may seem dispositive of the Dormant Commerce Clause analysis, the Court nevertheless continued with a quasi-dormant analysis, finding it "plausible" that Congress "never considered whether [s]tates should be permitted to impose sales taxes on foreign, as opposed to domestic, carriers"¹⁵¹

In turning to its analysis, Wardair conceded that the Florida tax fulfilled the first four requirements of the Dormant Commerce Clause tests under *Complete Auto*.¹⁵² Likewise, Wardair recognized the first prong of *Japan Line* was satisfied. Since the tax was imposed upon on one discrete transaction, it followed that there was no threat of multiple taxation.¹⁵³

Wardair's principle argument, as joined by the Solicitor General as *amicus curae*, argued the Florida tax inhibited the Federal Government from "speaking with one voice" in the area of foreign commerce.¹⁵⁴ With respect to this second prong of the *Japan Line* analysis, Wardair maintained that there existed a clear federal policy of reciprocal tax exemptions for instrumentalities of international air traffic.¹⁵⁵ Wardair submitted in support of its argument: (1)

143. *Id.* at 6.

144. *Id.* at 5-6.

145. *Wardair Canada, Inc.*, 477 U.S. at 6 (emphasis added).

146. *Id.*

147. 49 U.S.C. § 1513 (1982).

148. *Wardair Canada, Inc.*, 477 U.S. at 7.

149. *Id.*

150. *Id.* at 6.

151. *Id.* at 7.

152. *Wardair Canada, Inc.*, 477 U.S. at 8-9.

153. *Id.* at 9.

154. *Id.* at 9-10.

155. *Id.* at 9.

the Chicago Convention on International Civil Aviation (Chicago Convention);¹⁵⁶ (2) a Resolution (Resolution) adopted by the International Civil Aviation Organization (ICAO);¹⁵⁷ and (3) more than seventy bilateral agreements dealing with international aviation, in which the United States was a party with several different countries.¹⁵⁸

The Court rejected this argument, pointing out that instead of bolstering Wardair's position, this evidence in fact proved the Federal Government had permitted state taxation of this type. The Court stated what these documents show is "that while there appears to be an international *aspiration* on the one hand to eliminate all impediments to foreign air travel—including taxation of fuel—the *law* as it presently stands acquiesces in taxation of the sale of that fuel"¹⁵⁹

In addressing Wardair's first evidence, the Court pointed to the terms of Article 24(a) of the Chicago Convention.¹⁶⁰ This provision only precluded the imposition of taxes on fuel brought on board into the state. The Court reasoned the "negative implication" of this provision provided evidence of a decision of the contracting parties not to limit the state's power to tax.¹⁶¹

Next, the Court turned to what Wardair deemed its second manifestation of federal policy. To be sure, the Resolution unequivocally supported an international scheme by which fuel would be exempt from all taxes levied by any taxing authority within the state. However, the Court summarily dismissed the Resolution. Pointing out that the ICAO was merely an organization of which the United States was a member by virtue of its participation in the Chicago Convention, the Court emphasized that the Resolution was the policy of the organization rather than of the United States.¹⁶² Equally important in the Court's analysis was the fact that neither the Executive branch nor the Legislative branch had endorsed the Resolution. Consequently, the Resolution lacked the force of law.¹⁶³

With respect to the bilateral aviation agreements, the Court was unwilling to find a federal policy which would deny the state's power to tax. Rather, the Court determined the agreements represented a policy choice of the parties to implicitly preserve the state's power to tax aviation fuel. In reaching this conclusion, the Court noted that in none of the seventy agreements had the United States denied this power to the states. As with the Chicago Convention, the Court resolved the issue by its "negative implication" analysis. Since none of the agreements specifically denied the state's right to tax, the Court inferred

156. Convention on International Civil Aviation, Dec. 7, 1944, 61 Stat. 1180, 15 U.N.T.S. 295 [hereinafter Chicago Convention].

157. ICAO's Policies on Taxation in the Field of International Air Transport, ICAO Doc. 8632C/968 (Nov. 1966).

158. 49 U.S.C. § 1502(a) (1982).

159. *Wardair Canada, Inc.*, 447 U.S. at 10.

160. Chicago Convention, *supra* note 156, art. 24(a).

161. *Wardair Canada, Inc.*, 447 U.S. at 10.

162. *Id.* at 10-11.

163. *Id.* at 11.

the United States had, at the very least, acquiesced in state taxation of fuel used by foreign carriers in international travel.¹⁶⁴

The Court concluded that the Federal Government had not remained silent. "It would turn Dormant Commerce Clause analysis 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."¹⁶⁵ In the Court's view, the facts and circumstances of the case suggested the Federal Government had affirmatively decided, albeit by "negative implication," to allow state taxation of aviation fuel. As a result, the Court found that it should not apply dormant analysis.

IV. A RETURN TO *CONTAINER CORP., BARCLAYS BANK V. FRANCHISE TAX BD. OF CALIFORNIA*

A. *The Facts*

Barclays Bank PLC (Barclays) is a United Kingdom corporation in the Barclays Group, a multinational banking enterprise. Barclays Bank International Limited (BBI) is the subsidiary of Barclays Bank PLC. Barclays Bank of California (Barcal) is a wholly owned subsidiary of BBI. Only two of Barclays Bank PLC's two hundred twenty subsidiaries are incorporated in the United States (specifically, Barcal and Barclays Bank of New York). The Barclays Group conducted over ninety-eight percent of its business outside the United States.¹⁶⁶ During the years in question, Barcal and BBI reported income as a unitary business to the Franchise Tax Board of California. However, Barcal and BBI did not report any of the income of the parent corporation, nor did it report any income of the parent company's subsidiaries. The Tax Board determined that Barcal and BBI were part of a worldwide unitary group, therefore, it assessed an additional \$154,098 tax liability, based upon the total apportioned income of the Barclays Group.¹⁶⁷

Barcal and BBI prevailed in the Superior Court of Sacramento County, which held California's method of apportionment violated the Foreign Commerce Clause.¹⁶⁸ The Court of Appeal affirmed, reasoning the application of WWCR to a foreign parent multinational involved "foreign policy issues that must be left to the [F]ederal [G]overnment,"¹⁶⁹ and the tax was inconsistent with respect to the executive policy that had "qualified as a source of the 'clear federal directive.'"¹⁷⁰ The California Supreme Court granted review, superseding the opinion of the Court of Appeal.

164. *Id.* at 11-12.

165. *Id.* at 12.

166. Brief of Petitioner at 3, *Barclays Bank PLC v. Franchise Tax Bd. of California*, ___ U.S. ___, 114 S. Ct. 2268 (1994) (No. 92-1384).

167. *Barclays Bank*, 114 S. Ct. at 2274.

168. *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd.*, Superior Court of Sacramento County, 232 Cal. App. 3d 1187 (1990), *rev'd*, 829 P.2d 279 (Cal. 1992), *aff'd on reh'g*, 10 Cal. App. 4th 1742 (Cal. Ct. App. 1992), *aff'd on other grounds*, ___ U.S. ___, 114 S. Ct. 2268 (1994).

169. *Barclays Bank Int'l, Ltd.*, 829 P.2d at 280-81.

170. *Id.* at 281, 289-90.

The California Supreme Court reversed the Court of Appeal. Having noted the court was presented with the issue left open in *Container Corp.*, (whether formula apportionment as applied to a foreign rather than a domestic corporation violates the Constitution), it examined the competing methods of taxation (WWCR and AL/SA). The court concluded that the Supreme Court of the United States had delineated no particular mandate of methodology to withstand Commerce or Due Process Clause scrutiny. Accordingly, the California Supreme Court determined the apportionment formula carried out by the Tax Board constitutionally viable.¹⁷¹

Additionally, the California Supreme Court examined Barclays' claim of a Dormant Foreign Commerce Clause violation. In rejecting Barclays' position, the court relied upon *Wardair*.¹⁷² The court reasoned that dormant analysis was unnecessary, stating that Congress had by "negative implication" remained silent with respect to the states' taxation schemes.¹⁷³ In so concluding, the California Supreme Court held that the tax did not proscribe the Federal Government's ability to "speak with one voice."¹⁷⁴ The Court of Appeal struck down the California scheme on dormant analysis before reaching Barclays' Due Process and nondiscrimination issues in the prior decision. Consequently, the California Supreme Court remanded the case for further development on Barclays' assertion that the compliance burden on foreign-based multinational corporations violated both the nondiscrimination requirements of the Commerce Clause and the Due Process Clause.

The California Court of Appeal then held California's unitary tax method of worldwide combined reporting did not violate the nondiscrimination component of Dormant Commerce Clause. Barclays' greater administrative costs alone, the court determined, were insufficient to support a discrimination claim.¹⁷⁵ Moreover, the court found these compliance costs were neither unreasonable, undue, or arbitrary, nor were the compliance standards without reasonable and adequate enforcement standards.¹⁷⁶ Thus, the court held these standards did not violate Due Process.¹⁷⁷ Barclays appealed and the California Supreme Court denied review. The case went before the Supreme Court of the United States upon writ of certiorari.

B. The Supreme Court Decision¹⁷⁸

The Supreme Court ruled, seven to two, that California's unitary taxing scheme of worldwide combined reporting violated neither the Foreign Commerce Clause nor the Due Process Clause of the Constitution as applied to Barclays, a foreign corporation with foreign parents. The Court was unanimous in reaffirming their opinion in *Container Corp.*, where the Court determined the

171. *Id.* at 285-86.

172. *Id.* at 292-93.

173. *Id.* at 294-95.

174. *Barclays Bank Int'l, Ltd.*, 829 P.2d at 292-93, 300.

175. *Barclays Bank Int'l Ltd.*, 10 Cal. App. 4th at 1753.

176. *Id.* at 1757-61.

177. *Id.* at 1767.

178. *Barclays Bank PLC*, 114 S. Ct. at 2268.

unitary tax method is constitutional as applied to a domestic corporation with foreign subsidiaries.¹⁷⁹ With respect to the foreign parent issue, the Court felt it necessary to delve into its analysis of *Container Corp.* to resolve those questions that it had left unanswered.¹⁸⁰

For purposes of litigation, Barclays conceded that it was part of the Barclays Group and thus formed a worldwide unitary business.¹⁸¹ The Court then began its analysis with an examination of the rules of law established in its Due Process and Commerce Clause jurisprudence. The Court first noted that not only did the Commerce Clause give Congress the power to regulate interstate commerce, but also that it provided interstate commerce protection from state legislation in areas where Congress had not legislated.¹⁸² However, the Court recognized that the Commerce Clause did not preclude the states from extrapolating a "fair share" of its tax burden from corporations doing business within its borders.¹⁸³

The Court then referred to its decision in *Complete Auto*.¹⁸⁴ As previously noted, *Complete Auto* dictates that where Congress has not approved a state tax on commerce, the tax will not be held Constitutionally viable if the taxpayer can prove either the tax: (1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; or (4) is not fairly related to the services provided by the State.¹⁸⁵ The Court then confirmed that, because of "the special need for federal uniformity"¹⁸⁶ with respect to foreign commerce, the tax must also pass the *Container Corp.* two-prong test.¹⁸⁷ The Court summarily dismissed three of the four *Complete Auto* requirements, stating that California's worldwide combined reporting system easily met all but the anti-discrimination requirement.¹⁸⁸

Barclays contended the compliance burdens of California's WWCR scheme were cost prohibitive and discriminatory. It pointed out that foreign corporations must convert their accounting records into the accounting principles of the United States to comply with WWCR, while domestic corporations did not face this prohibitively expensive process. More specifically, it pointed to the trial court's estimate of establishing and maintaining a system capable of converting its records to the WWCR standards.¹⁸⁹ The trial court found Barclays would

179. *Id.* at 2285-87.

180. *Id.* at 2271.

181. *Id.* at 2274-75.

182. *Id.* at 2276 (quoting *Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 769 (1945)); see also *South Carolina State Highway Dep't v. Barnwell Brothers, Inc.*, 303 U.S. 177 (1938).

183. *Barclays Bank PLC*, 114 S. Ct. at 2276 (quoting *Dep't of Revenue, Washington v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 750 (1978)).

184. *Id.* at 2276-77.

185. *Id.* at 2276 (quoting *Complete Auto Transit, Inc.*, 430 U.S. at 279).

186. *Wardair Canada, Inc.*, 477 U.S. at 8.

187. *Barclays Bank PLC*, 114 S. Ct. at 2276.

188. *Id.* at 2276-77.

189. *Id.* at 2277.

expend \$5,000,000 to establish and over \$2,000,000 annually to maintain the records.¹⁹⁰

The Court responded that indeed, disproportionate compliance burdens may be inconsistent with the Commerce Clause.¹⁹¹ However, the Court discounted Barclays discrimination contention. California's regulations provide the Tax Board the discretion to allow "reasonable approximations" of the corporations accounting records based upon the "effort and expense required to obtain the necessary information."¹⁹² With these approximations, Barclays actual cost of compliance just before the years at issue here ranged from \$900 to \$1,250 per annum.¹⁹³ The Court relied upon this "reasonable approximations" provision, and concluded that the taxing system had not imposed an "inordinate" compliance burden on Barclays.¹⁹⁴

Barclays then asserted that the grant of "standardless discretion" transgressed due process, and that there were no standards by which to determine what approximations would be accepted. The Court reasoned along the same lines, pointing out that "California's judiciary had construed the California law to curtail the discretion of California tax officials."¹⁹⁵ Viewed in this light, the Court held due process had not been violated.¹⁹⁶

The Court then examined the first of the two additional considerations set forth in *Container Corp.*. This first consideration is "the enhanced risk of multiple taxation."¹⁹⁷ Barclays maintained that foreign multinationals were exposed to a "'more aggravated' risk . . . of double taxation."¹⁹⁸ Barclays emphasized, and the Court conceded, that foreign multinationals typically maintain more of its businesses outside the confines of the United States as compared to domestic multinationals. Thus, foreign sovereigns have already taxed a large portion of this income. Based upon this fact, Barclays concluded that "the breadth of double taxation and the degree of burden on foreign commerce are greater than in the case of domestic multinationals."¹⁹⁹

The Court rejected this argument, responding that multiple taxation of a domestic corporation had indeed occurred in *Container Corp.* The Court reasoned that its analysis in *Container Corp.* was not diminished when applied to a foreign entity.²⁰⁰ In *Container Corp.*, the Court based its holding upon two qualifications. First, the California tax did not inevitably result in double taxation, and second, adopting another method of taxation could not eliminate the risk of double taxation. The Court found this rationale applicable here as well. The Court determined California's tax would not inevitably result in

190. *Id.* at 2277 n.11.

191. *Id.* at 2277; *see e.g.*, *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 350-51 (1977).

192. *Barclays Bank PLC*, 114 S. Ct. at 2278; CAL. REV. & TAX. CODE, § 25137-6(e)(1) (West 1985).

193. *Barclays Bank PLC*, 114 S. Ct. at 2278 n.13.

194. *Id.* at 2278.

195. *Id.* at 2278; *see Barclays Bank Int'l, Ltd.*, 10 Cal. App. 4th at 1762.

196. *Barclays Bank PLC*, 114 S. Ct. at 2278-79.

197. *Id.* at 2279.

198. *Id.*

199. *Id.*

200. *Id.* at 2280.

double taxation, since that result would "depend upon the facts of the individual case."²⁰¹ Moreover, the Court adopted its analysis in *Container Corp.*, refusing "to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation."²⁰²

The Court then directed the largest part of the analysis to the argument "most energetically presented" by Barclays.²⁰³ The argument was whether California's taxing method "impairs federal uniformity in an area where federal uniformity is essential." More specifically, does the method "preven[t] the Federal government from 'speaking with one voice' in international trade"?²⁰⁴ The Court principally relied upon its decisions in *Container Corp.* and *Wardair*.²⁰⁵ The Court first underscored that Congress may passively indicate that state practices do not impair federal uniformity, and second, that Congress "need not convey its intent with the unmistakable clarity required to permit state regulation that discriminates against interstate commerce or otherwise falls short under *Complete Auto* inspection."²⁰⁶

As with *Wardair* and *Container Corp.*, the Court found that Congress had not specifically indicated any intent to preclude California from imposing its taxing method. It observed that in the years both before and after *Container Corp.*, Congress had failed to enact any legislation precluding a state from taxing corporate income based on the worldwide combined reporting method. This was despite the fact that Congress was fully aware of the foreign sovereign's objection to California's reporting requirement.²⁰⁷

Equally important, the Court found its prior analysis of Senate action on a United States/United Kingdom treaty particularly enlightening. The Senate refused to ratify this tax treaty while it contained a provision banning California's taxing scheme. After this provision had been specifically reserved as inapplicable to the states, the Senate then ratified the agreement. The Court stated this action "reinforces our conclusion that Congress has implicitly permitted the States to use the worldwide combined reporting method."²⁰⁸ The Court viewed this legislation, or with respect to the former the lack thereof, as an indication that Congress had permitted the states' practice of worldwide combined reporting. Therefore, Barclays' objection to California's method was "directed to the wrong forum."²⁰⁹ Thus, the Court once again reiterated it is Congress, not the judiciary, with whom the duty lies to determine federal policy.

201. *Barclays Bank PLC*, 114 S. Ct. at 2280.

202. *Id.* (quoting *Container Corp.*, 463 U.S. at 193).

203. *Id.* at 2281.

204. *Id.* (quoting *Japan Line, Ltd.*, 441 U.S. at 448, 453 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. at 285)).

205. *Id.* at 2281-86.

206. *Barclays Bank PLC*, 114 S. Ct. at 2282-88.

207. *Id.* at 2283.

208. *Id.* at 2284.

209. *Id.* at 2285.

V. CONCLUSION

Despite the state's power to collect an equitable amount of tax revenue from corporations doing business within its borders, a strong argument can be made that the WWCR method extrapolates a disproportionate amount of tax from international business. The Court in *Container Corp.* expressly declined to decide if California's tax would withstand *Japan Line's* two-prong test as applied to a foreign multinational, even though the same tax might be constitutional as applied to a domestic corporation. As noted previously, the Barclays Group conducted over ninety-eight percent of its business outside the United States. California was successful in obtaining an additional \$154,098.00 in tax liability for a total of \$709,822.00. While noting the broader protection of foreign commerce, the Court failed to extend the exacting scrutiny required of dormant foreign commerce analysis.

In the first instance, the language of *Japan Line*, modified in *Container Corp.*, provides that a state's tax will not survive Constitutional scrutiny if the tax creates "an enhanced risk of multiple taxation." Nevertheless, the Court reasoned that multiple taxation would not inevitably result because multiple taxation would depend upon the facts of each case. But what the Court failed to do was apply the express language of the test. It is the risk of multiple taxation that will strike down the tax, not that the tax will inevitably result in multiple taxation. If the test is viewed with the exacting scrutiny expected from the High Court, in an international context this risk is apparent.

Because California's method is incommensurate with the method the world community employs, the risk is that multiple taxation will occur. This stems from the fact that three factors used by California assign a higher proportion of income to California. However, the formula apportions a lower proportion of income to the jurisdiction outside California. Since the factors used to calculate the income in California are higher and the foreign sovereign has already taxed this income using the arm's length method, the corporation's income is exposed to the risk multiple taxation.

In reaching its decision, the Court refused to evaluate WWCR on its own merits. The Court also refused to adopt the lesser of two evils and allow the marketplace to adjust to any distortions of the alternate taxing schemes. If states were required to adopt the arm's length method with respect to foreign corporations, any resultant multiple taxation could be cured through compromise and negotiation with the parties involved. However, the Court effectively dodged the obvious ramifications of its holding by the unsound reasoning of Congress' "negative implication." With the "negative implication" standard, the Court broke from its prior settled jurisprudence that required the intent of the Federal Government to permit state activity be necessarily "unmistakably clear."²¹⁰ It seems clear that the affirmative approval in the instant case had not been acquired. Therefore, the net effect of the Court's decision is to allow the states to escape the reach of the Dormant Foreign Commerce Clause and has

210. *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 91 (1984).

confirmed a more congenial approach to Dormant Commerce Clause analysis in favor of the states.

The effect of the Court's decision is to favor revenue starved states at the cost of the economic development of the country as a whole. First, the Court failed to consider that a foreign corporation will be less apt to invest in the United States due to less uniform application by the states of formula apportionment. As a practical matter, the states will be able apply their formula apportionment methods with fewer uniform standards. This follows from the Court's liberal treatment of the state's methods of taxing income, which places multinationals at a competitive disadvantage. Second, retaliatory legislation by foreign governments is likely to follow the *Barclays Bank* decision. This retaliation will disrupt foreign policy negotiations at the cost of the nation as a whole. In today's volatile economic climate, with all of the discussion centering around removing barriers to international trade and investment, this decision seems to be a step in the wrong direction. Accordingly, Congress did not "at least acquiesce" by "negative implication" in the state's use of formula apportionment as applied to a foreign multinational corporation.

The foreign multinational corporations are both sensitive and responsive to tax effects. They will undoubtedly consider the ramifications of formula apportionment. If the multinational corporation finds that formula apportionment disallows a reasonable return on their investment, the result will be a shift in investment and income from the United States to foreign sources. Moreover, the multinational corporations may alter the form of their companies into passive investments to circumvent being classified as a unitary business. While this may seem insignificant, valuable economies of scale and specialized expertise will be lost. The effect of these losses could result in lower tax bases and thus lower tax revenues for the state and the United States as a whole.

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