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Barclays Bank PLC v. Franchise Tax Board: The Need for Judicial Restraint in Foreign Commerce Clause Analysis

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NOTES

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I. Introduction

It is an oft-repeated legal maxim that hard cases make bad law. To this statement it should be added that good results in hard cases still make bad law. *Barclays Bank PLC v. Franchise Tax Board*[1] illustrates this principle perfectly. Despite strenuous arguments to the contrary,[2] the Court in *Barclays* held that California's method of taxing the income of domestic and foreign-based "unitary" businesses[3] violated neither the Due Process nor the Commerce Clause.[4] While the Supreme Court wisely refused to overturn the California tax,[5] their reasoning succeeding in muddying the waters of dormant foreign Commerce Clause analysis.

California uses a unitary taxation method called the "worldwide combined reporting"[6] (WWCR) method to tax unitary businesses and corporations.[7] Using this method, a state applies an "apportionment formula" to all the income of the unitary business, including its foreign

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[1] 114 S. Ct. 2268 (1994) [hereinafter Barclays]. Due to the potential impact of this case, reporters from the Financial Times, the Wall Street Journal, the Guardian, and the London Observer attended oral arguments. *Final Verdict by June; Barclays Argues Tax Case Before U.S. Supreme Court*, THOMSON'S INT'L BANKING REGULATOR, Apr. 4, 1994, at 1 [hereinafter *Final Verdict by June*]. There was even "a BBC television crew . . . waiting outside on the marble steps of the court building . . . [to interview] various interested observers who had flown in for the [oral arguments]." *Id.* These observers were British trade and government officials. *Id.*

[2] These arguments were presented in numerous amicus briefs. Australia, Austria, Canada, the European Community, Finland, Japan, Norway, Sweden, Switzerland, and the United Kingdom all filed amicus briefs. *Barclays*, *supra* note 1, 114 S. Ct. at 2283 n.22.

[3] A business is unitary if "the operation of the portion of the business done within [a] state is dependent upon or contributes to the operation of the business [outside the] state." Edison Cal. Stores, Inc. v. McColgan, 183 P.2d 16, 21 (Cal. 1947).

[4] *Barclays*, *supra* note 1, 114 S. Ct. at 2272.

[5] For a discussion of the harm that would have resulted from the Court's rejection of the tax, see *infra* note 187 and accompanying text.

[6] *Barclays*, *supra* note 1, 114 S. Ct. 2268.

[7] Unitary taxation is essentially a formula-apportionment method of taxing unitary businesses. *Id.* It "involves taxing a slice of a multinational[ ] [corporation's business] profits; the size of the slice is calculated according to a simple formula based on how much of the multinational's worldwide workforce, assets and sales are located within [a] state." *Unhappy*

members.[8] The formula is then used to calculate the approximate amount of income attributable to the in-state activities of the unitary business.[9]

WWCR taxation remains the target of much criticism throughout the world.[10] Indeed, some nations, incensed by California's taxation method, took retaliatory measures in an unsuccessful effort to end it. Japan, for instance, threatened to pull out investment in states that used the unitary taxation method,[11] while the United Kingdom enacted tax legislation detrimental to U.S. corporations conducting business in Great Britain.[12]

Two recent American presidents were concerned enough about the foreign implications of state unitary taxation to take action.[13] In 1985, President Ronald Reagan agreed to support legislation banning states from using unitary taxation to tax foreign corporations conducting business within a state's borders.[14] Following Reagan's lead, President George Bush condemned the use of unitary taxation by states.[15] Meanwhile, Congress consistently failed to pass laws limiting unitary taxation at the state level.[16] Despite all the controversy, California persisted in using its WWCR method of taxation. The *Barclays* case was the natural result of that persistence.

This Note explains the reasoning for the Court's holding in *Barclays* in Part II. Part III of this Note compares the *Barclays* case with the prior law in the area. Finally, Part IV analyzes the effects and implications of the *Barclays* decision, and offers some suggestions for clarifying foreign Commerce Clause review.

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returns for Barclays, THE ECONOMIST, June 25, 1994, at 79. Its aim is to tax that income that the corporation earned within the taxing state.

8 Paul J. Hartman, *Constitutional Limitations on State Taxation of Corporate Income from Multinational Corporations*, 37 VAND. L. REV. 217, 218 n.4 (1984).

9 David Hudson & Daniel C. Turner, *International and Interstate Approaches to Taxing Business Income*, 6 NW. J. INT'L L. & BUS. 562, 606 n.277 (1984).

10 *See Final Verdict by June*, *supra* note 1, at 1 (noting that many national governments, including the U.S. government, are critical of California's taxation method); *Japanese Applaud Unitary Tax Vote; Many Say Ending System Will Boost Investment in State*, L.A. TIMES, Aug. 28, 1986, sec. IV, at 2 (noting that Britain and Japan believe California's tax system to be unfair); *see also* Jonathan Schwarz, *Survey of World Taxation*, FIN. TIMES, May 20, 1994, at III (stating that the Bush administration was opposed to states using unitary taxation methods); *European Commission Report Says Some Tax Laws Threaten Access to U.S. Markets*, Int'l Bus. & Fin. Daily (BNA) (May 6, 1994), *available in* LEXIS, News Library, Curnws File (reporting that the European Commission believes American states which use unitary taxation methods impair European access to U.S. markets).

11 *Japanese May Not Invest in Unitary Tax States*, FIN. TIMES, Oct. 11, 1983, at 6.

12 *Reagan Agrees to Bill Banning Unitary Taxation*, AUSTRALIAN FIN. REV., Nov. 11, 1985, at 2.

13 However, one American Chief Executive, Bill Clinton, supports California's unitary tax. Schwarz, *supra* note 10, at III.

14 *Reagan Agrees to Bill Banning Unitary Taxation*, *supra* note 12, at 2.

15 Schwarz, *supra* note 10, at III.

16 *See infra* notes 99-107 and accompanying text.

II. Statement of the Case

A. *Factual Background*

Barclays was really two cases, not one. In the first case, there were two petitioners, Barclays Bank of California (Barcal) and Barclays Bank International Limited (BBI).[17] Both of these corporations were members of the Barclays Group, a multinational banking enterprise based in the United Kingdom including "more than 220 corporations doing business in some 60 nations."[18] Barcal and BBI conducted business in California.[19] Barcal, a subsidiary of BBI, was a California banking corporation.[20] BBI, a British banking corporation, conducted business in California, the United Kingdom, and thirty-three other nations.[21]

The controversy in the case centered around the California franchise tax returns of Barcal and BBI for 1977. When Barcal filed its tax returns in California for that year, it only reported income from its own operations; it did not report the income of its parent corporation (i.e., BBI), nor did it report the income of the other members of the Barclays Group.[22] BBI did include the income of itself and its subsidiaries in its California tax return for 1977, including Barcal. However, it reported neither the income of its parent (i.e., the Barclays Group) nor the income of the Barclays Group's subsidiaries.[23] After reviewing both Barcal's and BBI's tax returns, the California Franchise Tax Board determined that both were members of a unitary business—the Barclays Group—and that the entire income of the unitary business had to be reported on both the Barcal and BBI returns.[24] The Tax Board then applied California's three-factor WWCR method to the taxpayers' returns and assessed additional taxes of $1,678 on BBI and $152,420 on Barcal.[25] Both taxpayers paid "the assessments and sued for refunds."[26]

The petitioner in the second case was Colgate-Palmolive Co. (Colgate), a Delaware corporation with its headquarters in New York.[27] Colgate and its domestic subsidiaries manufacture and distribute household and personal hygiene products.[28] Colgate also owns seventy-five foreign subsidiaries which engage in the same line of business.[29]

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[17] Barclays, *supra* note 1, 114 S. Ct. 2268, 2274 (1994).
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] *See id.*
[25] *Id.*
[26] *Id.*
[27] *Id.* at 2275.
[28] *Id.*
[29] *Id.*

The dispute in the Colgate litigation focused on Colgate's California franchise tax returns for 1970-73.[30] Unlike BBI and Barcal, Colgate did in fact report the income of all the members of its unitary enterprise on its tax returns. However, Colgate reported the income from its foreign subsidiaries using an Arm's Length/Separate Accounting Method (AL/SA).[31] Colgate argued that the Constitution forced "California to limit the reach of its unitary [taxation method] to the United States' water's edge."[32] The California Franchise Tax Board did not agree with Colgate's argument and ruled that Colgate's taxes should be calculated by using the WWCR method.[33] Using this method, the Tax Board assessed additional taxes of $604,765 on Colgate for the years in question.[34] After Colgate paid the taxes, it sued in the California courts for a refund.[35]

B. *The Litigation in the California Courts*

1. *The* Barclays *Litigation*

BBI and Barcal (Barclays) brought suit in a California Superior Court charging that the WWCR method violated the foreign Commerce Clause[36] of the U.S. Constitution.[37] The Superior Court ruled in favor of Barclays, and a California appellate court affirmed the ruling, holding that WWCR taxation was "unconstitutional as applied to *foreign-based* unitary groups."[38]

On appeal, the California Supreme Court overturned the appellate court's ruling. Relying on prior precedents,[39] the court held that WWCR taxation withstood scrutiny under foreign Commerce Clause analysis.[40] It then remanded the case to a California appellate court for a determination of whether the WWCR method violated either the Due Process Clause or the anti-discrimination component of the inter-

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30 *Id.*

31 *Id.* When a state uses an Arm's Length/Separate Accounting (AL/SA) taxation method "the corporation's operations within the taxing State are regarded as though separate and distinct" from the other branches of the corporation. PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE & LOCAL TAXATION § 9:17 (1981). The income of the in-state business "is determined without reference to the success or failure of the taxpayer's operations in other States." *Id.*

32 *Barclays, supra* note 1, 114 S. Ct. at 2275. *See infra* note 185 and accompanying text.

33 *Barclays, supra* note 1, 114 S. Ct. at 2275.

34 *Id.*

35 *Id.*

36 "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations . . . ." U.S. CONST. art. I, § 8, cl. 3.

37 Barclays Bank PLC v. Franchise Tax Bd., 829 P.2d 279, 280 (Cal. 1992) [hereinafter Barclays I].

38 *Id.* at 280-81 (emphasis added).

39 See *infra* notes 128-42, 175-84 and accompanying text for a discussion of Japan Line, Ltd. v. County of L.A., 441 U.S. 434 (1979), and Wardair Can. v. Florida Dept. of Revenue, 477 U.S. 1 (1986).

40 *Barclays I, supra* note 37, 829 P.2d at 300.

state Commerce Clause.[41] On remand, the appellate court ruled that the tax as applied neither discriminated nor violated the Due Process Clause.[42]

2. *The* Colgate *Litigation*

The problem facing Colgate was somewhat different than that facing Barclays. Essentially, the issue in the Colgate litigation was whether California's WWCR method as applied to a domestic-based unitary group violated the foreign Commerce Clause. Basing its ruling on prior case law (including one case directly on point), the California appellate court held that the WWCR method did not violate the Commerce Clause.[43] The court reasoned that even under the dormant foreign Commerce Clause—which prohibits certain state actions whether or not Congress has acted—California's tax was legal.[44]

On appeal, the California Supreme Court vacated the decision of the Court of Appeals, and remanded it with instructions to reconsider the decision in light of the California Supreme Court's ruling in *Barclays I.*[45] On remand, the Court of Appeals decided that a dormant Commerce Clause analysis did not apply.[46] Instead, the court held that Congress had acted, thereby acquiescing in the WWCR method of taxation.[47] In short, the tax did not violate the foreign Commerce Clause.[48]

C. *The Case Before the U.S. Supreme Court*

The Supreme Court consolidated both Colgate's and Barclays' claims for purposes of their decision. In the opinion, written by Justice Ginsburg, the Court divided its legal analysis into three parts.[49] The

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[41] *Id.*

[42] Barclays Bank PLC v. Franchise Tax Bd., 14 Cal. Rptr. 2d 537, 539 (Cal. Ct. App. 1992) [hereinafter Barclays II].

[43] Colgate-Palmolive v. Franchise Tax Bd., 284 Cal. Rptr. 780, 801 (Cal. Ct. App. 1991) [hereinafter Colgate I].

In Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 169 (1983), the U.S. Supreme Court had previously upheld California's tax as applied to domestic-based unitary businesses. *See infra* notes 162-74 and accompanying text.

[44] *Colgate I, supra* note 43, 284 Cal. Rptr. at 790-800.

[45] In *Barclays I*, the California Supreme Court, following the U.S. Supreme Court's decision in *Wardair*, held that when Congress has acted there is no need to resort to dormant Commerce Clause analysis. Barclays I, *supra* note 37, 829 P.2d 279, 294 (Cal. 1992) (citing Wardair Can. v. Florida Dep't of Revenue, 477 U.S. 1, 9 (1986)). Moreover, certain types of congressional "silence," such as affirmative refusal to pass laws, constitutes congressional action precluding resort to dormant Commerce Clause analysis. *Id.* at 291.

[46] Colgate-Palmolive v. Franchise Tax Bd., 13 Cal. Rptr. 2d 761, 770-71 (Cal. Ct. App. 1992) [hereinafter Colgate II].

[47] *Id.*

[48] *Id.*

[49] Justice Ginsburg was joined in the opinion by Chief Justice Rehnquist, and Justices Blackmun, Stevens, Kennedy, and Souter. Justice Scalia joined all but part IV-B of the opinion, which addressed whether "federal uniformity" would be impaired by the tax. See *infra* notes 72-79 and accompanying text for a discussion of part IV-B of the Court's opinion. In

first part analyzed the dormant interstate Commerce Clause as it applied to the claims of Barclays and Colgate.[50] The second part of the analysis addressed the petitioners Due Process claims,[51] and the final section dealt with the dormant foreign Commerce Clause.[52]

The Court's legal analysis began with a review of the Commerce Clause. Justice Ginsberg first noted that the dormant Commerce Clause, which prohibits certain state actions relating to commerce even in the absence of congressional action, is a well-established rule.[53] Next, the Court discussed the two components of the dormant Commerce Clause: the dormant interstate Commerce Clause and the dormant foreign Commerce Clause.[54] The opinion noted that the dormant interstate Commerce Clause prohibits state taxation schemes which: (1) tax activities "lacking a substantial nexus to the taxing state"; (2) apportion income unfairly; (3) "discriminate[ ] against interstate commerce"; or (4) are not "fairly related to the services provided by the state."[55]

Relying on prior precedents, the Supreme Court, like the California courts,[56] stated that the dormant foreign Commerce Clause incorporates these four elements, and adds two additional requirements. The first of these new requirements outlaws state taxation methods which create an "enhanced risk of multiple taxation,"[57] and the second requirement mandates that the scheme not interfere "with the Federal Government's capacity to 'speak with one voice when regulating [foreign] commercial relations.' "[58]

The Court then addressed whether California's WWCR method failed any of the four tests of the interstate Commerce Clause. It held that there was no such violation. The Court reached this conclusion without much difficulty, except with respect to the possibility that

addition, Justices Blackmun and Souter filed separate concurrences, while Justice O'Connor wrote a dissent in which Justice Thomas joined. Barclays, *supra* note 1, 114 S. Ct. 2268, 2268 (1994).

50 *Barclays, supra* note 1, 114 S. Ct. at 2276-78. *See infra* notes 53-61 and accompanying text.

51 *Barclays, supra* note 1, 114 S. Ct. at 2278-79. *See infra* notes 62-68 and accompanying text.

52 *Barclays, supra* note 1, 114 S. Ct. at 2279-86. *See infra* notes 69-79 and accompanying text.

53 *Barclays, supra* note 1, 114 S. Ct. at 2276. *See generally* JOHN E. NOWAK, RONALD ROTUNDA & S. NELSON YOUNG, CONSTITUTIONAL LAW §§ 8.1-8.6 (3d ed. 1986) (tracing the development of the dormant Commerce Clause and describing types of state actions affected by the clause).

54 *Barclays, supra* note 1, 114 S. Ct. at 2276.

55 *Id.* (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)).

56 *See* Barclays I, *supra* note 37, 829 P.2d 279, 287 (Cal. 1992); Colgate II, *supra* note 46, 13 Cal. Rptr. 2d 761, 767 (Cal. Ct. App. 1992).

57 *Barclays, supra* note 1, 114 S. Ct. at 2276 (quoting Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 169, 185 (1983)).

58 *Id.* (quoting Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 448 (1979) (quoting Michelin Tire Corp. v. Wages, 423 U.S. 276, 285 (1976))).

WWCR taxation might discriminate against foreign commerce.[59] On this point Barclays made the same argument before the Court that it made in the California courts: complying with WWCR's reporting requirements placed a greater burden on foreign companies than on domestic companies.[60] The Court dismissed this argument, pointing to California regulations which allowed "reasonable approximations" of a corporation's income to be made if it was too costly or expensive to assemble certain records.[61]

Having made this ruling, the Court was forced to address whether the California regulation allowing the use of reasonable approximations of a corporation's income[62] violated Due Process.[63] Barclays argued that this regulation unconstitutionally granted the California Franchise Tax Board unlimited discretion to determine what "approximations" of a corporation's income would be accepted.[64] Barclays' argument failed. In support of its holding the Court argued that: (1) "reasonableness" was an effective guide in judicial review;[65] (2) the California courts had narrowly construed the law to limit the Tax Board's discretion;[66] (3) taxpayers have the ability to clarify their tax burden through an "advance determination";[67] and (4) rules governing multijurisdictional taxes were generally imprecise.[68]

In the last section of its opinion, the Court addressed the two specific requirements of the dormant foreign Commerce Clause. Initially, the opinion dealt with the mandate that a state taxing scheme avoid creating an enhanced risk of multiple taxation. The Court admitted that foreign-based multinational corporations face a high risk of multiple taxation, as they often have operations in jurisdictions with lower wage rates and property values than in American states.[69] Moreover,

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59 *Id.* at 2276-78.

60 *Id.* at 2277. Barclays contended that this burden resulted from the prohibitive costs it had to incur as a result of converting "its diverse financial and accounting records from around the world into the language, currency, and accounting principles of the United States." *Id.*

61 *Id.* at 2278 (quoting CAL. CODE REGS. tit. 18, § 25137-6(e)(1) (1985)).

62 *See infra* notes 91-98 and accompanying text.

63 *Barclays*, *supra* note 1, 114 S. Ct. at 2278.

64 *Id.*

65 *Id.*

66 *Id.* For example, the California Court of Appeals had read the regulations to require that the Board consider the effort and expense required for a corporation to assemble records before the Board could even decide to apply the reasonable approximations standard. *See* Barclays II, *supra* note 42, 14 Cal. Rptr. 2d 537, 541 (Cal. Ct. App. 1992).

67 *Barclays*, *supra* note 1, 114 S. Ct. at 2279 (quoting CAL. CODE REGS., tit. 18, § 25137-6(e)(2) (1985)). These advance determinations would help the taxpayer determine the tax effects of his actions. *Id.* *See also infra* notes 97-98 and accompanying text.

68 *Barclays*, *supra* note 1, 114 S. Ct. at 2279.

69 *Id.* at 2279-80. Justice Powell's dissent in Container Corp. of Am. v. Franchise Tax Bd. does an excellent job of pointing out this problem. 463 U.S. 159, 198-201 (1982) (Powell, J., dissenting). In *Container Corp.*, 27% of the taxpayer's income was earned and taxed in Latin America under the AL/SA method. *Id.* at 200 (Powell, J., dissenting). However, the taxpayer only had 6% of its worldwide wage base in Latin America, 20% of its property in that

the Court had to address the difficult fact that the trial court had found multiple taxation to exist in this case, at least in relation to Barclays.[70] Unphased by this finding, the Court simply stated that this multiple taxation was not the "inevitable result" of California's WWCR taxation, and that the alternative to WWCR taxation (i.e., AL/SA taxation) would not eliminate the risk of multiple taxation.[71] Thus, California's taxation scheme did not fail on this count.

Finally, the majority addressed the last prong of the dormant Commerce Clause analysis. Prior to this point the Court's analysis had applied with equal force to both Barclays' and Colgate's claims. However, facing the question of whether WWCR taxation impaired federal uniformity in an area where it was essential, or whether it prevented the federal government from speaking with one voice, the Court decided to address Barclays' and Colgate's claims separately. Quickly dismissing Colgate's claim in this area, the Court noted that *Container Corp. of America v. Franchise Tax Board*[72] had "held that California's [WWCR] requirement, as applied to domestic corporations with foreign subsidiaries, did not violate the 'one voice' standard."[73]

However, Barclays' claim was not identical to that of *Container Corp.* As a result, a more in-depth analysis was required with respect to their claim. At the outset, the Court stated that the lessons of *Container Corp.* and *Wardair Canada, Inc. v. Florida Department of Revenue*[74] were simply that:

> Congress may more passively indicate that certain state practices do *not* "impair federal uniformity in an area where federal uniformity is essential[;]" it 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.[75]

region, and 14% of its sales in Latin America. *Id.* (Powell, J., dissenting). Thus, under Worldwide Combined Reporting (WWCR) only 13% of its worldwide income was attributed to Latin America. *Id.* (Powell, J., dissenting). The amount of income attributed to a jurisdiction under WWCR taxation is calculated by averaging the wages, property, and sales of a corporation within a jurisdiction. *See id.* (Powell, J., dissenting). For a further discussion of how this method operates, see *infra* notes 89-90 and accompanying text. This model shows the high likelihood that the income earned in Latin America would be taxed again in a jurisdiction, like California, that used WWCR taxation since that method can (at least theoretically) under-value the income earned in low-wage and low-property jurisdictions. *See also* JEROME R. HELLERSTEIN, STATE TAXATION: I CORPORATE INCOME AND FRANCHISE TAXES ¶¶ 8.10[5]-[6] (1983) (outlining double taxation argument against WWCR taxation).

[70] *Barclays, supra* note 1, 114 S. Ct. at 2288 (O'Connor, J., dissenting in part).

[71] *Id.* at 2280-81.

[72] 463 U.S. 169 (1983).

[73] *Barclays, supra* note 1, 114 S. Ct. at 2281. *See infra* notes 162-74 and accompanying text.

[74] 477 U.S. 1 (1986). *See infra* notes 175-84 and accompanying text.

[75] *Barclays, supra* note 1, 114 S. Ct. at 2282-83 (quoting Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 448 (1979)) (internal citations omitted). Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), was a case dealing with a Mississippi tax on a business engaged in interstate commerce. Using dormant interstate Commerce Clause review, the Court set forth

Here, the Court found such passive indications through repeated congressional refusal to enact treaties or laws prohibiting WWCR.[76] The Court then ruled that given such indications, it would not overturn the tax on grounds that it impaired foreign policy as decisions on these grounds were best left to the federal executive and legislative branches.

The Court also made short work of the argument that executive statements critical of WWCR could act as "the one voice" of the federal government prohibiting such taxes. The majority simply stated that the Commerce Clause gives power to regulate Commerce to Congress not the President.[77]. Therefore, the executive statements could not act as the "one voice."[78] Having completed its analysis, the Court upheld California's WWCR taxation method as applied to both domestic and foreign-based corporations.[79]

Both Justices Blackmun and Scalia filed concurring opinions in the case. Justice Blackmun concurred in the entirety of the majority opinion but expressed reservations about using congressional inaction to infer approval of WWCR taxation.[80] Justice Scalia too had concurred in the majority opinion, but did not join the Court's opinion on the "federal uniformity" and "one voice" tests.[81] Instead, he used his concurrence to state that he would enforce a negative or dormant Commerce Clause in only two instances: (1) "against a state law that facially discriminates against [interstate or foreign] commerce";[82] and (2) "against a state law that is indistinguishable from a type of law previously held unconstitutional by this Court."[83]

Justice O'Connor, joined by Justice Thomas, concurred in the judgment in part and dissented in part. With regards to Colgate's

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the four requirements that a state tax dealing with interstate commerce has to meet in order to be valid.

> [D]ecisions [of the Court] have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.

Complete Auto, 430 U.S. at 279. For a discussion of how these requirements applied to the *Barclays* decision, see *supra* notes 59-61 and accompanying text.

76 *Barclays*, *supra* note 1, 114 S. Ct. at 2283-84. *See infra* notes 99-107 and accompanying text.

77 *Barclays*, *supra* note 1, 114 S. Ct. at 2285.

78 *Id.* However, the Court explicitly refused to rule on the question of whether executive action could preempt state laws dealing with commerce "in the absence of either a congressional grant or denial of authority." *Id.* at 2286.

79 *Id.*

80 *Id.* at 2286-87 (Blackmun, J., concurring).

81 *Id.* at 2287 (Scalia, J., concurring in part and concurring in the judgment).

82 *Id.* (Scalia, J., concurring in part and concurring in the judgment) (quoting Itel Containers Int'l Corp. v. Huddleston, 113 S. Ct. 1095, 1106-07 (1993) (Scalia, J., concurring in part and concurring in the judgment)).

83 *Id.* (Scalia, J., concurring in part and concurring in the judgment) (quoting Itel Containers Int'l Corp. v. Huddleston, 113 S. Ct. 1095, 1106-07 (1993) (Scalia, J., concurring in part and concurring in the judgment)).

claim, the dissent agreed with the Court that it should fail.[84] However, the dissent simply believed that the decision to uphold WWCR taxation in *Container Corp.* should control the result in Colgate's case, as both cases involved the application of WWCR to domestic-based unitary businesses.[85]

However, Justice O'Connor opined that WWCR taxation could not survive a constitutional challenge made by a foreign-based corporation.[86] In her view, WWCR taxation simply created too great a risk of multiple taxation. The dissent believed this risk was a consequence of the inconsistency of California's tax scheme relative to the taxation method adopted by most foreign nations (i.e., AL/SA taxation) and the fact that foreign nations would usually have lower wage rates and property values than California.[87]

III. Background Law

A. *Statutory Law*

1. *California Law*

When Barclays and Colgate were originally subject to California's WWCR taxation method, they had no options as the tax was mandatory.[88] The tax used a three-factor formula based on property, payroll, and sales.[89] Under the WWCR method, a unitary business was taxed on a percentage of its worldwide income equaling the average percentage of the business' property, payroll, and sales located in California.[90] For example, if a unitary business has eleven percent of its payroll in California, three percent of property in the state, and made ten percent of its sales in the state, it would be taxed on eight percent of its worldwide income since that represents the average of its business' payroll, property, and sales. Thus, if that business had worldwide income of $9,000,000, California would levy a $720,000 tax (i.e., eight percent of its worldwide income).

California had also promulgated regulations implementing section 25128 of the California Revenue and Taxation Code.[91] These reg-

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84 *Id.* (O'Connor, J., dissenting in part).

85 *Id.* (O'Connor, J., dissenting in part).

86 *Id.* (O'Connor, J., concurring in part).

87 *Id.* at 2288-90 (O'Connor, J., dissenting). *See supra* note 69 and accompanying text.

88 "[All] business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." CAL. REV. & TAX. CODE § 25128 (West 1992).

California has since amended its tax laws to allow a corporate taxpayer to limit its income to that which is derived from its U.S. operations. CAL. REV. & TAX. CODE § 25110 (West 1992). This is known as the "water's edge" method. *See infra* note 185 and accompanying text.

89 CAL. REV. & TAX. CODE § 25128.

90 *Id.*

91 *See* CAL. CODE REGS. tit. 18, § 25137-6 (1993).

ulations contained extensive reporting requirements. A unitary business was required to file a profit and loss statement for each foreign corporation within the unitary business, in order to enable the Franchise Tax Board to compute the unitary business' tax.[92] Moreover, adjustments had to be made to those profit and loss statements so that it would conform "to the accounting principles generally accepted in the United States."[93] In lieu of preparing a profit and loss statement for each foreign corporation within the unitary business, a "consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission" could be submitted to the Franchise Tax Board.[94]

Undoubtedly, these provisions would have a great impact on a unitary business with numerous foreign subsidiaries. Other provisions within the regulations, however, softened the blow. For instance, the regulations required that the Franchise Tax Board "consider the effort and expense required to obtain the necessary information."[95] In cases where the "necessary data cannot be developed from financial records maintained in the regular course of business [the Board] may accept reasonable approximations" of a unitary business' income.[96] A taxpayer could also request an advanced determination of the effect of certain actions he might take.[97] Additionally, "[f]ailure to request or to obtain a favorable advance determination" would not preclude reconsideration of those same issues at a later date.[98]

2. *U.S. Congressional Action*

The Supreme Court was correct when it found that Congress had repeatedly refused to enact legislation prohibiting WWCR taxation. On numerous occasions Congress considered bills which would have prohibited states from using the WWCR method to tax the foreign members of a unitary business if those members earned a "substantial" amount of their income from outside the United States.[99] However, none of the bills passed. On other occasions, Congress failed to pass bills which would have prohibited states from forcing taxpayers to report any income not subject to federal income tax.[100] These bills would have generally kept the income of foreign-based members of

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92 *Id.* § 25137-6(b)(1)(A).
93 *Id.* § 25137-6(b)(1)(B).
94 *Id.* § 25137-6(b)(2).
95 *Id.* § 25137-6(e)(1).
96 *Id.*
97 *Id.* § 25137-6(e)(2).
98 *Id.*
99 *See, e.g.*, S. 1245, 93rd Cong., 1st Sess. (1973); S. 2173, 95th Cong., 1st Sess. (1978); H.R. 6146, 98th Cong., 2d Sess. (1984).
100 *See, e.g.*, H.R. 11,798, 89th Cong., 1st Sess. (1965); H.R. 5076, 96th Cong., 1st Sess. (1979); S. 1225, 98th Cong., 1st Sess. (1983).

unitary groups from being aggregated with the income of the unitary group.[101] However, these too failed to pass.

President Ronald Reagan, at the height of his popularity, also introduced legislation which attempted to outlaw states from using the income of foreign-based members of a unitary business to compute the income of that business.[102] However, Reagan and supporters of the proposal withdrew support for the bill after California moved to curtail WWCR taxation.[103]

Barclays' claim was also impacted by the Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains.[104] This particular convention was an agreement between the United Kingdom and the United States. In its original form, the treaty explicitly prohibited subnational units such as states and municipalities from "tak[ing] into account" the income of a non-domestic member of a unitary business when it was computing the taxable income of the unitary business.[105] The version of the treaty that included this provision failed to pass.[106] Eventually, the treaty was ratified subject to the reservation that states would not be explicitly prohibited by the treaty from taking into account the income of non-domestic members of a unitary group when it was computing the taxable income of that group.[107]

B. *Case Law*

1. *Early Precedents*

The Supreme Court first addressed a formula-apportionment method of taxation similar to WWCR in *Underwood Typewriter Co. v. Chamberlain.*[108] In that case, the Court was faced with the constitutionality of Connecticut's method of taxing "manufacturing and trading companies."[109] In Connecticut, such companies were taxed on two

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[101] Generally, the federal taxation scheme relies on an AL/SA method. Lewis B. Kaden, *State Taxation of Multinational Corporations*, 32 CATH. U. L. REV. 829, 831 (1983). Thus, a foreign member of a unitary group is presumed to be a separate entity, and its income is simply not taken into account. United States Steel Corp. v. Commissioner, 617 F.2d 942, 947 (2d Cir. 1980). However, under 26 U.S.C. § 482 (1988), the Commissioner of Internal Revenue can allocate income from a subsidiary to a parent group if it can be shown that the parent "has complete power to shift income among its subsidiaries, and has [in fact] exercised that power." Procter and Gamble Co. v. Commissioner, 961 F.2d 1255, 1259 (6th Cir. 1992).

[102] *Reagan Agrees to Bill Banning Unitary Taxation*, *supra* note 12, at 2.

[103] *Federal Unitary Tax Legislation Loses Support During Senate Finance Panel Hearing*, 3 Int'l Trade Rep. (BNA) No. 39, at 1207 (Oct. 1, 1986).

[104] Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5670.

[105] *Id.* at art. 9(4).

[106] 124 CONG. REC. 18,670 (1978).

[107] Proclamation on the Convention for the Avoidance of Double Taxation, Apr. 9, 1980, U.S.-U.K., 31 U.S.T. 5668.

[108] 254 U.S. 113 (1920).

[109] *Id.* at 117.

percent of their annual income earned in the state.[110] The state calculated such income using a formula-apportionment method. If the taxpayer derived its net profits "principally from ownership, sale or rental of real property, or from the sale or use of tangible personal property," the tax was imposed on the proportion of their entire net profits that equaled the proportion of their in-state property relative to their entire property.[111]

The taxpayer in the case, a U.S.-based company, claimed that Connecticut's taxation method violated the interstate Commerce Clause and violated the Due Process Clause of the Fourteenth Amendment because Connecticut was taxing income earned outside the state.[112] The Court rejected the Commerce Clause claim with little elaboration and ruled against the taxpayer on the Due Process claim as well. The Court held that Connecticut was not taxing income earned outside its jurisdiction as:

> the profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States.... 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. It, therefore, adopted a method of apportionment which . . . was meant to reach . . . only the profits earned within the State.[113]

Thus, in its first foray into the area of state formula-apportionment taxation, the Court upheld the state's tax.

In the next case in this area, *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*,[114] the Court faced a formula- apportionment method of taxation applied to a foreign-based business. The petitioner in *Bass* was a British brewery that imported beer into the United States through the cities of New York and Chicago.[115] At issue in the case was New York's method of taxing foreign corporations conducting business in the state. Foreign businesses conducting business both inside and outside New York were taxed on that portion of their net income which equaled "the proportion which the aggregate value of specified classes of the assets of the corporation within the State bears to the aggregate value of all such classes of assets wherever located."[116]

The British taxpayer claimed that the New York tax violated the Due Process and foreign Commerce Clauses as it taxed income earned outside the United States.[117] The Court noted that *Underwood* con-

110 *Id.*
111 *Id.* at 118.
112 *Id.* at 119-20.
113 *Id.* at 120-21.
114 266 U.S. 271 (1924).
115 *Id.* at 278-79.
116 *Id.* at 278.
117 *Id.* at 280.

trolled; as a result the taxpayer's claim failed.[118] The opinion stated that:

> [A]s the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning . . . in England and ending in sales in New York . . . the state was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business.[119]

Before concluding, the Court turned to the taxpayer's argument that it should not be taxed by New York since it posted no net profits within the state for the tax years in question. This argument was rejected on the grounds that merely because a corporation "did not happen to . . . [make] any profit" within a state did not mean it should not be taxed; the Court indicated that as long as the corporation "derive[d] a benefit" from its New York operations it could legitimately be taxed by that state.[120]

In *Hans Rees' Sons v. North Carolina*[121] the Supreme Court finally struck down a state's formula-apportionment method of taxation.[122] *Hans Rees'* addressed North Carolina's one-factor formula-apportionment method of taxation. In that case, a New York corporation conducted manufacturing operations in North Carolina.[123] Forty percent of its output was then shipped to a warehouse in New York for shipment to customers, while sixty percent of the output was shipped, on directions from New York, directly from North Carolina to customers across the country.[124]

In this case, North Carolina taxed that proportion of a corporation's income that equaled the proportion of property owned by the

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118 *Id.* at 280-81. See *supra* notes 108-13 and accompanying text for a discussion of the *Underwood* decision.

119 Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 282 (1924).

120 *Id.* at 284. At first reading this statement appears to make little sense. If a corporation earned no income within a state, that state could not impose an income tax on that corporation. However, the Court appears to be saying in this instance that Bass did in fact earn income from its New York operations; it contributed to the success and profitability of the overall unitary business. Thus, the fact that no *accounting* profits were attributable to the New York operations did not mean that there were in reality no profits at all attributable to the New York operations.

121 283 U.S. 123 (1931).

122 *Hans Rees'* is one of the rare cases in which the Supreme Court has struck down a state formula-apportionment method of *income* taxation. *See* Kaden, *supra* note 101, at 832-33 (discussing the infrequency with which courts have struck state formula-apportionment methods of taxation). The Court has held a local ad valorem property tax on a foreign-based instrumentality of commerce unconstitutional. *See infra* notes 128-42 and accompanying text. The Court has also held that certain unitary formula-apportionment methods of income taxation were unconstitutional as applied to specific taxpayers. *See* F.W. Woolworth Co. v. Taxation and Revenue Dept. of N.M., 458 U.S. 354 (1982) (holding that the unitary formula-apportionment method of taxation could not be used against a corporation engaged in interstate commerce absent a showing that it was a "unitary business"); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982) (holding that the unitary taxation method could not be used against a corporation which was not a unitary business).

123 *Hans Rees'*, 283 U.S. at 126-27.

124 *Id.* at 127.

corporation within North Carolina relative to all property owned by the corporation.[125] Despite the similarity between Connecticut's and North Carolina's taxation schemes, the Supreme Court struck down the North Carolina law stating that it "unreasonably and arbitrarily . . . [attributed to North Carolina] a percentage of income out of all proportion to the business transacted by the [taxpayer] in the state."[126] The ruling was to be based in part on the fact that the taxpayer offered evidence using a method of separate accounting that indicated North Carolina's formula-apportionment method distorted the corporation's income.[127]

2. *Modern Precedents*

Japan Line, Ltd. v. County of Los Angeles[128] is one of the modern landmark decisions in the area of state taxation and foreign commerce. The appellant/taxpayers in that case were six Japanese corporations engaged in the international cargo shipping business.[129] They were dependent on using cargo containers for conducting their shipping operations.[130] These containers were subject to property tax in Japan.[131]

Unfortunately for the appellants, the containers were also subject to tax by California despite the fact that a container's average annual stay in the state was only three weeks.[132] The state taxed property present within its jurisdiction on March 1 of any year; some of the taxpayers' containers were located within the state on that date.[133] The taxpayers contested the tax on Commerce Clause grounds.

California argued that under the four requirements set out by *Complete Auto*[134] for interstate Commerce Clause analysis, the tax should be upheld.[135] The Court did not directly rule on the state's claim but instead set forth a new standard for reviewing alleged burdens on *foreign* commerce. When analyzing alleged obstacles to this type of commerce, the Court stated that, in addition to the *Complete Auto* requirements, "a court must also inquire, 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

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125 *Id.* at 128.
126 *Id.* at 135.
127 *Id.* at 134-35.
128 441 U.S. 434 (1979).
129 *Id.* at 436.
130 *Id.*
131 *Id.*
132 *Id.* at 437.
133 *Id.*
134 *See supra* note 55 and accompanying text.
135 Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 445 (1979).

commercial relations with foreign governments.' "[136]

Under this standard the Court ruled that California's property tax as applied to the foreign-based appellants failed. The California tax was found to violate the first prong of the test because Japan had the "right and the power to tax the containers in full."[137] Thus, any tax California placed on the containers would not only create a risk of multiple taxation, but would in fact produce multiple taxation.[138]

The tax also was found to violate the second prong of the test. On this issue the Court pointed to the Customs Convention on Containers, an international agreement signed by both the United States and Japan.[139] This Convention directly addressed the temporary importation of containers into the two nations.[140] It specifically exempted such containers from "*all* duties and taxes whatsoever chargeable by reason of importation."[141] California's tax, stated the Court, would violate this rule, and thus impair federal uniformity and prevent the United States from "speaking with one voice."[142]

Mobil Oil Corp. v. Commissioner of Taxes[143] followed quickly on the heels of *Japan Line, Ltd.* It addressed the legality of certain aspects of a Vermont income tax as applied to a corporate taxpayer. Vermont imposed an annual income tax on corporations doing business within its borders.[144] The income of the corporation was computed by using a three-factor apportionment formula similar to California's.[145]

The taxpayer in the case, Mobil Oil Corporation—a New York corporation doing business in Vermont—engaged in "integrated petroleum business" and had a substantial number of subsidiaries and affiliates abroad that engaged in similar operations.[146] During the tax years at issue in the case, Mobil received a substantial amount of dividend income from those subsidiaries operating abroad.[147] In calculating Mobil's taxable income, Vermont included the dividends received from the subsidiaries.[148] Mobil challenged the tax as a violation of the

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136 *Id.* at 451.

137 *Id.* at 451-52.

138 *Id.*

139 *Id.* (citing Customs Convention on Containers, art. 2, May 18, 1956, [1969], 20 U.S.T. 301, 304, T.I.A.S. No. 6634).

140 Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 452-53 (1979).

141 *Id.* at 453 (emphasis added).

142 *Id.*

143 445 U.S. 425 (1980).

144 *Id.* at 429.

145 *Id.* The formula was calculated by multiplying corporate income by a fraction; the numerator consisted of the sum of the corporation's Vermont payroll, property values, and sales, while the denominator was three. *Id.* Vermont's tax was different from California's in that Vermont only required a corporation to report its income on its tax returns; a corporation's subsidiaries and affiliates did not have to have their income directly reported on the corporation's tax return. *See id.*

146 *Id.* at 428.

147 *Id.* at 430.

148 *Id.* at 431.

Due Process and Commerce Clauses.[149]

The Court first confronted the taxpayer's Due Process claim. The Court began its examination of the problem by stating that the Due Process Clause only imposed two requirements on state taxes levied on businesses engaged in commercial activities outside of the state: (1) "a minimal connection between the interstate activities [of the business] and the state";[150] and (2) "a rational relationship between the income attributed to the state and the intrastate values of the enterprise."[151] Mobil argued that the Vermont tax failed under this test because the state could not tax income with a "foreign source" (i.e., the dividends received from the corporations operating abroad) and because dividends earned from affiliates and subsidiaries simply could not be taxed.[152]

The Court rejected the taxpayer's first argument by concluding that there was an adequate connection between the corporation's in-state and foreign activities since the corporation's "foreign activites [were] part of [Mobil's] integrated petroleum enterprise."[153] The Court then faced Mobil's second argument. In support of its contention that dividends from its subsidiairies and affiliates should not be included as part of its Vermont taxable income, Mobil argued that the activities of its holding company, in which capacity it received the dividend income, were a separate business from its petroleum enterprise.[154] Nevertheless, the Court found Mobil's argument unpersuasive and held that as "long as dividends . . . from subsidiaries . . . reflect[ ] profits derived from a functionally integrated enterprise, those dividends are income to the parent company."[155]

The Court concluded the opinion by ruling on the taxpayer's Commerce Clause arguments. Looking at the *Complete Auto* requirements,[156] the Court found that the Vermont tax did not violate the interstate Commerce Clause. However, Mobil argued that, under the foreign Commerce Clause, Vermont could not apportion any of the "foreign source" dividend income to Mobil's in-state operations.[157] Mobil believed that Vermont's method of taxing such income simply created too great a risk of imposing multiple taxation on "foreign source income."[158]

To prevent this problem, Mobil proposed that "foreign source" dividend income be taxed only at a corporation's place of incorpora-

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149 *Id.* at 432.
150 *Id.* at 436-37.
151 *Id.*
152 *Id.* at 437-38.
153 *Id.* at 439-40.
154 *Id.* at 440.
155 *Id.*
156 *See supra* note 55 and accompanying text.
157 Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 446 (1980).
158 *Id.*

tion (i.e., New York).[159] The Court did not accept the argument and ruled that the Vermont tax did not violate the foreign Commerce Clause.[160] The Court found further support for this position by noting that Congress had refused to prohibit state taxes on "foreign source" dividend income.[161]

The next important case in the area of foreign commerce and state taxation was *Container Corp. of America v. Franchise Tax Board.*[162] In *Container Corp.* the question arose whether California's WWCR method was constitutional as applied to a domestic-based unitary business with foreign subsidiaries.[163] By a five to three vote, the Court upheld California's tax.[164]

At the outset, the Court discussed the "fairness" of the tax. If the tax was not fair then it would not survive Due Process or Commerce Clause scrutiny.[165] The taxpayer argued that WWCR taxation, unlike AL/SA taxation, ignored the fact that its foreign subsidiaries were significantly more profitable than its domestic subsidiaries and thus unfairly taxed foreign income.[166] The Court responded to that argument by pointing out that WWCR taxation, unlike AL/SA taxation, did not ignore the income generated by "functional integration, centralization of management, and economies of scale." This feat would support the Tax Board's contention that the California operations were contributing to the profits earned by the foreign subsidiaries and should be taxed.[167] The Court, after addressing a similar argument related to the differences in payroll in domestic and foreign operations, concluded that WWCR taxation was fair.[168]

Next the majority confronted the two *Japan Line* factors which are specific to foreign Commerce Clause analysis.[169] The majority conceded that in this case, WWCR taxation, like the tax in *Japan Line,* had resulted in double taxation.[170] Nevertheless, the opinion was able to distinguish WWCR taxation from the property tax struck down in *Japan Line.* First, the tax in *Container Corp.* was on income rather than property.[171] Second, the double taxation here was not the inevitable result of WWCR taxation; instead, it resulted from the fact that most foreign

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159 *Id.*

160 *Id.* at 449.

161 *Id.* at 448-49.

162 463 U.S. 159 (1983).

163 *Id.* at 163.

164 Justice Stevens did not participate in the decision, and Justice Powell wrote a dissenting opinion in which Chief Justice Burger and Justice O'Connor joined. *Id.* at 197 (Powell, J., dissenting).

165 *Id.* at 169.

166 *Id.* at 181.

167 *Id.* (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980)).

168 *Id.* at 184.

169 *See supra* notes 136-42 and accompanying text.

170 Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 169, 187 (1983).

171 *Id.* at 188.

jurisdictions used AL/SA taxation schemes. Even if California switched to that scheme, double taxation might still result.[172] Finally, the tax at issue fell on a domestic parent, whereas the tax in *Japan Line* fell on the "foreign owners of an instrumentality of foreign commerce."[173]

The majority concluded their opinion by ruling on the second prong of the *Japan Line* test. The taxpayer's claim failed on this issue as well. The Court found that California's tax did not implicate foreign policy issues which should be left to the federal government or otherwise violate the one-voice standard. Here, the tax was imposed on a domestic entity rather than a foreign one, the executive branch had not indicated its opposition to the tax by filing an amicus brief, nor were there any indications of congressional intent to ban the tax.[174] Thus, California's WWCR tax was upheld.

The final major case prior to *Barclays* which implicated state taxation and foreign commerce issues was *Wardair Canada, Inc. v. Florida Department of Revenue.*[175] In *Wardair* the constitutionality of Florida's tax on the sale of fuel to common carriers, including airlines, was questioned. The petitioner in that case was a Canadian airline who had been taxed on fuel it had bought in Florida.[176]

The Court engaged in a dormant Commerce Clause analysis to determine the validity of the statute. The petitioner and the United States as amicus curiae, however, limited their attack on the statute to its validity under the second prong of the *Japan Line* test.[177] The petitioner argued that the statute impaired the ability of the federal government to speak with one voice, and supported its argument by pointing to several international agreements.[178] The Court rejected this argument and in fact drew the opposite conclusion from those same contentions: "[T]he international agreements cited demonstrate that the Federal Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax aviation fuel, and thus the case does not call for dormant Commerce Clause analysis at all."[179]

The Court in perusing the agreements noted that one of them had never been officially "endorsed . . . signed, entered into . . . or

[172] *Id.*

[173] *Id.* The Court did not explicitly state why it would matter whether the tax fell on foreign, as opposed to domestic, owners. Possibly, the assumption was that foreign nations have the right to tax the entire value of the property and income of their citizens, whereas they could not do such to non-citizens operating within their boundaries. See *supra* notes 128-42 and accompanying text for a discussion of the *Japan Line* case.

[174] *Container Corp.*, 463 U.S. at 193-97.

[175] 477 U.S. 1 (1986).

[176] *Id.* at 3.

[177] *Id.* at 9-10.

[178] *Id.*

[179] *Id.*

passed by the Executive or Legislative Branch of the Federal Government."[180] The Court also found that in seventy of the bilateral agreements to which the United States was a party, not one of them denied *states* the power to tax aviation fuel.[181] In fact, a U.S.-Canadian agreement limited the tax exemption on the sale of fuel to "*national* duties and charges."[182] The Court believed that these agreements all led to the conclusion that the federal government had acted and thereby acquiesced to the tax.[183] Thus, no dormant Commerce Clause analysis was necessary.[184]

IV. Analysis

A. *Practical Ramifications of* Barclays

Arguably, the sound and fury swarming around California's tax method was much ado about nothing. After all, California had revised its tax code in 1986 to allow corporations to choose between using the WWCR and the "water's edge" method.[185] Moreover, only three U.S. states still applied a mandatory unitary tax scheme method at the time of the litigation.[186] Thus, it would appear that the debate over the validity of California's unitary taxing scheme was largely academic.

Of course, the evidence also suggests that the decision in *Barclays* was of great import. For instance, because of the *Barclays* holding, California will not have to send out $1.5 billion in refund checks, and the state should receive an estimated $500 million in back taxes.[187] In addition, many in the international community fear the Supreme Court's ruling will lead cash-strapped American states to adopt WWCR taxation.[188]

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180 *Id.* at 11.

181 *Id.*

182 *Id.*

183 *Id.* at 12.

184 *Id.* at 12-13.

185 CAL. REV. & TAX. CODE § 25110 (West 1992).

> The " 'water's-edge' method restricts tax allocation methods to the United States as the jurisdictional boundary . . . . In general [it] permits a taxpayer corporation to exclude the income . . . of foreign subsidiaries from the corporation's . . . tax base. [Under § 25110] California could rely only on income derived from permanent establishments of [the taxpayer] in the United States, and not on income derived from wholly foreign interests, to calculate [the taxpayer's] franchise tax.

Colgate-Palmolive v. Franchise Tax Bd., 13 Cal. Rptr. 2d 761, 765 n.4 (Cal. Ct. App. 1992).

186 Paul Laird, *Walk Softly or Carry a Big Carrot*, ALASKA BUS. MONTHLY, Feb. 1987, at 24, *available in* LEXIS, NEWS Library, ABD File. Those three states are Alaska, Montana, and North Dakota. *Id.*

187 Adrian Croft, *California Officials Hail US High Court Ruling*, REUTERS, June 20, 1994, *available in* LEXIS, NEWS Library, REUNA File.

188 Mark Milner & Larry Elliot, *Supreme Court Risks Global Tax Battle*, THE GUARDIAN, June 21, 1994, at 15.

B. Barclays*' Consistency with Precedent*

In some ways *Barclays* is fairly consistent with prior precedent. After all, with the exception of *Hans Rees'*, a state unitary income tax has never been overturned on the grounds that it apportions income unfairly. In fact in *Bass*, the first case to reach the Court on the issue of state unitary taxation of foreign corporations, the court upheld the tax in question.[189] Moreover, since California's WWCR tax had already been upheld in *Container Corp.*,[190] it would have been a blatant violation of the stare decisis principle to overturn the tax at issue in *Barclays*, at least with regards to Colgate's claim.

Yet on closer inspection, it is somewhat suspect to suggest that *Barclays* and the three most recent Supreme Court decisions preceding it on the subject of state taxation of foreign commerce are at all logically consistent. Take for instance the position of the *Barclays* court on the WWCR method and the possibility of multiple taxation. The *Barclays* Court, like the Court in *Container Corp.*, paid little attention to the fact that actual multiple taxation has occurred.[191] According to the Court, any such multiple taxation resulted not from California's taxation method, but from the fact that other nations use a different method of determining the amount of income subject to tax.[192] As a factual matter this may be true, but it was also true in the case of the *Japan Line.*[193] In that case, such a consideration did not keep the Court from finding that the tax scheme unconstitutionally placed a multiple tax on the taxpayers.[194]

Admittedly, the Court is probably right when it says that the alternative to WWCR taxation, the AL/SA method, would not have been able to always avoid placing a double tax on foreign commerce.[195] If different rules under which income is allocated under the AL/SA approach are used by different jurisdictions, there is a strong possibility of double taxation.[196] Nevertheless, it needs to be pointed out that the likelihood of multiple taxation, or lack thereof, has not always been a determining factor in deciding the validity of a state taxation scheme. For instance, the Court chose to strike down a tax in *Japan Line* when it was faced with the choice of either retaining the tax and allowing double taxation or striking it.[197] Yet, in *Barclays* the Court chose to retain the tax when it had to choose between: (1) retaining the tax

189 Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924)

190 *See supra* notes 162-74 and accompanying text.

191 Barclays, *supra* note 1, 114 S. Ct. 2268, 2280 (1994).

192 *Id.*

193 Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 452 (1979). *See supra* notes 128-42 and accompanying text.

194 *Japan Line*, 441 U.S. at 452.

195 *Barclays*, *supra* note 1, 114 S. Ct. at 2280.

196 Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 169, 192-93 (1983).

197 *Japan Line*, 441 U.S. at 453-54.

that had in fact caused double taxation; (2) moving to a tax that very possibly might cause double taxation; or (3) having no tax at all. In fact in *Mobil Oil*, the lack of the existence of any double taxation at all did not prevent the Court from determining whether the tax created too great a risk of multiple taxation.[198] Clearly, these results are not consistent. There might be very good policy reasons to make a legitimate distinction between the property tax at issue in *Japan Line* and the income tax at issue in *Barclays*.[199] Logically, however, little separates the types of double taxation in each case.[200]

Barclays is also somewhat inconsistent with *Wardair*. In *Wardair* the Court had read congressional refusal to enact treaties and laws prohibiting a Florida tax as congressional action.[201] Having found such congressional action, they refused to resort to a dormant Commerce Clause analysis.[202] The California Supreme Court in *Barclays I* seemed to follow the *Wardair* rule exactly, and read the repeated congressional refusal to prohibit WWCR taxation as congressional action precluding resort to dormant Commerce Clause analysis.[203] The Supreme Court's majority opinion in *Barclays* took a different tack. It viewed the congressional refusal to outlaw WWCR taxation as congressional action indicating that WWCR taxation did not impair federal uniformity in an area where such uniformity was necessary, not as congressional action forbidding resort to dormant Commerce Clause analysis.[204] In other words, the Court used the congressional refusal to pass laws in its dormant Commerce Clause analysis, rather than as an excuse to avoid such an analysis. Practically, there may be little difference between the two approaches, but the decision certainly muddies the analytical waters of the Commerce Clause.

C. *Possible Solutions to Problems Posed by* Barclays

Barclays, while perhaps making perfect sense as a practical matter, has created confusion in the Court's rules in the area of the foreign Commerce Clause. After the decision it is unclear when a tax will be deemed to have created impermissible multiple taxation. It is equally unclear when congressional silence constitutes affirmative action precluding resort to dormant Commerce Clause analysis or merely indicates that a tax will withstand dormant foreign Commerce Clause review.

198 Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 444 (1980).

199 *See supra* note 187 and accompanying text.

200 Ironically, the Court could have avoided the double taxation question entirely in *Japan Line* because it had found that the tax failed anyway under the one-voice test. *Japan Line*, 441 U.S. at 452-53.

201 Wardair Can. v. Florida Dept. of Revenue, 477 U.S. 1, 9 (1986).

202 *Id.*

203 Barclays I, *supra* note 37, 829 P.2d 279, 300 (Cal. 1992).

204 *Id.* at 2282-83.

Perhaps the best course of action for the Court is to minimize its analysis in this area. After all, the Court is not equipped to deal with the delicate balancing of domestic and foreign political considerations in the area of taxation of foreign trade. How then should it go about exercising judicial restraint in reviewing cases brought before it under the dormant foreign Commerce Clause? Basically, two choices seem open to the Court: (1) eliminate dormant foreign Commerce Clause review entirely; or (2) restrict the scope of the dormant foreign Commerce Clause.

One commentator, Amy Petragnani, has recently proposed the former approach.[205] She argues that the dormant Commerce Clause has absolutely "no direct support in the text of the Constitution."[206] Instead, the Constitution grants Congress, and not the Judiciary, the power to strike state laws interfering with Congress.[207] Accordingly, she believes that when the Court reviews state laws for their validity under the dormant Commerce Clause, they are making policy decisions that should be best left to the legislature.[208]

Of course, one might counter that the very purpose of the Commerce Clause was to prevent states from enacting discriminatory legislation against either interstate or foreign commerce. Thus, it is the role of the courts to strike down such legislation. Indeed, the historical situation at the time of the framing of the Constitution showed the harm that resulted when states enacted their own, often discriminatory, commercial regulatory laws.[209] The Founding Fathers were themselves well aware of the need for federal rather than state control of commercial relations between the states and with foreign nations. Alexander Hamilton wrote in regards to the subject of foreign commerce that there was "no object, either as it respects the interests of trade or finance, that more strongly demands a federal preeminence. The want of it has already operated as a bar to the formation of beneficial treaties with foreign powers."[210]

Petragnani, however, would counter that abolishing the judicially

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205 *See* Amy M. Petragnani, *The Dormant Commerce Clause: On its Last Leg*, 57 ALB. L. REV. 1215 (1994) (discussing dormant Commerce Clause review and attacking its textual validity under the Constitution).

206 *Id.* at 1237.

207 *Id.* at 1242.

208 *Id.*

209 Another commentator has written about the problems confronting the young nation prior to the adoption of the Constitution:

> Another conflict simmered over trade. Only a handful of the States, New York, Massachussets, and Pennsylvania had good harbors, and the others were dependent on them for their imports—foreign and domestic, staples and luxuries. The port states exploited their advantage mercilessly, slapping heavy taxes on goods needed by neighboring states, driving up their prices while fattening their own treasuries .... The Congress could do nothing, for it was denied the power to regulate commerce.

FRED BARBASH, THE FOUNDING 35 (1987).

210 THE FEDERALIST No. 22 (Alexander Hamilton).

created foreign dormant Commerce Clause does not mean that the federal government will not have power to prevent discriminatory state regulation of commerce. Rather, it will ensure that only Congress—the textual possessor of the power to regulate commerce—strikes such discriminatory laws.[211] Certainly, her argument carries much force. However, there are several shortcomings with her analysis. First, while Petragnani criticizes the judicial activist approach of dormant Commerce Clause analysis, she ignores the judicial activism that it would take to abolish such a long-standing rule. Second, it is not always certain that a popularly elected Congress would always abolish discriminatory state economic legislation. Congress might not strike discriminatory economic legislation of some politically powerful states, while it may strike discriminatory economic laws enacted by politically weaker states. Thus, abolishing the dormant Commerce Clause might not create any more certainty or predictability in determining what state laws will be upheld under the Commerce Clause.

Instead of using the approach advocated by Petragnani, the Court should try to simply confine the scope of its dormant Commerce Clause analysis. Justice Scalia's concurrence in *Barclays* offers a responsible choice for the Court. The Court should only strike a state tax on foreign commerce when it facially discriminates against foreign commerce or when it is indistinguishable from a law the Court has previously declared unconstitutional.[212] These rules would offer clear judicial guidance. They would also enable the business community to ascertain when a law will be upheld, thus assisting them in planning their operations to conform to the law.

In addition to the need for better judicial responses to state laws dealing with state taxation, Congress should legislate in this area in view of the high international stakes involved. Either it should definitively state that WWCR taxation is acceptable, or it should require that states use an AL/SA method like many other nations. It is important not that Congress mandate one system above another, but that Congress *act* under its Commerce Clause powers so as to keep the courts from making rules in the volatile area of international commerce.

V. Conclusion

Barclays and other recent Supreme Court decisions demonstrate an admirable restraint in refusing to overturn state taxation schemes which impact foreign commerce. Unfortunately, the reasoning used to reach such results is not so laudable. The Court still purports, at least at times, to use the dormant Commerce Clause to analyze state

[211] Petragnani, *supra* note 205, at 1242.

[212] *See* Barclays, *supra* note 1, 114 S. Ct. 2268, 2287 (1994) (Scalia, J., concurring) (describing the two situations in which the Court would enforce a self-executing Commerce Clause).

legislation dealing with foreign commerce. Still more troublesome are the inconsistent standards the Court uses in reviewing state taxation schemes and the inconsistent application of these standards to state taxation methods.

In the absence of affirmative congressional action, the best option for the Court is to exercise judicial restraint in its legal reasoning and to refuse to overturn state taxation methods which impact foreign commerce, with the possible exception of a state tax which facially discriminates against foreign commerce. Regardless of the actions of the judicial branch, Congress, as a policy matter, should exercise its plenary Commerce Clause power to ensure greater uniformity in state income taxation methods impacting foreign commerce.

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