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# STATE TAXATION OF MULTINATIONAL CORPORATIONS

*Lewis B. Kaden\**

State governments face the prospect of unprecedented fiscal crisis in the next few years. Under pressure from continuing recession and cutbacks in federal aid, state budget officials reported recently that revenues for the current fiscal year were \$7.9 billion below the projections made just six months ago.<sup>1</sup> Service cuts and tax increases are the order of the day throughout the nation. In these circumstances, any additional threat to anticipated revenue is cause for serious concern. Yet, according to the National Governors Association, constitutional challenges to state taxes on the earnings of multinational corporations could cost the states as much as \$625 million this year.<sup>2</sup>

In our federal system, a state generally has discretion over the design of its tax system as long as its taxes do not infringe upon the constitutional rights of taxpayers.<sup>3</sup> The constitution itself imposes just two explicit limita-

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1. NATIONAL GOVERNORS' ASSOC., FISCAL SURVEY OF THE STATES (1982). In July 1982, the National Conference of State Legislatures reported that a majority of states are beset by "the worst fiscal conditions in 40 years." NATIONAL CONFERENCE OF STATE LEGISLATURES, STATE BUDGET ACTIONS IN 1982 I (1982).

2. MULTISTATE TAX COMM'N, SUMMARY OF STATE RESPONSES TO TREASURY DEPARTMENT QUESTIONNAIRE ON USE OF UNITARY METHOD AND TAXATION OF DIVIDEND INCOME (1982). Thirteen states currently apply a unitary apportionment formula to the worldwide income of multinational corporations: Alaska, California, Colorado, Idaho, Illinois, Indiana, Massachusetts, Montana, New Hampshire, New York, North Dakota, Oregon and Utah. G.A.O., KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED RESOLVING 31 (1982) (Report to the Chairman, House Committee on Ways and Means) [hereinafter cited as G.A.O. REPORT]. The figure of \$625 million represents the official estimate of losses in these states, excluding Illinois, Indiana, Massachusetts, New Hampshire, and Oregon if the Supreme Court decides that the states are precluded from including foreign subsidiary earnings in a unitary tax base subject to apportionment.

3. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-80 (1978); *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). See generally P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION (1981). The Supreme Court has recently restated that "absent congressional action . . . the States' power to tax can be deprived only under the clearest constitutional mandate." *United States v. New Mexico*, 455 U.S. 720, 738 (1982) (citing *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 293 (1976)).

tions on state taxing powers. Absent congressional consent, no state may impose any "duty of tonnage"<sup>4</sup> or any tax on imports.<sup>5</sup> More significant, however, are the constraints imposed on the states by the due process and equal protection guarantees of the fourteenth amendment and by the negative implications of the federal power to regulate commerce.<sup>6</sup> It is well settled that due process obliges a state to ensure that its exercise of the taxing power "bears fiscal relation to protection, opportunities and benefits given by the state."<sup>7</sup> In other words, the state must take care to impose its taxes on activities which have a substantial linkage to the jurisdiction and not on activities entirely unrelated to the state. At the same time, it is clearly established that "net income taxes" are not direct levies on any particular activity of a business. In the context of an income tax applied to a corporation active in many states or foreign countries, the due process question posed is whether the state's tax is fairly related to the activities conducted in the state and the benefits conferred by the state.<sup>8</sup> Under the commerce clause, the requirement is similar. A tax on interstate commerce will be upheld if it satisfies the requirements of due process, does not discriminate against interstate or foreign trade and is "fairly apportioned."<sup>9</sup> In addition, when foreign trade is involved, the state's levy may also be challenged on the basis that it interferes with the national government's capacity to "speak with a single voice" in the conduct of foreign policy.<sup>10</sup>

The requirement that the states "fairly apportion" the tax burden comes into play when the subject or target of the state's action is involved in

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4. U.S. CONST., art. I, § 10, cl. 3. See *Clyde Mallory Lines v. Alabama*, 296 U.S. 261 (1935). The duty of tonnage clause does not bar local charges for specific services such as pilotage or warfage. *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851).

5. U.S. CONST., art. I, § 9, cl. 5. It is well established, however, that a tax on income from exports is not prohibited as a tax on exports. *Peck & Co. v. Lowe*, 247 U.S. 165 (1918). Also the Court recently held that a nondiscriminatory property tax could be imposed on imports so long as they were no longer in transit. *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976).

6. See generally J. HELLERSTEIN & W. HELLERSTEIN, *STATE AND LOCAL TAXATION* (4th ed. 1978); L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 334-74 (1978).

7. *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444.

8. For early statements of the due process test, see *Union Tank Line Co. v. Wright*, 249 U.S. 275 (1919); *Louisville & Jefferson Ferry Co. v. Kentucky*, 188 U.S. 385 (1903). The due process requirement measures the result of the state's action, inquiring whether the tax levied amounts substantially to an unfair deprivation of the taxpayer's property because it lacks a rational relationship to the business activities within the state. See Lathrop, *Due Process Considerations and the Apportionment of Dividend Income*, 16 TAX NOTES 3 (July 5, 1982) (Tax Analysts).

9. *Department of Revenue v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734 (1978); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

10. *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979).

activity both within and without the taxing jurisdiction. For example, a railroad car, a truck or other instrumentality of commerce on which the state attempts to impose an *ad valorem* property tax may be within the state's territory for only part of the time in any tax period. Similarly, a corporation subject to a state income tax may conduct its business both within the state and in other jurisdictions. Some method is obviously needed to ensure that the value being taxed or the activity subject to tax is sufficiently connected to the state to warrant the exercise of its revenue-raising power. In the case of a property tax, various allocation techniques are generally accepted, including an apportionment based on the time spent within the state or the distance traveled on the state's highways or railroad tracks.<sup>11</sup> With respect to a corporate income tax, the most obvious method of apportionment might be a separate accounting for profits attributable to in-state activities. This method is used to calculate federal income tax liability under the Internal Revenue Code,<sup>12</sup> and the Supreme Court has upheld a state's decision to tax on the basis of separate accounts.<sup>13</sup> In many cases, however, separate accounting is neither fair nor practical. A business equipment company, for example, may have its research laboratory in Massachusetts, its manufacturing facilities in Pennsylvania, its distribution warehouse in New Jersey, and retail outlets in California. An oil company may explore for oil and gas off the coast of Louisiana, operate a refinery in Texas, and market its gasoline or heating oil in Maryland. A major department store chain may have its executive and managerial staff in New York, a warehouse in Indiana and its most successful retail outlet in Virginia. In each of these cases, activities in several states contribute to the company's earnings. Businesses tend to operate as a unit with an overall strategy aimed at increasing profitability in the enterprise as a whole. Strategic decisions about the extent of centralized control over purchasing, accounting or financing are based on a calculation of many factors, including the managerial style and preferences of the senior officers. Separate accounting for earnings attributable to the Texas refinery or the Massachusetts laboratory is neither possible nor likely to produce a fair distribution of the tax burden. If the apportionment is based on the firm's internal accounts, there is a potential for manipulation

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11. *Id.*; *Johnson Oil Refining Co. v. Oklahoma*, 290 U.S. 158 (1933) (number of cars in state); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, *aff'd on rehearing*, 166 U.S. 185 (1897); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U.S. 18 (1891) (mileage ration). *But see* *Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968) (mileage formula invalid when taxpayer shows resulting tax is grossly distorted).

12. I.R.C. § 482 (1976).

13. *See, e.g.*, ALASKA STAT. § 43.21.010 (repealed 1981).

of income among the states in order to minimize tax liability. Nor should the corporate form determine tax treatment. Whether the company chooses to operate its diverse activities through divisions, subsidiaries or joint ventures should not determine the constitutional limits of the state's capacity to impose a tax.<sup>14</sup>

In order to find a method of taxation in this kind of situation, most states have adopted a method known as formula apportionment, that allocates corporate profits earned from activities in many states or foreign countries to the taxing jurisdiction. Reasonable apportionment formulas have been consistently upheld by the Supreme Court in cases involving property, net income or franchise taxes.<sup>15</sup> As long as the activities are functionally related so that it is fair to treat the enterprise as a "unitary business," the state may apportion earnings even if the activities take place in many states and foreign countries.

Most typically, an apportionment formula for a corporate income tax applies that proportion of the taxpayer's property, sales and payroll within the state to the company's total earnings in order to determine the amount of net income attributable to the taxing jurisdiction.<sup>16</sup> However, the Court has also approved the use of a single-factor formula, measuring simply the amount of property<sup>17</sup> or sales<sup>18</sup> in the state as compared to overall property or sales. Only rarely has the taxpayer been able to show that the state is, in fact, taxing extra-territorial values or so grossly distorting the amount of tax liability as to warrant an order invalidating a state tax formula.<sup>19</sup> Until last year, the Supreme Court routinely rejected challenges to state income tax apportionment schemes, including cases where apportionment was applied to business enterprises conducted in part in foreign countries.<sup>20</sup> Traditionally, neither due process nor the commerce clause has

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

15. *See, e.g., Exxon Corp. v. Dep't of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897).

16. The three-factor formula is incorporated in the Uniform Div. of Income for Tax Purposes Act, 7 U.L.A. 91 (1957). *See Pierce, The Uniform Division of Income for State Tax Purposes*, 35 TAXES 747 (1957).

17. *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

18. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939).

19. *Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968); *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).

20. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980); *Butler Bros. v. McColligan*, 315 U.S. 501 (1942); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924).

required more than a rational relationship between the in-state activities and the amount of income allocated to the state. Virtually any apportionment formula based on factors such as sales, property or payroll has been sufficient to satisfy the constitutional requirement that the state have a means of roughly approximating the activity in the state to the amount of income subject to tax. The Court had articulated a limiting principle that formula apportionment was appropriate only where the diverse business activities subject to apportionment were part of a "unitary" business.<sup>21</sup> But, until 1982, no taxpayer had succeeded in avoiding formula apportionment by arguing that his business was not sufficiently integrated to fit the definition of a unitary business. Formula apportionment has been upheld regardless of corporate form, the nature of the business or the fact that it was conducted partly through foreign subsidiaries. In two 1980 cases, in fact, the Supreme Court rejected challenges to this method of apportionment. The Court denied Mobile Corporation's attack on Vermont's formula to apportion the company's worldwide income,<sup>22</sup> as well as Exxon's effort to invalidate Wisconsin's inclusion of production and refining income in earnings subject to apportionment, despite the fact that Exxon was engaged solely in retail activity within the state.<sup>23</sup>

Recently, however, an increasing number of states have applied formula apportionment to the worldwide activities of multinational corporations in circumstances which have provoked the opposition of foreign governments and produced a surging of litigation challenging apportionment schemes. The modern multinational corporation is a far-flung enterprise, active in markets scattered throughout the world. Decisions on the location of different facilities are commonly based on a complex set of factors, including financing, government relations, regulation, labor conditions and marketing opportunities. The corporation's activities are usually directed from a central headquarters where strategic decisions are made and communicated to units around the world. Professor Vernon describes the multinational corporation as "a cluster of corporations of diverse nationality joined together by ties of common ownership and responsive to a common management strategy."<sup>24</sup> Most commentators have concluded that the

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21. The term "unitary business" is most often used to describe the circumstance of two or more corporate entities engaged in activities sufficiently interdependent to justify a taxing jurisdiction in treating them as a single enterprise and requiring a combined report of their earnings. See G. ALTMAN & F. KEESLING, ALLOCATION OF INCOME IN STATE TAXATION 101 (1946); Dexter, *The Unitary Concept in State Income Taxation of Multistate—Multinational Business*, 10 URB. LAW. 181 (1978).

22. *Mobil*, 445 U.S. 425.

23. *Exxon*, 447 U.S. 207.

24. Vernon, *Economic Sovereignty at Bay*, 47 FOREIGN AFFAIRS 110, 114 (1968).

typical multinational considers its diverse components "parts of the single global system whose overall success, rather than that of any individual component, is considered critical."<sup>25</sup> Although the degree of centralized control exercised by a multinational depends to a considerable extent on the preference and style of the particular firm, a survey of 127 large American corporations with subsidiaries in western Europe indicates a trend toward increased centralization.<sup>26</sup> More significantly, Professor Solomon found that a corporate commitment to decentralized control may, in fact, be misleading. In one particular case he noted that "a decentralization ideology masks the reality of centralization in which one corporate nerve center devised a common corporate strategy and made fundamental decisions regarding production, market, finance and research. Discipline and continuity was maintained through common training and coordination."<sup>27</sup>

In general, most observers of the multinational corporation believe the extent of centralized control is a function of strategic plans and corporate style. The entity pursues its objectives on a global scale, evaluating opportunities in terms of their potential contribution to the worldwide goals of the enterprise. The location of particular activities and the form in which they are pursued depend upon a multifaceted analysis made by those responsible for directing the corporation.

Two important issues have recently come before the Supreme Court in cases concerning the effects of state taxing decisions on multinational firms. The first concerns the propriety of "unitary" tax treatment for purposes of determining which sources of income are subject to apportionment. In *ASARCO, Inc. v. Idaho State Tax Commission*<sup>28</sup> and *F.W. Woolworth, Inc. v. Taxation & Revenue Department of New Mexico*,<sup>29</sup> both decided in June 1982, the Supreme Court invalidated the inclusion of dividends paid by foreign subsidiaries in an apportionable tax base on grounds that the activities of the taxpayer's foreign affiliates were not part of its unitary business. Second, assuming a business is "unitary," the question arises as to whether the Constitution bars combined reporting of income earned by foreign affiliates with the domestic profits of the taxpayer. In January 1983, the Court heard argument in *Container Corporation v.*

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25. Note, *Multinational Corporations and Income Allocations Under Section 482 of the Internal Revenue Code*, 89 HARV. L. REV. 1202 (1976).

26. L. SOLOMON, *MULTINATIONAL CORPORATIONS AND THE EMERGING WORLD ORDER* 21 (1978).

27. *Id.* at 20.

28. 102 S. Ct. 3102 (1982).

29. 102 S. Ct. 3128 (1982).

*Franchise Tax Board*,<sup>30</sup> an appeal from a California state court decision rejecting the taxpayer's claim that worldwide combined reporting violates the requirements of due process and the negative commerce clause.

#### I. DEFINING A UNITARY BUSINESS: *ASARCO* AND *WOOLWORTH*

In both *ASARCO* and *F.W. Woolworth* the Supreme Court found that foreign subsidiaries of a United States corporation were engaged in "separate and discrete" or "unrelated" business activities, and, therefore, that the dividends received from those affiliates could not be included in the unitary tax base subject to state apportionment. By describing the unitary business principle as "the lynchpin of apportionability," the majority appeared to define the due process requirement of a rational relationship between in-state activity and the amount of income allocated to the state in terms of whether the subsidiaries' contribution to income resulted from "functional integration, centralization of management and economies of scale."<sup>31</sup>

*ASARCO* is engaged in the nonferrous mining business. Its activity is conducted through a large number of affiliates throughout the world, including six foreign companies in which *ASARCO*'s interests range from 34% to 53%.<sup>32</sup> *ASARCO* operated silver mining facilities in the state of Idaho, and its activity in that state represented 2.5% of companywide property, payroll and sales.<sup>33</sup> The Court found insufficient evidence of the "unitizing" factors of ownership, managerial control, and economies of scale, and thereby precluded Idaho from including dividends received from these foreign affiliates in the unitary tax base used to apportion the state's franchise tax. While there was a significant flow of products and intracorporate trade from the subsidiaries to the parent, this did not constitute, in the majority's view, a sufficient justification for unitary treatment.

*F.W. Woolworth* operates chains of retail outlets through affiliates, in a manner similar to that of *ASARCO*'s operations, in various countries as well as throughout the United States. Each affiliate is involved in an identical type of business, but the parent has adopted a decentralized manage-

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30. 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), *prob. juris noted*, 456 U.S. 960 (1982).

31. *F.W. Woolworth Co.*, 102 S. Ct. at 3125 (quoting *Mobil*, 445 U.S. at 438). *See also Butler Bros.*, 315 U.S. 501.

32. *ASARCO*, 102 S. Ct. at 3106 n.2. *ASARCO*'s affiliates were Southern Peru Copper Corp. (51.5%), M.I.M. Holdings, Ltd. (53%), General Cable Corp. (34%) and *ASARCO Mexicana, S.A.* (49%). Three of these affiliates—Southern Peru Copper, M.I.M. Holdings and *ASARCO Mexicana S.A.*—conducted business only outside of the United States.

33. *Id.* at 3105.



ment strategy. Although local autonomy is a product of Woolworth's strategic preferences and style of operation, the Court found that "the *potential* to operate a company as part of the unitary business is not dispositive" in circumstances where the "underlying economic realities" suggest a lack of functional integration.<sup>34</sup> The Justices emphasized the lack of centralized training, accounting controls, lending, purchasing, personnel exchange, central participation in selecting store locations as well as a lack of a "flow of international business."<sup>35</sup> These factors led to the conclusion that the foreign affiliates constituted "discrete business enterprises" separate and unrelated to the activity in New Mexico, the taxing state asserting its right to apportion on a unitary basis.

In *Container Corporation v. Franchise Tax Board*, the taxpayer also challenged the state's inclusion of foreign subsidiary earnings and the base subject to apportionment on grounds that the business was not appropriate for "unitary treatment." Container Corporation had in fact stipulated facts showing a considerable amount of integration, centralized control and economies of scale in the relationship between parent and foreign subsidiaries. Both the parent and the affiliates were engaged in the same line of business. The parent owned a controlling interest in all twenty subsidiaries and a majority of all directors were persons not resident in the local country. The stipulation also showed parental influence over financing, technical services, personnel training, purchasing, controls over proprietary information, major policy decisions, auditing, insurance and legal services, budget reviews, and capital financing. Despite these facts, the taxpayer argued that absence of a significant flow of goods or trade between the subsidiaries and the parent was enough to defeat the state's attempt to "unitize" the business. In other words, Container Corp. sought a ruling that a substantial flow of goods is a *necessary* requirement for a manufacturing or a merchantile enterprise to qualify for unitary tax treatment. While *ASARCO* held that a "flow of goods" alone did not mean that affiliated companies were unitary, Container Corp. argued that this finding should be essential to unitary treatment.

Obviously, the presence of operational interdependence in a case where products are made in one country and sold in another is highly suggestive of the kind of functional integration or contribution of the foreign based activity to domestic earnings that underlies the justification for apportionment. Historically, apportionment was created to deal with problems involving companies that geographically separated manufacturing and

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34. *F.W. Woolworth Co.*, 102 S. Ct. at 3134.

35. *Id.* at 3139.

marketing operations. In *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n* the Court stated this problem meant that "[t]he 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."<sup>36</sup> Fifteen years ago, Professor Hellerstein wrote that this "impossibility" explains not only the origins but also the limits of unitary tax treatment.<sup>37</sup> He noted that nonoperating functions may be centralized but "the costs of these centralized operations can be spread by cost accounting methods regularly used by accountants . . . and do not involve the elusive effort to segregate profits between interdependent stages in operations such as producing in one state and selling in another."<sup>38</sup> Thus, Professor Hellerstein concluded that such centralized nonoperating functions "ought not lay the basis for holding the enterprise unitary . . . [because] so broad a sweep formulary apportionment tends to push distortion and misallocation to unacceptable levels."<sup>39</sup>

Professor Hellerstein's view seems to be carrying the day with a majority on the Supreme Court. As Justice O'Connor noted in her sharply worded

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36. *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 281 (1924).

37. Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 NAT'L TAX J. 487 (1968).

38. *Id.* at 501-02.

39. *Id.* Professor Hellerstein's formulation is quoted at length in Appellant's Brief on the Merits at 48, *Container Corp. v. Franchise Tax Bd.*, 51 U.S.L.W. 4987 (U.S. June 27, 1983). *Mobil* and *ASARCO* both involved the treatment of dividends received from corporate affiliates, while *Container Corp.* concerns the validity of California's combined reporting of earnings from all affiliates. Some comments treat them as separate and distinct issues—the "combination method" issue and the "apportionable income" issue. See, e.g., Brief of Amicus Curiae Multistate Tax Comm'n and Participating States at 9-10 & n.15, *Container Corp.*; Dexter, *Post Oral Argument comments on ASARCO and Woolworth*, 15 TAX NOTES 867 (June 14, 1982); Note, *The Supreme Court 1981 Term, Due Process*, 96 HARV. L. REV. 77, 92-95 (1982). Under this view, *ASARCO* is objectionable because dividends ought to be treated simply as intracorporate transfers, and an emphasis on the "dividend" nature of the unitary business income allows a multinational corporation to manipulate earnings in order to reduce taxes. See Keesling, *The Impact of the Mobil case on Apportionment of Income*, B.Y.U. L. REV. 87, 103 (1981); Peters, *Supreme Court's Mobil Decision on Multistate Income Apportionment Raises New Questions*, 53 J. TAX'N 36, 40 (1980). But the Supreme Court seems to treat both issues the same—whether the activities of the business are sufficiently interpreted to justify combination and unitary tax apportionment. See, e.g., *Russell Stover Candies, Inc. v. Department of Revenue*, 103 S. Ct. 26 (1982), *vacating and remanding Ward Paper Box Co. v. Department of Revenue*, 638 P.2d 1053 (Mont. 1981). A state may decide to use dividends as a rough and available measure of foreign affiliate earnings because of doubts about any other accounting method. The critical inquiry still focuses on the relationship of activity within the state's taxing jurisdiction to activity outside of the state's taxing jurisdiction.

dissent to both *ASARCO* and *Woolworth*,<sup>40</sup> this view may be at odds with the concern over state sovereignty in the interests of federalism evident in other recent opinions. But, whatever the Court's view of the reach of the unitary business principle, Professor Hellerstein's opinion may not be either historically correct or consistent with the practical realities of operating a modern multinational corporation. Since the Bass case was decided in 1924, it has been clearly established that a state may include the earnings of overseas branches in the income base subject to apportionment. The Court also has indicated repeatedly that practical economic circumstances, not the corporate form adopted by the multinational, determines whether it qualifies for "unitary" treatment. Regardless of the form the company adopts, whether it conducts its business through divisions, subsidiaries or joint ventures and whether the activity is limited to the United States or extends to foreign countries, the unitary business principle requires simply that the component parts of the business be so inter-related and interdependent that they form one business, not separate and discrete business enterprises.

This limitation on the state's capacity to use formula apportionment derives its force from the due process requirement that there be at least a connection between the corporation's tax liability and the activity conducted in the state and the benefits conferred by the state. Since a tax on income is not a direct levy on any particular business transaction, the inclusion of different activities into a single tax base is justified only if there exists some degree of interrelationship among the parts. Such a relationship can be shown by evidence that the activities within the taxing state depend upon or contribute to the functions of the business as a whole.<sup>41</sup> When the Court speaks of the unities of function, managerial control, and

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40. *ASARCO*, 102 S. Ct. at 3117; *F.W. Woolworth*, 102 S. Ct. at 3140. Justice O'Connor's dissent was joined by Justices Blackmun and Rehnquist.

41. G. ALTMAN & F. KEESLING, *supra* note 21, at 101. In several states, unitary tax treatment will be applied so long as the business activity outside the state bears a relationship of dependency and contribution to in-state activity. *See, e.g.*, Wisconsin Dep't of Revenue v. Exxon, 90 Wisc. 2d 700, 281 N.W.2d 94 (1979), *aff'd*, 477 U.S. 207 (1980); Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472 (1947); Crawford Mfg. Co. v. State Comm'n of Revenue & Tax, 180 Kan. 352, 304 P.2d 504 (1956). A few state courts do require functional or operational integration. *See, e.g.*, Commonwealth v. Advance-Wilson Industries, 456 Pa. 200, 317 A.2d 642 (1974). At least since 1942 the Supreme Court has consistently emphasized unity of ownership, managerial control and use. *Butler Bros.*, 315 U.S. 501. One commentator seems to find the test of mutual dependency and contribution "a more relaxed standard" than integration. Note, *supra* note 39, at 88-89. But as recently as *Mobil* the Supreme Court noted that a unitary business may have "contributions to income resulting from functional integration, centralization of management, and economics of scale." 445 U.S. at 438. The Court referred to this statement in both *ASARCO* and *Woolworth*. It would appear that the unities of ownership, control and use (including the econo-

economies of scale, it is describing guidelines for determining whether there exists enough interrelationship and mutual dependency to make it "fair" and consistent with due process to combine the activities of the different constituent parts for the purpose of apportioning the tax burden among the states. It is the result that matters, and separate accounting may not be used to impeach an apportionment formula in the absence of evidence that the resulting liability is unfair or excessive.<sup>42</sup>

For example, in *Butler Brothers v. McColgan*,<sup>43</sup> the company operated seven department stores in seven different states, but controlled the operations from executive offices in Chicago. Economies were realized by the technique of centralized purchasing. On a separate accounting basis, the company was able to show that its retail outlet in California showed a net loss, but the California sales contributed to the values produced for the whole enterprise by centralized purchasing, which in turn were critical to the profitability of the business as a whole. This relationship plainly justified the state's determination to allocate some of the income to California by using the apportionment formula based on sales, property and payroll. Evidence of a "flow of goods" indicates the requisite degree of interdependence, but even without it, there may still be more than enough central management and direction to warrant unitary treatment. In a dispersed network of enterprises common to the modern corporation, each decision concerning services, training, financing, or trade is inevitably part of a comprehensive strategy. What should matter for the purposes of due process is the economic relationship among the disparate parts and not the managerial preferences expressed in a particular arrangement. In constitutional terms, the resulting apportionment of tax liability is significant. The proper constitutional inquiry, therefore, is whether an allocation of liability represents a fair approximation of a rational relationship between in-

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mies of scale that result from integration) are examples that define the meaning of the "contribution" required to qualify a business for unitary tax treatment.

42. *Mobil*, 445 U.S. 425; *Exxon*, 447 U.S. 207. *Butler Bros.*, 315 U.S. 501. See Brief of Amicus Curiae Multistate Tax Comm'n and Participating States at 6, *Container Corp.* Container Corp. argued, though, that its separate accounting analysis could be used to impeach formula apportionment so long as it is supplemented by "evidence explaining why the formula is inadequate and persuades an unfair result." In that event, Container Corp. maintained that "at a minimum, the burden of proof shifts to the state." Appellant's Reply Brief at 12 n.13, *Container Corp.*. See *Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317 (1968); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931). In fact, both parties seem to agree that the taxpayers must show that formula produces an "unfair result." That is the essence of the due process test. An analysis of separate accounting results alone will not be enough. The taxpayers and the Multistate Tax Commission differed sharply on the issue of whether the company had made the required showing.

43. 315 U.S. 501 (1942).

state activity and the entire enterprise or whether the relationship is *grossly distorted*. Making fine distinction among *ASARCO*'s foreign subsidiaries based upon the degree of parental control evident in the makeup of the board of directors or between *Woolworth*'s operating divisions and its foreign affiliates based on the extent of managerial autonomy misses the point. Due process requires only that the earnings allocated bear a fair relationship to the amount of in-state activity. In this sense, the definition of a unitary business or apportionable sources of income tends to merge with the underlying due process issue presented in *Container Corporation*. That is, does combined worldwide reporting by a multinational excessively distort the income attributed to the taxing state or interfere with the need for national uniformity in the exercise of foreign policy?

## II. COMBINED WORLDWIDE REPORTING

Along with twelve other states, California requires a unitary business to report the earnings of all its affiliates throughout the world on a combined basis. The combined income is then apportioned based on the ratio of sales, property, and payroll in California to worldwide totals for these three factors.<sup>44</sup> *Container Corp.* objected to the inclusion of its foreign subsidiaries' income in the unitary base. In the three tax years involved in the case, the company reported worldwide earnings averaging \$41.7 million based on its internal accounts.<sup>45</sup> California's requirement for combined reporting had the effect of increasing the amount allocated to the United States from \$28 million to \$32 million a year and the income attributed to California from an average of \$3 million to \$3.4 million.<sup>46</sup> The state applied its franchise tax rate to that revised amount of net income. The taxpayer argued that the obligation to include earnings from foreign subsidiaries in the apportionable tax base violated due process by distorting the income fairly attributed to California because lower unit payroll costs and other differences made its overseas activities significantly more profitable than its United States operations. The taxpayer also argued that the combined report violated the foreign commerce clause because (1) it resulted in double taxation of foreign earnings already taxed

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44. This is the same three-factor apportionment formula used by at least thirty nine states. See G.A.O. REPORT, *supra* note 2, at 13.

45. Appellant's Brief on the Merits at 17, *Container Corp.* (citing Schedule VI to Exh. 1, Stip. re testimony, Jr. App. 109-13). In *Container Corp.*'s reply brief at appendix A, the chart comparing arms-length earnings and apportionment earnings is restated by the taxpayer, based upon taxable separate accounting for *Container (U.S.)* and book separate accounting for the foreign subsidiaries. This "restatement" produces a combined average annual income of \$45.137 million for the years 1913-1965.

46. *Id.* at 16.

abroad; (2) it interfered with the national interest in uniformity in the conduct of foreign policy; and (3) it was preempted by the provisions of bilateral international treaties and other principles of international law.<sup>47</sup>

But for the radiating implications from the *ASARCO* and *Woolworth* decisions, one would think the taxpayer faced a difficult task in establishing gross distortion under the due process clause. Assuming that its business is unitary, previous Supreme Court decisions have suggested that foreign income may be included in a tax base subject to apportionment, whether those earnings are the profits of foreign divisions or intracorporate dividends paid by separately incorporated subsidiaries.<sup>48</sup> Thus, a facial attack on the California apportionment statute should not succeed, and *Container Corp.* has the obligation to show by specific evidence that the formula grossly distorts the amount of its income attributed to the state of California. On this point, the Multistate Tax Commission in its brief as amicus curiae effectively rebuts the taxpayer's proof.<sup>49</sup> The company's profits showing internal separate accounts are not necessarily equal to taxable income under the Internal Revenue Code or earnings subject to tax under the laws of the foreign countries in which the company does business. Nor is it appropriate to use internal accounts in circumstances where a parent corporation can determine for itself the extent to which its subsidiaries are charged for various centralized services or equipment. The wage cost differences in foreign operations alone should have no more bearing under the due process clause than a comparable argument against apportionment of earnings by combining activity in various states within the union.<sup>50</sup> Moreover, a three factor apportionment formula has tended to produce an average approximation of income producing activity within the state. One factor, such as payroll, can not be taken separately to prove distortion.<sup>51</sup> Even if the company's profitability based on investment is greater abroad, this evidence alone fails to substantiate a claim of distor-

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47. *Id.* at 21-36.

48. *Mobil*, 445 U.S. 425 (1980); *Bass*, 266 U.S. 271.

49. The Multistate Tax Commission is the administrative agency of the Multistate Tax Compact, which is a device for achieving uniformity and cooperation among the states in tax administration. Currently, 19 states and the District of Columbia have subscribed to the compact as full members and 14 other states have entered as associate members. The Court rejected a constitutional challenge to the compact in *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978).

50. Compare Appellant's Brief on the Merits at 15, *Container Corp. with Brief of Amicus Curiae Multistate Tax Comm'n and Participating States* at 16-17, *Container Corp.* The taxpayer cited its own study showing unit labor cost in its Cali, Columbia plant was only about 40% that of its California facilities.

51. See *Norfolk & Western Ry. v. North Carolina*, 297 U.S. 682, 688 (1936); *North American Cement Corp. v. Graves*, 299 U.S. 517 (1936).

tion. Multinational corporations frequently conduct research and development programs in domestic facilities to the point where they have a proven product before expanding production and marketing in other countries. In such circumstances, an allocation based on relative profitability as a factor of investment might itself misrepresent the contribution of domestic activities to those worldwide earnings.

The taxpayer in *Container Corp.* argued at length that it had produced evidence showing why the formula was inadequate and produced an unfair result and that in circumstances where such evidence is produced, the burden of proof shifts to the state.<sup>52</sup> The company conceded that separate accounts by themselves do not establish unfairness, and that the Court must examine the results produced by the formula. The Multistate Tax Commission argued in its brief that the relevant comparison was between Container Corp's United States source federal taxable income as reported to the IRS and the company's combined income apportioned to United States sources under the California formula. By this analysis, it calculated the difference for the years in question as only \$1.4 million, or approximately 3.23% more earnings allocated to United States activity under the California apportionment formula than is attributed to the United States for federal income tax purposes. Since the California formula allocates 8% of worldwide income to the state, the actual result is an increase in net income tax by California of an average of \$115,000.<sup>53</sup> According to the Commission, the difference in tax resulting from the state's formula is "*de minimus* particularly when California's net income tax is deductible for federal income tax purposes. Furthermore, if the foregoing adjustments take into account foreign source income which is included in federal taxable income and the difference between federal depreciation and California depreciation deductions, this slight difference disappears."<sup>54</sup> If this analytic approach is sound, no case of gross distortion can be shown.

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52. Appellant's Reply Brief at 12 n.13, *Container Corp.* and Appellant's Brief on the Merits at 20, *Container Corp.* (citing as *Norfolk & Western Ry.*, 390 U.S. 317, 329.) In fact, the Court in *Norfolk* stated that

when a taxpayer comes forward with strong evidence tending to prove that the . . . formula will yield a grossly distorted result in its particular case, the State is obliged to counter that evidence. . . . If it fails to do so and if the record shows that the taxpayer has sustained the burden of proof to show that the tax is so excessive as to burden interstate commerce, the taxpayer must prevail.

*Norfolk & Western Ry.*, 390 U.S. at 329.

53. Brief of Amicus Curiae Multistate Tax Comm'n and Participating States at 19, *Container Corp.*

54. *Id.* California Law provides for apportionment relief in the event the formula produces an unfair result out of line with the taxpayer's business activity in the state. CAL. REV. & TAX CODE § 25137 (West 1979). *Container Corp.* did not request this form of relief.

An evaluation of this kind of evidence is, however, a complex task, requiring a more technical analysis than the Court may be able to provide. State tax formulas are not the only context in which the Court is called upon to deal with complex economic or technical information. But this area scarcely lends itself to the kind of broad generalizations common to due process jurisprudence. The state of California argued that there should be a presumption favoring the state's taxing power and that the taxpayer has the burden to show gross distortion by clear evidence. If this is the test, Container Corp. should have long odds against it, at least on the due process argument.

The state's problems may be greater, however, in the foreign commerce clause issues. Decisions under the commerce clause are, of course, subject to congressional override.<sup>55</sup> In an area like state tax apportionment applied to multinational corporations where the Court might justifiably be concerned about the effect of state actions conflicting with the conduct of foreign policy, the possibility that a judicial ruling may stimulate action in Congress should provide some comfort to the Justices as they consider the state's formula. Indeed, in *ASARCO* and *Woolworth*, Chief Justice Burger concurred separately to emphasize his conviction that the decision should be grounded on the negative commerce clause and not on the fourteenth amendment, and explicitly invited Congress to consider the problem of state tax apportionment.<sup>56</sup> Although Congress has debated proposals in this area, and the General Accounting Office has conducted numerous studies of state tax apportionment, the legislature has not been able to forge a consensus sufficient to enact uniform rules.

The most recent case involving the foreign commerce clause as a constraint on state and local taxing authority is *Japan Line Ltd. v. County of Los Angeles*.<sup>57</sup> A Japanese company owned containers that were physically located for at least part of the year within the Los Angeles port. The

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55. In *Moorman Mfg.*, 437 U.S. 267, 280, the Court said "[i]t is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income." See also *Mobil*, 445 U.S. at 449. In contrast, Congress is generally precluded from authorizing state actions inconsistent with the requirements of due process under judicial constitutions of the fourteenth amendment. See *Oregon v. Mitchell*, 400 U.S. 112 (1970); *Katzenbach v. Morgan* 384 U.S. 641 (1966). Cohen, *Congressional Power to Interpret Due Process and Equal Protection*, 27 STAN. L. REV. 603 (1975); Monaghan, *Foreword: Constitutional Common Law*, 89 HARV. L. REV. 1 (1975); Cox, *Foreword: Constitutional Adjudication and the Protection of Human Rights*, 80 HARV. L. REV. 91 (1966).

56. 102 S. Ct. at 3115 n.23. The GAO study issued in 1982 indicated that proposals for a uniform system of interstate taxation have been introduced every year since 1965. See G.A.O. REPORT, *supra* note 2, at 6.

57. 441 U.S. 434 (1979).



Supreme Court held that application of the tax, even if fairly apportioned in relation to the amount of time in the jurisdiction, violated the negative commerce clause because it resulted in double taxation of property already fully taxed in Japan and because it interfered with the nation's capacity to speak with a single voice in the conduct of foreign trade and foreign affairs. *Japan Line*, however, involved a property tax on an instrumentality owned by a foreign company and used exclusively in foreign trade. The Court has recently questioned the relevance of the *Japan Line* opinion to the apportionment of corporate income taxes. In *Mobil* the Court stated:

[Mobil's] attempted analogy between this case and *Japan Line* strikes us as forced. That case involved ad valorem property taxes assessed directly upon instrumentalities of foreign commerce. As has been noted, the factors favoring use of the allocation method in property taxation has no immediate applicability to an income tax.<sup>58</sup>

Unlike a property tax, income taxes are not direct levies on commercial activity. Nevertheless, some of the reasons supporting the *Japan Line* decision, including the fear of recrimination from other taxing authorities and the risk of multiple burdens of taxation, might be grounds for concern about income taxes. At first blush, the possibility of double taxation does seem to exist when the overseas earnings included in an apportionable income base have already been subjected to tax in the foreign country in which the activity takes place. In *Japan Line*, the container itself had actually been subjected to full property taxation in Japan. Any ad valorem levy in the United States would, therefore, inevitably create multiple tax burdens. The underlying concept of income apportionment by formula, however, belies the double taxation argument. Formula apportionment does not aim at taxing extraterritorial activity. Rather, its function is to make available to taxing officials a technique for approximating the value of in-state activities. When the diverse components of a business each contribute to the combined profits, the formula looks to certain objective factors by which to measure a fair proportion of income borne by in-state activity in relation to the total enterprise and then uses that ratio to allocate a part of the combined earnings to the taxing state. The critical inquiry in each case, then, is whether a formula excessively distorts the value of the business carried on in the state by attributing too much income to that activity. If it does not have that kind of distorting effect, then, by definition, the apportionment formula produces a fair approximation of in-state values as measured by a fair and reasonable apportionment

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58. 445 U.S. at 448.

formula. The only multiple burdens in such a case are those imposed as a result of a federal system which accepts the prospect of taxation by both federal and state governments, and limits the effect of this double taxation by making state payouts deductible from federal taxable income.

The fact that overseas earnings have been taxed by foreign tax collectors cannot change this result. If the foreign country uses separate, arms-length accounting or some formula other than sales, payroll and property, there will be some distortion in the allocation of income to different jurisdictions, but the same result will occur if one state in the union uses separate accounts or a single factor formula, options explicitly approved by the Supreme Court in earlier cases.<sup>59</sup> Seen this way, in the case of income taxation at least, the double taxation argument merges into the due process question of gross distortion.

The argument that formula apportionment for purposes of state income taxes interferes with the conduct of foreign policy also has initial appeal. Where a unitary tax with worldwide combined reporting is imposed on a foreign parent which has domestic affiliates in the taxing state, bilateral treaties may limit the state's authority to apply its apportionment formula. That issue was raised directly in *Shell Petroleum N.V. v. Graves*<sup>60</sup> in which the United States Court of Appeals for the Ninth Circuit recently affirmed a district court ruling dismissing Shell's complaint.<sup>61</sup> Shell N.V., a Netherlands multinational, with its domestic affiliates, held a substantial interest in two United States companies doing business in California. The district court held that Shell lacked standing to protest assessments against the taxpayers, and that the state's administrative procedures had not proceeded far enough to make the controversy ripe for constitutional adjudication. Domestic treatment for tax purposes of a foreign domiciliary corporation is an issue which may be governed by the provisions of various bilateral treaties for the avoidance of double taxation. The district court judge in *Shell Petroleum* indicated that the United States-Netherlands convention against double taxation did not give a Dutch corporation the right in its capacity as shareholder to assert claims on behalf of its American subsidiary. But some observers read these tax conventions to require that state governments, as well as the United States, adopt the separate accounting method for the calculation of earnings subject to tax.<sup>62</sup> The treaty provisions which generally refer to "nationals and companies" of the foreign country, however, may not apply to subsidiaries incorpo-

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59. See, e.g., *Moorman Mfg.*, 437 U.S. 267; *Bass*, 266 U.S. 27.

60. No. 82-4535 (6th Cir. Jun. 30, 1983).

61. No. 81-4302 (N.D. Cal. Sept. 23, 1982), *aff'd*, No. 82-4535 (6th Cir. Jun. 30, 1983).

62. See, e.g., Brief of Amicus Curiae Shell Petroleum N.V. at 8-9, *Container Corp.*

rated in the United States.<sup>63</sup> Last term, in a case testing the allocation of employment discrimination regulations to a domestic subsidiary of a Japanese company, the Supreme Court ruled that the United States affiliate was not an extension of a foreign parent for purposes of protection under the treaty between Japan and the United States.<sup>64</sup> Therefore, to permit a state to require combined reporting of worldwide earnings where the foreign parent conducts business in California through a separately incorporated subsidiary but not where it conducts that same business itself seems inconsistent with the Court's repeated warnings that economic realities, and not corporate form, should govern cases involving state taxing power. Moreover, a strong argument can be made that the bilateral tax treaties uniformly accept state taxation under reasonable apportionment formulas, and anticipate that the Supreme Court will give meaning to the constitutional requirement of "reasonableness."<sup>65</sup> In fact, the Senate recently rejected a treaty provision which would have prevented the use of formula apportionment by the states in circumstances where a British company had contact with the United States only through a domestic subsidiary.<sup>66</sup>

At least in cases involving a domestic parent corporation, there should be considerable doubt whether the double taxation treaties can properly be read to limit the state's otherwise acceptable use of formula apportionment. In oral argument last year, the Solicitor General of the United States argued the formula apportionment of unitary business income including overseas earnings "does not violate any provisions of any particular treaty."<sup>67</sup> Except for protections against discrimination,<sup>68</sup> the double taxation treaties exclude United States state and local governments from their application and reciprocally anticipate the imposition of taxes by subnational units of the foreign government as well.<sup>69</sup> While these treaties gener-

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63. See, e.g., Convention Between the Government of the United States of America and the Kingdom of the Netherlands For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Certain Other Taxes, signed at Wash., D.C., Apr. 29, 1948, 62 Stat. 1757, T.I.A.S. No. 1885, as amended by the Supplementary Convention, signed at Wash., D.C., Dec. 30, 1965, 17 U.S.T. 891, T.I.A.S. No. 6051.

64. *Sumitomo Shogi America, Inc. v. Avagliano*, 457 U.S. 176 (1982).

65. See Appellee's Brief on the Merits at 124-26, *Contain Corp.*

66. *Tax Treaties With the United Kingdom, the Republic of Korea, and the Republic of the Philippines: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. (1977).

67. Transcript at 18, *Chicago Bridge & Iron Co. v. Caterpillar Tractor*, 51 U.S.L.W. 3937 (Jul. 6, 1983), *dismissing appeal from* 84 Ill. 2d 102, 417 N.E.2d 1343 (1981).

68. See, e.g., Friendship, Commerce and Navigation Treaty between the United States and the Kingdom of the Netherlands, art. X, XI, para. 4, signed at the Hague, Mar. 27, 1956, 8 U.S.T. 2043, T.I.A.S. 3942.

69. For example, the Treasury Department's comments on a proposed Convention be-

ally provide that neither country will tax income not "reasonably allocable or apportionable" to the taxing jurisdiction, the State Department has regularly noted that this language does not apply to United States companies and that it does not bar formula apportionment by the states under formulas consistent with the Supreme Court's decision in *Mobil*.<sup>70</sup> Combined reporting of worldwide income for state apportionment does not frustrate the achievement of federal objectives in foreign policy as those goals are expressed in statutes or treaties having the effect of law, and the Court must treat the issue under the negative commerce clause and not under preemption cases.

Retaliation by foreign governments, however, is possible as unitary taxation is adopted by more states. The recent spread of combined reporting requirements has provoked response in several foreign capitols. Last year Parliament debated the possibility of a reciprocal unitary tax on United States companies doing business in Britain.<sup>71</sup> The Netherlands government is participating in *Shell Petroleum*.<sup>72</sup> Nonetheless, careful analysis suggests that if a state apportionment formula passes the due process test on the basis of an examination of the resulting liability, it should not be found to increase the risk of multiple tax burdens or to interfere with the conduct of foreign policy.

These arguments might be thought to support a prediction that California's application of the unitary tax and combined reporting should be upheld. But the widespread use of combined reports among the states in recent years has, in fact, created considerable controversy, notwithstanding the fact that foreign governments were generally silent at the time the Court decided *Bass* and *Mobil* and rejected similar arguments concerning the inclusion in a unitary tax base of foreign earnings. Perhaps as a result of this pressure, the Solicitor General appeared on behalf of the Reagan Administration in the unitary tax case argued last term and urged

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tween the United States and the U.S.S.R. for the Avoidance of Double Taxation included the following statement:

The taxes imposed by the Union Republic of the Soviet Union (comparable to states of the United States) are not concerned by the convention because in keeping with the post United States policy, the taxes of the state and local governments of the United States are excluded from the scope of the convention, except for purposes of article X (non-discrimination).

See Appellee's Brief on the Merits at 125-27, *Container Corp.*

70. *Id.* at 126 n.31. See *Exxon Corp. v. Wisc. Dept. of Revenue*, 447 U.S. 207 (1980).

71. House of Commons, Official Report, 27 April 1982, vol. 22, no. 105, C. 823-8.

72. See Brief of the Government of the Kingdom of the Netherlands as Amicus Curiae, *Shell Petroleum*. Japan also filed a Brief amicus curiae. On June 29, 1982, the government of Belgium, acting on behalf of the European Economic Community, protested to the State Department that apportionment of worldwide earnings was "entirely unsatisfactory."

the Court to find that "the combined apportionment method applied to a unitary business with foreign corporate constituents is barred by the commerce clause [because] it creates a substantial risk of international multiple taxation and impairs federal uniformity in the conduct of foreign relations."<sup>73</sup> The nation's governors promptly protested this appearance, arguing directly to President Reagan that the federal government could not ask the states to take on more responsibility for public services and at the same time deny them access to the unitary business tax as a source of revenue.<sup>74</sup>

Given a proper understanding of the purpose and workings of formula apportionment, the Solicitor General's arguments about multiple tax burdens do not seem persuasive. Nor is his concern about disturbing the "uniform international custom" of separate income accounting convincing. Formula apportionment by the states, so long as it is nondiscriminatory and reasonable, has been a feature of United States tax policy since the 1920's and an accepted backdrop in every bilateral negotiation of tax treaties. Yet, the Administration's plea that taxation of multinational business ought to be a matter over which "the freedom of the states . . . may have to yield to an overriding national interest in uniformity"<sup>75</sup> is more important. The issue then becomes whether a national rule should be formulated by the Court or Congress. The current confusion in international trade, caused in part by the unitary tax coupled with the prospect of its application by the states to foreign parent corporations, suggests the need for legislative attention. The growing complexity of applying apportionment formulas to widely disbursed business activities should at least argue against wide variations in the design of formulas by individual states. The Multistate Tax Compact, administered by the Multistate Tax Commission, was upheld by the Supreme Court against constitutional challenge because the Justices recognized "that as applied to multistate businesses, traditional state tax administration was insufficient and costly to both state and tax payer."<sup>76</sup> The Multistate Tax Compact includes the Uniform Division of

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73. Memorandum for the United States as Amicus Curiae at 12, 13, *Chicago Bridge*. The Solicitor General acted after consultation with the Departments of State, Treasury and Commerce and the United States Trade Representation. On Dec. 17, 1981, the Chancellor of the Exchequer of the United Kingdom specifically requested that the United States government participate in the *Chicago Bridge* case.

74. See letter from Governor Lamar Alexander to President Reagan, Feb. 25, 1982; letter from Governor Richard Swelling to President Reagan, Aug. 3, 1982, addendums B & C to Brief of National Governors Assoc. and Hawaii as Amicus Curiae, *Container Corp.*

75. Memorandum of the United States as Amicus Curiae at 17, *Chicago Bridge* (quoting *Moorman Mfg.*, 437 U.S. 456.)

76. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 456 (1978). The challenge was prompted by the decision of the Multistate Tax Comm'n in 1972 to set up a Joint Audit Program.

Income for Tax Purposes Act<sup>77</sup> which incorporates the three factor formula for apportionment based on sales, property and payroll.<sup>78</sup> But this Uniform Act is effective only in states which choose to join the compact or independently enact a similar formula.<sup>79</sup> For many years, Congress has had on its agenda proposals to impose uniform rules for apportionment on the states. The legislative chamber is the appropriate forum for debating the arguments raised by cases like *Container Corp.*<sup>80</sup> and *Shell Petroleum N.V.* Moreover, the Constitution plainly anticipates that the Court's judgments concerning the negative commerce clause will be subject to legislative override.

Congress has not yet been able to act on this issue, however, and the prospects for enactment are not good. Regardless of the Court's holding in the pending cases or those likely to arise in the future, the area of state taxation of multinational corporations would benefit from a more thoroughgoing consideration by the political branches of government. Congress has the authority to guarantee uniformity and determine the content of the uniform rules governing reasonable apportionment of income among the states. Legislative attention to that task would advance the interests of both the nation and the states.

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77. 7 U.L.A. 91 (1957). This Act was first promulgated in 1957 by the National Conference of Commissions on Uniform State Laws.

78. Uniform Division of Income for Tax Purposes Act §§ 4-8, 7 U.L.A. 91 (1957)..

79. See G.A.O. REPORT, *supra* note 2. Thirty-nine states now apply the three-factor formula. See STATE AND LOCAL TAXES SERV. (P-H) para. 1046.

80. In 1965, a House Committee recommended strict curbs on state apportionment. H.R. 11798, 89th Cong., 1st Sess. (1965). For an extensive review of the proposals made in the years between 1965 and 1973, see *Hearings Before the Subcomm. on State Taxation of Interstate Commerce, Senate Finance Comm.*, 93d Cong., 1st Sess. (Sept. 18-19, 1973); Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335 (1976). See also *Chicago Budge & Iron Co. v. Caterpillar Tractor*, 51 U.S.L.W. 3937 (July 6, 1983).

