



1-1-1993

California's Franchise Tax Board: A Bull in the International China Shop. Barclays Bank International, Ltd. v. Franchise Tax Board

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California's Franchise Tax Board: A Bull In The International China Shop.¹ *Barclays Bank International, Ltd. v. Franchise Tax Board*

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I. INTRODUCTION

Federalism² has been a constant source of controversy in the United States dating back to the failure of the Articles of Confederation.³ One of the primary reasons federalism causes so much controversy between the federal and state governments is that federalism requires a balancing of an interest in a unified national approach to government with the competing interest in state sovereignty.⁴

1. *Hearings Before the Senate Comm. on Foreign Relations, 95th Cong., 1st Sess. (1977)* (statement of Valentine Brookes, Partner, Brookes, Brookes & Vogel).

2. Federalism refers to: "a system of government wherein power is divided by a constitution between a central government and local governments, the local governments maintaining control over local affairs and the central government being accorded sufficient authority to deal with national needs and affairs." BARRON'S LAW DICTIONARY 186 (3rd ed. 1991).

3. Philip M. Tatarowicz & Rebecca Mims-Velarde, *Symposium on State and Local Taxation: An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 VAND. L. REV. 879, 881 (1986).

4. *Id.*

One of the most controversial areas regarding the balancing involved in federalism pertains to interstate and foreign commerce as controlled by the Commerce Clause of the United States Constitution.⁵ A common and continuing problem of constitutional interpretation of the Commerce Clause has been adjusting the demands of the individual states to regulate and tax corporations, specifically multinational corporations. This is especially difficult in light of the multistate nature of the United States.⁶ In *Barclays Bank Int'l, Ltd. v. Franchise Tax Bd. (Barclays)*,⁷ the California Supreme Court's decision allowed California's Franchise Tax Board, in effect, to ignore federal treaties and executive branch directives⁸ concerning how a state should tax foreign parent unitary⁹ multinational businesses.¹⁰ The California Supreme Court reasoned that since Congress has been silent¹¹ on the issue of state taxation of foreign parent unitary multinational businesses, Congress has manifested an affirmative intent not to prohibit the states from employing formula apportionment¹² when taxing the income of these businesses.¹³ Barclays Bank is such a business.¹⁴ The California Supreme Court concluded that the California Franchise Tax

5. *Id.* The Commerce Clause states: "The Congress shall have Power . . . To regulate commerce with foreign nations, and among the several States, and with the Indian Tribes." U.S. CONST., art. I, § 8, cl. 3. For the purpose of this Note, the phrase Commerce Clause is to be interpreted as commerce among the several states. The phrase Foreign Commerce Clause refers to commerce with foreign nations. Additionally, the terms Dormant Commerce Clause and Dormant Foreign Commerce Clause refer to the ability of the Commerce Clause to prohibit states from certain actions despite the lack of congressional legislation on the subject.

6. *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 532 (1959) (Brennan, J., concurring).

7. 2 Cal. 4th 708; 829 P.2d 279; 8 Cal Rptr. 2d 31 (1992). The text of the Third District Court of Appeal holding was superseded by the California Supreme Court on February 18, 1993, and pursuant to CAL. RULES OF COURT CODE §§976, 977 (Deering 1993), cannot be directly cited. Therefore, all subsequent references throughout this note will be memorializing that decision. The text can be located on electronic database and is available in LEXIS at 1990 Cal. App. LEXIS 1256, and WESTLAW at 59 U.S.L.W. 2384, and is on file at McGeorge School of Law, University of the Pacific, *The Transnational Lawyer*.

8. *Barclays*, 2 Cal. 4th at 712. The multitude of executive branch treaties and directives display a preference for a different taxation method than California uses. See *infra* note 101 and accompanying text (discussing the federal directive on this topic).

9. Throughout this note the term unitary refers to a more or less fully integrated business. A fully integrated business is characterized by the business' possession of its sources of supply, continuous control of production, and distribution from raw materials to diversified finished products. In light of these characteristics, a fully integrated business is capable of operating completely independently. See *infra* part II.A.1 and accompanying notes (discussing use of the term unitary).

10. *Barclays*, 2 Cal. 4th at 712. Throughout this Note, the term multinational business refers to a business which conducts business in more than one nation. The term foreign parent refers to a business which is headquartered out of or has the majority of its operations in a foreign nation.

11. See *id.* at 733 (noting that the legislature's silence denotes an affirmative intent not to prohibit certain types of state taxation in this area).

12. Formula apportionment is a taxation method which relies on a mathematical generalization to distribute a fair share of income or taxable value among taxing jurisdictions. *Id.* at 713. California uses a variation of the formula apportionment method called the three-factor formula. See *infra* notes 43-45 and accompanying text (discussing the three-factor formula).

13. *Id.* at 712.

14. *Id.*

Board's use of its three-factor formula,¹⁵ when taxing the income of Barclays Bank, did not violate the Foreign Commerce Clause of the U.S. Constitution.¹⁶

This Casenote examines the opposing arguments in *Barclays Bank International Ltd. v. Franchise Tax Board*. Part II of this Casenote discusses the legal background and developments leading up to *Barclays*.¹⁷ Part III discusses the decision of *Barclays*.¹⁸ Part IV analyzes the competing arguments of the now superseded Third District Court of Appeal and the California Supreme Court opinions, concluding that the decision of the California Supreme Court was incorrect.¹⁹ Part V assesses the international legal ramifications of *Barclays* on state taxation of international businesses.²⁰

II. LEGAL BACKGROUND

A. *Definitional Background*

1. *Unitary Business*

If a business is classified as unitary, it may be subject to taxes calculated by formula apportionment. The California Supreme Court has provided two general tests for determining whether a business is unitary and thus subject to formula apportionment. The first of these tests was expounded in *Butler Brothers v. McColgan*.²¹ In *Butler Bros.*, the California Supreme Court held that a business is unitary if there is "(1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and, (3) unity of use in its centralized executive force and general system of operation."²² Six years later, in *Edison California Stores v. McColgan*,²³ the California Supreme Court broadened its definition of unitary. The Court in *Edison* held that a business is unitary where the operation of the business within California contributes to or is dependent upon the operation of the business outside the state.²⁴ In subsequent California cases, courts have applied both of the above listed tests and in doing so they have interpreted the tests broadly.²⁵

15. *Id.* The three-factor model, employed by the Franchise Tax Board in this case, defines the multijurisdictional scope of the unitary enterprise of which the taxable intrastate activities are a part. This is done by calculating the combined income of the components of the unitary group, and distributing a portion of that result to the taxing state. The portion distributed to the state is calculated by using a mathematical formula based on an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall. *Id.* at 715 n.2.

16. *Id.* at 712.

17. *See infra* notes 21-94 and accompanying text.

18. *See infra* notes 95-132 and accompanying text.

19. *See infra* notes 133-64 and accompanying text.

20. *See infra* notes 165-81 and accompanying text.

21. 17 Cal. 2d 664, 111 P.2d 334 (1941), *aff'd*, 315 U.S. 501 (1942).

22. *Id.* at 678.

23. 30 Cal. 2d 472, 183 P.2d 16 (1947).

24. *Id.* at 481.

25. Gordon T. Yamate, Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?*, 20 SANTA CLARA L. REV. 123, 130-31 n.36 (1980). *See generally*, *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 386 P.2d 33, 34 Cal. Rptr. 545 (1963) (holding that a nonintegrated oil company was a unitary business); *Honolulu Oil Corp. v. Franchise Tax Board*, 60 Cal. 2d 417, 386 P.2d 40, 34 Cal. Rptr. 552 (1963) (holding that an oil company with only centrally controlled operations was unitary).

The broad interpretation of these tests in cases involving unitary corporations has continued to cause controversy.²⁶ However, no single field of state taxation has caused more controversy between the international business community and a state's taxing agencies than California's inclusion of foreign income in the unitary apportionment formula.²⁷

The unitary business concept of taxation was first applied to a foreign corporation in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*.²⁸ In *Bass*, the taxpayer was a British brewing corporation.²⁹ Plaintiff, Bass, questioned the constitutional validity of a New York law imposing an annual tax on a foreign corporation merely for the privilege of doing business in that state.³⁰ The United States Supreme Court classified Bass as a unitary business because it earned profits through a series of transactions beginning with manufacture in England and ending with sales in New York.³¹ The Court held that the New York Tax Commission was justified in attributing a just proportion of the corporation's entire net income to New York.³² The Court also held that the use of formula apportionment of income from a unitary business is permissible to the extent that the formula was not intrinsically arbitrary and did not produce an unreasonable result.³³

In arriving at its decision in *Bass*, the Supreme Court relied on *Underwood Typewriter Co. v. Chamberlain*.³⁴ In *Underwood*, a Connecticut statute which imposed a net income tax similar to the one in question in *Bass*, on corporations doing business both inside and outside of the state, was upheld.³⁵ However, in applying *Underwood*, the *Bass* Court made no distinction between a tax applied to a national business as in *Underwood* and a tax applied to an international business as in *Bass*.³⁶

2. State Taxation of International Business Income

A general principle of state taxation is that "a state may not tax value earned outside its borders."³⁷ Attempts by state taxing agencies to design tax schemes to comply fairly with this principle has given rise to two distinct models for dividing multijurisdictional income.³⁸

The first method of state taxation is the arms length/separate accounting (AL/SA) method which calculates income on a discrete geographical, transactional, or functional

26. See Yamate, *supra* note 25, at 125 (citing Hearings on the Matter of the Unitary Tax before the Cal. Franchise Tax Bd. (July 12 and August 22, 1977) (discussing the continuing controversy caused by determinations of unitary status for corporations)).

27. *Id.*

28. 266 U.S. 271 (1924).

29. *Id.* at 278.

30. *Id.* at 277.

31. *Id.* at 282.

32. *Id.*

33. *Id.* at 282-83.

34. 254 U.S. 113 (1920).

35. *Id.* at 119-20.

36. Bass, *supra* note 28.

37. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982). See also Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX. L. REV. 171, 181 (1970) (discussing the viability of state taxation methods encompassing corporations doing business outside as well as inside the state's jurisdiction).

38. *Barclays*, 2 Cal. 4th at 714. Throughout this Note multijurisdictional income refers to income attained from more than one jurisdiction. This could mean more than one state or a state and a foreign country.

basis.³⁹ This method allocates income to a single taxing entity, usually a state, rather than apportioning it among several jurisdictions and treats intracorporate transfers of value between commonly held or related entities as if they were arms length transactions between unaffiliated businesses.⁴⁰ The majority of United States and international businesses overwhelmingly employ the AL/SA method of state taxation.⁴¹

The competing method of dividing multijurisdictional income is the unitary business/formula apportionment method. This method of state taxation grew out of the difficulties tax agencies experienced in arriving at the precise territorial allocations of value, required under the application of the AL/SA method, to an integrated business operating in more than one state.⁴² The most commonly used variation of formula apportionment is the "three-factor" model.⁴³ California uses a special type of this three-factor model called the worldwide combined reporting (WWCR)⁴⁴ method that combines and apportions the worldwide income of multinational businesses.⁴⁵

Courts and commentators have criticized both the AL/SA and WWCR methods of taxation.⁴⁶ The main criticism against the AL/SA method is that it allows multinational corporations to hide income and avoid paying for the actual benefits gained from in-state incorporation.⁴⁷ On the other hand, tax boards utilizing the WWCR method have been accused of inducing double-taxation by taxing income that had already been accounted for and taxed in another jurisdiction.⁴⁸

3. *The Dormant Foreign Commerce Clause*

Even though the Commerce Clause of the United States Constitution expressly gives Congress the power to regulate commerce with foreign nations and among the several states,⁴⁹ most Commerce Clause jurisprudence has been developed by the Supreme Court under the Dormant Commerce Clause.⁵⁰ The Supreme Court has held on more than one occasion that:

For 100 years it has been accepted constitutional doctrine that the Commerce Clause, without the aid of congressional legislation . . . affords some protection from state legislation inimical to the national commerce, and that in such cases, where Congress has not acted, this Court, and not the state legislature, is under the

39. *Id.* at 715.

40. *Id.* For example, Barclays has affiliates in California and London. This method would treat Barclays intercorporate dealings and transfers as if each affiliate were its own separate business.

41. *Id.*

42. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 164 (1983).

43. *Barclays*, 2 Cal. 4th at 715. *See supra* note 15 (discussing the three-factor model of formula apportionment).

44. *Id.* at 714-16.

45. *Id.* at 716.

46. *Yamate*, *supra* note 25, at 125; Schlenger, Note, *State Worldwide Unitary Taxation: The Foreign Parent Case*, 23 COLUM. J. TRANSNAT'L L. 445, 446 (1985).

47. *Yamate*, *supra* note 25, at 125; Schlenger, *supra* note 46, at 446.

48. *Barclays*, 2 Cal. 4th at 716-17. *See id.* at 716 n.4 for a listing of critical literature.

49. U.S. CONST., art. 1, § 8, cl. 3.

50. *Barclays*, 2 Cal. 4th at 722.

Commerce Clause the final arbiter of the competing demands of state and national interests.⁵¹

This restriction on state power against state legislation contrary to the national commerce is what is often referred to as the Dormant Commerce Clause or the negative implication of the Commerce Clause.⁵² Under the authority of the Dormant Commerce Clause, the United States Supreme Court deemed unconstitutional a number of state regulatory and taxation measures as undue burdens on commerce.⁵³

B. Supreme Court Decisions Regarding State Taxation of Unitary Businesses

The United States Supreme Court has decided a number of important cases regarding state taxation by applying the Dormant Commerce Clause.⁵⁴ In *Complete Auto Transit v. Brady*,⁵⁵ the Supreme Court adopted a four part test to ensure that state tax plans complied with the Dormant Commerce Clause.⁵⁶ A tax must "[be] applied to an activity with a substantial nexus with the taxing state, [be] fairly apportioned, not discriminate against interstate commerce, and [be] fairly related to the services provided by the state."⁵⁷ Failing any one of these prongs makes the state tax unconstitutional under the Dormant Commerce Clause.⁵⁸

Two years later, in *Japan Line, Ltd. v. County of Los Angeles*,⁵⁹ the Court created two more parts for its four-part *Complete Auto* test. In *Japan Line*, six Japanese shipping companies owned containers which were based, registered, subject to property tax in Japan, and used exclusively in foreign commerce.⁶⁰ While the containers were temporarily present in California, that state levied a tax based on their value.⁶¹ The Court stated that when dealing with foreign commerce, in addition to the four-part *Complete Auto* test, the court must inquire whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation.⁶² The court must also ask whether the tax prevents the federal Government from speaking with one voice when regulating commercial relations with foreign governments.⁶³ If a state tax contravenes either of these two new factors, or any of the *Complete Auto* factors, the tax is unconstitutional under the Dormant Foreign

51. *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 769 (1945); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959); *Hughes v. Oklahoma*, 441 U.S. 322, 326 (1979).

52. *Tatarowicz & Mims-Velarde*, *supra* note 3, at 881-82.

53. *Id.* at 882.

54. *See, e.g.*, *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979); *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980), *Exxon Corp. v. Dep't. of Revenue of Wisconsin*, 447 U.S. 207 (1980); *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); and *Wardair Canada v. Florida Dep't. of Revenue*, 477 U.S. 1 (1986) (discussing text *infra* part II(B)).

55. 430 U.S. 274 (1977).

56. *Id.* at 279.

57. *Id.*

58. *Id.*

59. 441 U.S. 434 (1979).

60. *Id.* at 436.

61. *Id.* at 437.

62. *Id.* at 451.

63. *Id.*

Commerce Clause.⁶⁴ Since the California tax levied against Japan Line failed both of the new prongs the tax was deemed unconstitutional under the Dormant Foreign Commerce Clause.⁶⁵ In addition, the *Japan Line* Court held that instrumentalities of commerce that are owned, based, registered abroad, and which are exclusively in international commerce may not be subjected to an apportioned *ad valorem*⁶⁶ property tax by a state.⁶⁷

One year later, the Court refused to apply the *Japan Line* test in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*,⁶⁸ limiting the application of the test to international issues. Because the issue in *Mobil Oil* was classified by the Court as domestic, only the four-part *Complete Auto* test was relied on by the Court to assess whether the state tax complied with the Dormant Commerce Clause.⁶⁹ The Court also distinguished the business income tax in *Mobil* from the *ad valorem* tax in *Japan Line*.⁷⁰ Mobil Oil Corporation is an integrated corporation organized under the laws of New York and doing business in many states.⁷¹ Vermont imposed an apportioned income tax upon foreign source dividend income received by Mobil from its subsidiaries and affiliates doing business abroad.⁷² In reaching its conclusion, the Court reasoned that the foreign dividends derived from activities of a unitary business were apportionable income and upheld the tax against Mobil Oil Corp.⁷³

In *Exxon Corporation v. Wisconsin Department of Revenue*,⁷⁴ a case decided less than one year after *Mobil Oil*, the Court expanded the aspects available to be used for determining whether a corporation was unitary.⁷⁵ The Court rejected the evidence of Exxon's separate accounting technique, which seemed to indicate that Exxon was not a unitary corporation, and determined that the business was unitary.⁷⁶ In arriving at this holding, the Court stated that state taxation agencies were allowed to look beyond the formal structure of a corporation to determine whether a business was unitary and, if so, to apply an apportioned tax.⁷⁷ Consequently, the apportionment tax formula used by the Wisconsin Department of Revenue was upheld as constitutional due to a unitary determination not previously used in *Mobil*.⁷⁸

The Court paid closer attention to the apportionment method issue raised in both *Mobil* and *Exxon* in *Container Corporation v. Franchise Tax Board*.⁷⁹ The *Container Corp.* Court extended the scope of the apportionment method by including income, not just dividends, from activities in foreign countries.⁸⁰ In the *Container Corp.* decision, the Court sustained the use of formula apportionment by the Franchise Tax Board to determine

64. 441 U.S. 434, 451 (1979).

65. *Id.* at 453-54.

66. *Id.* at 436. An *ad valorem* tax is a duty levied on goods in proportion to their value. BARRON'S LAW DICTIONARY 14 (3rd ed. 1991).

67. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 436 (1979).

68. 445 U.S. 425 (1980).

69. *Id.* at 446-48.

70. *Id.* at 448.

71. *Id.* at 427.

72. *Id.*

73. 445 U.S. 425, 449 (1980).

74. 447 U.S. 207 (1980).

75. *Id.* at 222-23.

76. *Id.* at 224.

77. *Id.* at 229.

78. *Id.*

79. 463 U.S. 159 (1980).

80. *Id.* at 159, 175-80.

the taxable income of a domestic based unitary business with foreign domiciled subsidiaries.⁸¹ The Court stated that a key to *Container Corp.* was that Container was a domestic parent with foreign subsidiaries; therefore no international concerns were directly implicated.⁸² The Court indicated that it was not addressing the issue of taxing a foreign parent corporation with domestic subsidiaries.⁸³ This is the precise question in *Barclays*.

The open question in *Container Corp.* regarding state taxation of a foreign parent unitary corporation was answered in 1983, when the Court decided *Wardair Canada v. Florida Department of Revenue*.⁸⁴ In *Wardair*, a Canadian based air carrier challenged an excise tax on intrastate fuel purchases.⁸⁵ Plaintiff, Wardair, was charged with the full amount of the excise tax regardless of whether the fuel was consumed either in or out of Florida and regardless of the amount of intrastate business transacted by the airline.⁸⁶ Wardair, joined by the United States as *amicus curiae*, relied solely on the last prong of the Dormant Foreign Commerce Clause test from *Japan Line*—that the federal government must be able to speak with one voice—to argue that the tax was unconstitutional.⁸⁷ Wardair claimed that a multitude of multilateral agreements and conventions to which the United States was a party showed a clear national policy disallowing this tax.⁸⁸

The Supreme Court rejected this idea and stated that no Dormant Commerce Clause analysis was necessary.⁸⁹ For a Dormant Commerce Clause analysis to be invoked, there must be congressional silence.⁹⁰ The Court found that the federal government had not been silent on this issue.⁹¹ Rather, by failing to enact legislation endorsing these executive international agreements, Congress implied an acquiescence to let the states impose their own methods of taxation.⁹² Moreover, none of the international agreements relied upon by Wardair denied the states the kind of taxing power asserted by the Florida Department of Revenue in *Wardair*.⁹³ According to the Court, the absence of state taxation regulations in these international agreements did not indicate congressional silence, but rather demonstrated an affirmative policy choice to let a state choose its own taxation method.⁹⁴

III. THE CASE

A. The Facts

Plaintiffs, Barclays Bank of California and Barclays Bank International,⁹⁵ brought a refund action against the California Franchise Tax Board to recover assessments levied

81. *Id.* at 159, 180-84.

82. *Id.* at 196.

83. *Id.* at 189.

84. 477 U.S. 1 (1986).

85. *Id.* at 3.

86. *Id.* at 4.

87. *Id.* at 9.

88. *Id.*

89. 477 U.S. 1, 9 (1986).

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.* at 10.

94. 477 U.S. 1, 12 (1986).

95. Barclays Bank of California and Barclays Bank International are both subsidiaries of their ultimate corporate parent, Barclays Bank Limited. In this Note, the term Barclays Bank will refer to both plaintiffs.

against them of \$152,420 and \$1,678 respectively for the 1977 tax year.⁹⁶ Barclays did not contest the fact that the lower court found it to be a unitary corporation under the California tests discussed previously. However, the bank did argue that the application of California's apportionment formula to a business whose corporate parent is a foreign domiciliary violates the Foreign Commerce Clause of the Federal Constitution.⁹⁷

B. *Procedural History*

The Superior Court ruled in favor of the bank. The Third District Court of Appeal affirmed.⁹⁸ According to these rulings, the Board's taxation method, WWCR, violated the Commerce Clause in two respects.⁹⁹ First, the Board's application of the WWCR taxation method to a foreign parent unitary business implicated foreign policy issues that were constitutionally required to be left to the federal government.¹⁰⁰ Second, the use of the formula apportionment method by the Franchise Tax Board was at odds with a clear federal directive embodied in presidential and cabinet-level statements, letters, press releases, task force reports, and the congressional testimony of senior executive officials.¹⁰¹ Formula apportionment was against this clear federal directive in that American foreign commercial policy supports the use of an alternative accounting method to determine the taxable income of foreign based corporations.¹⁰²

The California Supreme Court granted review and reversed the Third District Court of Appeal in May, 1992.¹⁰³ Petition for writ of certiorari to the United States Supreme Court was filed by Barclays Bank on August 3, 1992, and was denied October 5, 1992.¹⁰⁴ The

96. *Barclays*, 2 Cal. 4th at 712-13. It is interesting to note that Barclays has now litigated this case for 15 years, all for a total claim of \$154,098. It is apparent to this writer that there is more at stake than the \$154,098 claim against the Franchise Tax Board.

97. *Barclays*, 2 Cal. 4th at 713.

98. *Id.* at 713.

99. *Id.*

100. *Id.*

101. *Id.* For example, the Treasury Department's senior career official for WWCR issues during the 1970's and 1980's testified that the executive branch's policy on the use of WWCR was a proscription against it. *Barclays Bank International Ltd. v. Franchise Tax Board*, 3 Cal. 4th 1034, 1061-63, 275 Cal. Rptr. 626 (1990). Former President Carter's Treasury Secretary, Michael Blumenthal wrote a letter to Martin Huff, then Executive director of the Franchise Tax Board, stating that the unitary apportionment system was inconsistent with accepted tax treaty policy. *Id.* President Carter's Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, explained his concern against the application of WWCR to both Houses of Congress in March and June of 1980. *Id.* In 1985, President Ronald Reagan publicly issued a directive on the matter and instructed the Attorney General and the Secretary of the Treasury to pursue, through appropriate means, the federal policy that states tax foreign corporations through the AL/SA method. *Id.* In 1986, Secretary of State George Schultz wrote to then California Governor, George Deukmejian, urging him to end California's use of WWCR. *Id.* See also 10 TAX PLAN. INT'L. REV. 20 (1983), Comptroller General Report, *Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving*, 3 GAO/IGD-82-38 (1982); Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices*, 42 J. TAX'N 106 (1975); *Unitary Working Group's Task Force Meets*, 21 TAX NOTES 627 (1983) (discussing efforts by the executive branch to persuade states to use the AL/SA method of taxation when dealing with foreign corporations).

102. *Barclays*, 2 Cal. 4th at 708.

103. *Id.*

104. *Barclays Bank PLC v. Franchise Tax Board*, 113 S.Ct. 202 (1992). The smaller issue of whether Barclays was being denied its due process by the application of formula apportionment was remanded to the Court of Appeal. The fact that the case was not fully completed in the state court system is the most probable reason that certiorari was denied, not an implicit recognition of a correct decision by the California Supreme

California Supreme Court did not decide the issue of whether Barclays Bank was denied its due process by the application of this formula apportionment taxation method.¹⁰⁵ This issue was remanded to the Court of Appeal,¹⁰⁶ and had not yet been decided when the Supreme Court denied certiorari. On remand, the Third District Court of Appeal decided the due process issue against the bank on November 20, 1992.¹⁰⁷ The Third District Court of Appeal decision was superseded on February 18, 1993.

C. The Opinion of the California Supreme Court

Much of the California Supreme Court's language in its holding refuted the findings of the Third District Court of Appeal.¹⁰⁸ The Court of Appeal agreed with the argument of Barclays Bank that the facts of *Wardair* were distinguishable from the facts of *Barclays*.¹⁰⁹ Therefore, *Wardair* was of little, if any, precedential value to the decision in *Barclays*.

The California Supreme Court disagreed and declared that the Court of Appeal failed to appreciate the limitations of *Wardair* regarding the Dormant Commerce Clause.¹¹⁰ Justice Arabian's decision, joined by all members of the court, stated that *Wardair* stood for the idea that the Executive Branch's aspirations as to what national foreign commercial policy ought to be cannot constitute a clear federal directive, at least where Congress has decreed otherwise.¹¹¹ The California Supreme Court also held that the Court of Appeal misunderstood how *Wardair* demonstrated that on the facts in *Barclays* a Dormant Commerce Clause analysis was completely unnecessary.¹¹² A Dormant Foreign Commerce Clause analysis was not necessary because the Court of Appeal did not confront the type of congressional silence that triggers this analysis.¹¹³

Court. (Brief of petition for certiorari, on file at McGeorge School of Law, University of Pacific, *The Transnational Lawyer*).

105. *Barclays*, 2 Cal. 4th at 742.

106. *Id.* at 743.

107. 10 Cal. App. 4th 1742, 14 Cal. Rptr. 2d. 537 (1992). The Court of Appeal held that the administrative burden put on Barclays Bank in complying with the WWCR method of taxation did not violate state or federal due process. *Id.*

108. *Barclays*, 2 Cal. 4th 708.

109. The Court of Appeal adopted the initial argument of the plaintiff and respondent Barclays Bank that the facts of *Wardair* were distinguishable from the facts of this case. *Barclays*, 2 Cal. 4th at 731. In *Wardair*, the specific subject matter of the airline fuel tax was specifically discussed at the relevant conventions concerning this tax. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal). There was also a previous course of conduct between the two federalist-type nations, the United States and Canada, that showed a clear acquiescence in the particular tax practice. *Id.* The Court of Appeal found that this was simply not the case in *Barclays*; neither the specific subject matter was discussed, nor was there any acquiescent course of conduct allowing the state taxation method between the United States and Britain. *Id.*

110. *Barclays*, 2 Cal 4th at 731.

111. *Id.*

112. *Id.* at 733. The Court of Appeal adopted the arguments of plaintiff and respondent Barclays Bank that a Foreign Dormant Commerce Clause analysis was necessary. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal). Under this analysis, California's unitary tax method, WWCR, as applied to foreign-based unitary corporations, was unconstitutional because it not only implicated foreign policy issues which must be left to the federal government, but also because it violated a clear federal directive. *Id.*

113. *Barclays*, 2 Cal. 4th at 732.

Just what congressional silence meant was the key disagreement between the Court of Appeal and the California Supreme Court.¹¹⁴ The Court of Appeal decided that a clear federal directive by Congress was, in fact, absent. Therefore, the executive branch was invited to assume the role of Congress and preempt state tax schemes.¹¹⁵ However, the California Supreme Court disagreed, holding that this issue of executive branch preemption need not even be decided, because Congress had clearly spoken on the matter.¹¹⁶ The California Supreme Court's theory was that there had been so much debate and executive level prodding over which type of taxation method can be used by the states, that by not enacting legislation, Congress had effectively condoned formula apportionment tax schemes by the states.¹¹⁷ The California Supreme Court claimed to hear the "din of a "governmental silence" that cannot be ignored."¹¹⁸ In effect, Congress had affirmatively acted by remaining silent.¹¹⁹

The California Supreme Court cited congressional refusal to ratify an income tax convention with the United Kingdom in 1978 as one example of Congress acting affirmatively through inaction.¹²⁰ The centerpiece of this tax convention was a provision prohibiting the use of formula apportionment by states.¹²¹ Only after the Senate deleted article 9(4) of this U.S.-U.K. Tax Treaty was the Senate ratification completed.¹²²

In addition, the California Supreme Court noted that, in fact, many of the bilateral tax treaties only contain prohibitions on national taxing schemes, and not subnational counterparts.¹²³ This again demonstrated a congressional refusal to impose its own taxation

114. *Id.*

115. This is a constitutional preemption question involving separation of powers. It is not the same as the Dormant Commerce Clause question regarding whether Congress had acted affirmatively by being silent, which once resolved, determines whether a court needs to engage in a Dormant Commerce Clause analysis to resolve the issues of a particular case. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal).

The Court of Appeal adopted the arguments of Barclays Bank by using Justice Jackson's often cited concurrence in the steel seizure case of *Youngstown Co. v. Sawyer*, 343 U.S. 579, 96 L.Ed. 1153, 72 S.Ct. 863 (1952). Jackson's concurrence defined a "zone of twilight" where congressional inertia may necessitate independent presidential responses depending upon the "imperatives of events and contemporary imponderables" rather than abstract theories of constitutional power. *Id.* The Court of Appeal agreed with Barclays Bank that this situation's imperative events and contemporary imponderables were the necessity for swift unified national power in an era of globalized world economies and the fact that taxation of foreign corporations falls under foreign policy which is traditionally an area of great executive power. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal).

116. *Barclays*, 2 Cal. 4th at 732.

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at 734.

121. Convention Between the United States and United Kingdom for Avoidance of Double Taxation, Dec. 31, 1975, U.S.-U.K., 21 U.S.T. 5670, 5677, T.I.A.G. 9682 [hereinafter U.S.-U.K. Tax Treaty]. (The provision was article 9(4)).

122. *Barclays*, 2 Cal. 4th at 735. Contrary to this, the Court of Appeal agreed with Barclays Bank and found that there was a strong congressional majority for the U.S.-U.K. Tax Treaty (49 to 32) even before the removal of article 9(4). The Court of Appeal believed that majority approval simply did not show congressional disapproval for the article as the Tax Board had claimed. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal).

123. *Barclays*, 2 Cal. 4th at 735. Throughout this note, the term "subnational counterparts" refers to the states within the United States. It can also mean the provinces within Canada.

method preferences upon the states.¹²⁴ In fact, the California Supreme Court noted that twenty bills, including former President Ronald Reagan's "waters edge" legislation,¹²⁵ have been brought before Congress to curb states' use of formula apportionment taxing methods.¹²⁶ However, none of these bills have been enacted into law.¹²⁷

Therefore, the California Supreme Court held that this congressional inaction was actually an affirmative decision not to enact any restrictions on state taxing options into law.¹²⁸ The California Supreme Court stated that all of the executive branch's efforts, in the wake of congressional inaction, embodied "nothing more than executive aspirations of what the federal government's policy in this area ought to be."¹²⁹ Thus, the California Supreme Court determined that the absence of congressional legislation on the issue of state taxation of foreign corporations was a "governmental silence that [was] eloquent."¹³⁰

Following this reasoning, the California Supreme Court held that it was unnecessary to conduct a Dormant Foreign Commerce Clause analysis.¹³¹ Therefore, the California Franchise Tax Board's use of WWCR as applied to foreign parent unitary corporations could not be held to be unconstitutional under a Dormant Foreign Commerce Clause theory.¹³²

IV. LEGAL ANALYSIS OF THE COMPETING ARGUMENTS

A. The Competing Arguments

This section addresses the competing arguments of the California Supreme Court and the Third District Court of Appeal. The decisive divergence between the two courts centered on the issue of whether *Wardair* was the controlling precedent regarding the issues in *Barclays*.

Unlike *Container Corp.* and *Japan Line*, the California Supreme Court in *Wardair* did not conduct a Dormant Commerce Clause analysis because it found that the federal government had affirmatively acted, rather than remaining silent.¹³³ The California Supreme Court held that under established constitutional doctrine, the courts sometimes are required

124. *Barclays*, 2 Cal. 4th at 735. The Court of Appeal agreed with the Bank on this point in that there was simply no mention of WWCR, either for or against it, for subnational units within these treaties. *See supra* note 7 (referring to the superseded decision of the Third District Court of Appeal). Additionally, general reservations were made to model treaty provisions which state that the treaties should apply to subnational, as well as national taxes. *Id.* Moreover, many of these treaties were made long before the use of WWCR gave rise to the international problems that it does today, especially in light of the role of multinational corporations in the new globalized world economy. *Id.*

125. This 1985 legislation sponsored by the Treasury Department, would have limited state use of worldwide formula apportionment to members of foreign based corporate groups actually doing business in the United States. *Barclays*, 2 Cal. 4th at 736.

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.* at 734. In contrast, the Court of Appeal relied upon numerous statements and actions by the executive branch as a clear expression of federal policy opposed to state use of formula apportionment taxation methods. *See supra* note 101 and accompanying text (discussing various actions and statements of the executive branch against formula apportionment taxation).

130. *Barclays*, 2 Cal.4th at 742.

131. *Id.*

132. *Id.*

133. *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1, 9 (1986).

to assume and enact the foreign commerce policy choices Congress would make when there is no indication that Congress had given the matter any thought.¹³⁴ It is very different, however, for a court to ignore a pattern of congressional policy decisions that demonstrate both an awareness of an issue and a refusal to adopt the remedy urged upon it by executive officials while being lobbied against by its state constituencies.¹³⁵

The Third District Court of Appeal differed with the California Supreme Court's characterization of congressional silence on the issue of state taxation of foreign corporations. The Court of Appeal held that: "It is difficult enough trying to ascertain legislative intent when a statute has been enacted, but trying to find meaning in legislative silence is about as difficult as hearing sound in a vacuum."

Consequently, if *Wardair* is controlling and correct, the issue in *Barclays* is already decided by *Wardair*, and the United States Supreme Court, if this case is heard at that level, will unquestionably affirm the California Supreme Court. However, both logical reasoning and an examination of public policy give strong credence to concluding that *Wardair* is not controlling precedent in *Barclays*. Thus, the arguments adopted by the Court of Appeal, and not the California Supreme Court, were correct in their analysis.

Both *Container Corp.* and *Wardair* reaffirmed *Japan Line's* sensitivity to the essential need for federal uniformity in international relations and the special situation raised by foreign commerce. The Court in *Wardair* also recognized the Foreign Dormant Commerce Clause's underlying importance that "the essential attributes of nationhood will not be jeopardized by states acting as independent economic actors."¹³⁶ The *Wardair* Court also noted the importance of the need for the United States to act through a single government with unified and adequate national power with respect to foreign relations and commerce.¹³⁷ In looking at the facts, the *Wardair* Court pointed to specific acts of acquiescence between the United States and Canada regarding the specific fuel tax at issue.¹³⁸ As noted previously, there was no such specific acquiescence between the United States and Britain in *Barclays*.¹³⁹

The strongest point in favor of the Board's position that Congress had affirmatively acted not to prohibit states from employing their own taxation scheme was the deletion of article 9(4) from the Senate ratification of the United States - United Kingdom Tax Treaty [hereinafter U.S.-U.K. Tax Treaty].¹⁴⁰ Article 9(4) would have mandated that States within the United States be prohibited from using formula apportionment in taxing British based corporations doing business within those states.¹⁴¹ However, it does not necessarily follow,

134. *Barclays*, 2 Cal. 4th at 741-42.

135. *Id.*

136. *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1, 12 (1986).

137. *Id.* at 7-8 (quoting *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979)).

138. *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986). See *supra* notes 84-94 and accompanying text (discussing the acts of acquiescence involved in *Wardair*).

139. See *supra* note 109 (discussing the lack of specific acquiescence toward the taxation scheme between the United States and Britain).

140. *Barclays*, 2 Cal. 4th at 734-35.

141. Article 9(4) states:

Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision, or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State.

U.S.-U.K. Tax Treaty, *supra* note 121, at 5677.

as the California Supreme Court found, that the Senate ratification of this treaty without article 9(4) condones the use of formula apportionment by the states. The passage of treaties or legislation in the Senate is a much more complex issue.

A chronology of events that led to the passage of the U.S.-U.K. Tax Treaty demonstrates that no affirmative congressional intent for permitting state use of formula apportionment can be gleaned from the ratification of the U.S.-U.K. tax treaty. Senator Morgan noted during floor discussion immediately after Senate ratification of the tax treaty without article 9(4): "Last Friday, we rejected the Church reservation¹⁴² by a comfortable majority only to find it reappear in today's version of the vote."¹⁴³ This initial congressional vote against the Church reservation indicates that Congress intended to prohibit state use of formula apportionment taxation of foreign corporations. It cannot, as the California Supreme Court claims, be construed to show congressional acquiescence in state use of formula apportionment.

Senator Morgan continued:

Thus we combined two issues, one which requires only a majority vote, namely the Church reservation, and ratification of the treaty and its two protocols which require a two-thirds vote. I would have very much preferred to follow the original suggestion of the Senator from West Virginia, made last Friday, to have two votes back to back, thereby keeping votes and issues apart. I am convinced that in this case we would have had a treaty today including article 9(4).¹⁴⁴

It becomes apparent from this statement that only through congressional vote maneuvering was the tax treaty passed with the Church reservation included. First, the Church reservation was rejected by a majority vote, indicating a congressional preference for prohibiting state use of formula apportionment taxation methods. The tax treaty then received a majority vote (49 to 32),¹⁴⁵ but fell just short of the two-thirds requirement for treaty ratification. Finally, and clearly against some senators wishes, the treaty was voted on again, this time including the Church reservation. This seems to demonstrate an overall concern with finally getting the treaty passed, more than anything else.

If treaties and treaty provisions can be ratified or rejected by political jockeying of the order of votes and combination of issues, it is illogical to construe these actions as affirmative congressional policy decisions. At best, an evaluation of the entire congressional voting record, including the initial vote rejecting the Church reservation by itself, demonstrates congressional intent to prohibit state use of formula apportionment taxation methods, contrary to the finding of the California Supreme Court. At worst, due to the conflicting congressional voting patterns, no affirmative congressional action can be found.

Thus, even the strongest argument offered by the California Supreme Court is insupportable. To claim that this treaty ratification amounted to affirmative congressional action either simply ignores the congressional record in its entirety or is a result oriented decision aimed at preserving California's taxation scheme.

142. The excision of article 9(4) was sponsored by Senator Church, and was called the Church Reservation.

143. 124 Cong. Rec. 19078 (1978).

144. *Id.*

145. *Id.*

B. *Supporting Arguments*

Besides the Appellate Court's cogent arguments, other strong arguments can be made in support of why California should be prohibited from applying its WWCR method of taxation.¹⁴⁶ The United States Supreme Court's decision in *Zschernig v. Miller*¹⁴⁷ points to an analogous area of state action that must give way to the effective maintenance of the United States foreign policy.¹⁴⁸ In *Zschernig*, the Oregon courts, applying a state probate statute, denied inheritance to an East German resident's heirs residing in a foreign country.¹⁴⁹ In *Zschernig*, the conflict was between a 1923 Treaty of Friendship, Commerce and Consular rights with Germany, and a 1957 Oregon Revised Statute (111.070) regarding probate of personal property.¹⁵⁰ The *Zschernig* Court held that where the state probate laws conflict with a treaty, they must bow to superior federal policy encompassed within the treaty.¹⁵¹ In this case, the federal policy concerned the exclusive United States government control over the international transmission of property, funds, and credit, as demonstrated in executive branch treaties.¹⁵² Analogizing this case to *Barclays*, it can be reasoned that California's state tax laws must give way to a superior federal policy preferring the AL/SA method of taxation of foreign corporations. Although Congress has not acted affirmatively on this issue, the executive branch has repeatedly expressed its preference for the AL/SA method of taxation.¹⁵³

Furthermore, the California courts themselves recognized this exclusive federal power in *Bethlehem Steel Corp. v. Board of Commissioners*.¹⁵⁴ *Bethlehem Steel* involved a state statute requiring public contracts only to be awarded to corporations agreeing to use substantially American raw materials.¹⁵⁵ The *Bethlehem Steel* Court held that the California statute constituted an undue encroachment into national foreign policy decisions and an unconstitutional interference into the federal government's exclusive power over foreign affairs.¹⁵⁶ The federal policy in *Bethlehem Steel* was expressed through international agreements signed by the executive branch and not endorsed by Congress, very similar to those in *Barclays*.¹⁵⁷ Again, California's application of the WWCR taxation method can be deemed unconstitutional for the reasons expounded in *Bethlehem Steel*.

In another California case, *Scandinavian Airline Systems, Inc. v. County of Los Angeles*,¹⁵⁸ the California Supreme Court struck down a personal property tax assessment on foreign-owned aircraft.¹⁵⁹ The California Supreme Court in *Scandinavian* held that taxation of foreign instruments of commerce represents an area that is uniquely federal in

146. Yamate, *supra* note 25.

147. 389 U.S. 429, *reh'g denied*, 390 U.S. 974 (1968).

148. *Id.* at 440.

149. *Id.* at 430.

150. *Id.* at 441.

151. *Id.* at 440.

152. 389 U.S. 429, 433 (1968).

153. *See supra* note 101 and accompanying text (discussing various actions and statements of the executive branch).

154. 276 Cal. App. 2d 221 (1969).

155. *Id.* at 222.

156. *Id.* at 224.

157. *Id.*

158. 56 Cal. 2d 11 (1961).

159. *Id.* at 42.

nature.¹⁶⁰ The *Scandinavian* Court concluded that this area of taxation must be left to the administration of the federal government, even without any Congressional legislation thereon.¹⁶¹ The *Scandinavian* Court noted that both federal and state courts have considered this subject to be one best handled by the federal government without any reference to any theory that it only becomes such a subject when Congress preempts the field by enacting legislation.¹⁶² In this case, as in *Zschernig* and *Bethlehem*, the federal policy is demonstrated through a number of treaties.¹⁶³ The *Scandinavian* Court declared in no uncertain terms that: "Treaties are the supreme law of the land, binding upon the courts of every state (U.S. CONST. art. IV, cl. 2). If the tax under review is repugnant to the terms of any such treaty, the tax must be declared invalid."¹⁶⁴ This case seems to make clear that California's taxation scheme regarding foreign corporations, despite not having been addressed by Congress, must give way to federal policy as expounded by the executive branch.

V. RAMIFICATIONS

If the decision of the California Supreme Court is left intact, the international ramifications will be detrimental to the United States and to United States business.¹⁶⁵ When examining the costs and benefits of a state taxation system that may affect the entire nation, one must carefully examine those impacts upon that nation as a whole.

A. Loss of Credibility

The essential interest in efficient and effective achievement of United States foreign policy objectives mandates that foreign nations see the United States foreign policy as clear and consistent.¹⁶⁶ State involvement in international issues, especially if not in accord with administration policy, may undermine the conduct of United States foreign relations.¹⁶⁷ Furthermore, the credibility of the United States negotiating position in international trade disputes and treaty negotiations may be undermined by a showing of disagreement and weakness in the United States stated foreign policies.¹⁶⁸

In addition, state and local activities may frustrate or embarrass national foreign relations by offending foreign nations or their economic interests.¹⁶⁹ It is simply inappropriate and irresponsible for states to act on their own without regard to the national picture, causing detrimental effects on the entire nation.¹⁷⁰ Furthermore, state governments

160. *Id.* at 42.

161. *Id.* at 42.

162. *Id.* at 20.

163. 56 Cal.2d 11, 36 (1961).

164. *Id.*

165. Yitzhak (Issac) Hadari, *Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise*, 20 AM. J. COMP. L. 111, 112-113 (1972).

166. Richard B. Bilder, *Special Issue: The United States Constitution in its Third Century: Foreign Affairs: Distribution of Constitutional Authority: The Role of States and Cities in Foreign Relations*, 83 AM. J. INT'L L. 821, 827 (1989).

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

do not have the expertise or resources to make decisions involving complex international issues.¹⁷¹

B. Retaliation

Because the facts and issues involved in *Barclays* disrupt the delicate balance in international taxation, by unfair or overly burdensome tax treatment by one or more countries, retaliation is probable.¹⁷² A prime example of such retaliation is the statement of British prime Minister Margaret Thatcher following the decision in *Container Corp.*; Margaret Thatcher told former Treasury Secretary Donald Regan “. . . we might be under very severe pressure to take retaliatory measures.”¹⁷³ In 1985, Britain retaliated when it passed retroactive legislation withdrawing tax advantages for United States corporations conducting business simultaneously in Britain and in a unitary tax state. Another example of Britain’s retaliation was its cancellation of a trade mission to Florida because of Florida’s use of the WWCR method of taxation. The likelihood of retaliation is strengthened by the fact that every nation in the industrialized western world has sent correspondence to the United States Government avidly protesting the use of WWCR by single American states. In addition, objections by other countries to WWCR has given the United States difficulties in its treaty negotiations.

A number of factors show that this retaliation is fully justified and should have been expected. These factors include that over a number of years the governments of Britain and Canada¹⁷⁴ incessantly and continuously protested the use of formula apportionment. Moreover, both Britain and Canada sent *amici curiae* briefs to the Third District Court of Appeal stating their disapproval of the use of WWCR. Lastly, the state tax creates an inequality in international taxation which operates to the disadvantage of foreign corporations.

Another factor demonstrating why California’s taxation method is unfair and justifies retaliation involves the taxation method’s compliance costs. Compliance costs associated with California’s WWCR method are astronomical.¹⁷⁵ For example, only 1.5 per cent of Barclays’ worldwide income in 1977 can be attributed to California, but it would cost millions of dollars to establish and maintain the global system necessary to comply with California’s WWCR tax method.¹⁷⁶ Additionally, there is the problem of the California Tax Board forcing foreign corporations to reveal information that is confidential under that foreign country’s laws and which California’s Tax Board has no right to obtain. The Court of Appeal realized the impact of retaliation in *Barclays*. In contrast to *Container Corp.*, the Court of Appeal did not have to guess whether the WWCR taxation method at issue offended foreign trading partners or whether it led them to retaliate against the United States as a

171. *Id.*

172. See generally Hadari, *supra* note 165, at 112-13 (discussing the probable response of retaliation for unfair international tax treatment).

173. 10 TAX PLANNING INT’L REV. 20 (1983).

174. Britain is the United States largest foreign investor and Canada is the United States largest trading partner.

175. Comptroller general report, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving, 3 GAO/GGD-82-38 (1982).

176. The figures range from \$6.4 to \$7.7 million to establish, and \$2 to \$3.8 million a year to maintain.

whole. There was no question that in this case; the foreign trading partners were offended and they retaliated.

C. Decreased Foreign Investment

When unfair or overly burdensome tax treatment by one or more countries disrupts the delicate balance of international taxation, decreased international investment is likely.¹⁷⁷ Encouraging international investment is a primary goal of U.S. international tax policy.¹⁷⁸ On the whole, the WWCR taxation method gives rise to higher taxes for multinational corporations doing business within a state.¹⁷⁹ Continued use of WWCR by California may deter future investors in all of the states due to this increased amount of taxation.¹⁸⁰ In fact, some corporations have already pulled investments out of states that use unitary taxation methods, and more will surely follow.¹⁸¹

VI. CONCLUSION

A major purpose of the Constitution was to place control of foreign relations firmly in the hands of the federal government.¹⁸² As stated pointedly by one commentator: "The national interest demands that local interference in foreign and defense policy be curtailed before the federal government finds itself hamstrung by hundreds of would-be secretaries of state touting their own parochial agendas . . . Foreign policy must be made in Washington and not in the citizen's backyards."¹⁸³ As stated before the Senate committee hearings on state taxation of foreign-based multinational corporations:

To permit [the states] to roam the world threatening U.K. based companies having no permanent establishment in the U.S., demanding information which the U.S. would have no treaty right to demand, and generally acting like a bull in the international china shop, is unbecoming to the dignity of the U.S., to the placidity of its relations with those countries with which it solemnly negotiates treaties, and

177. Hadari, *supra* note 165, at 112-13.

178. See generally Kingson, *The Coherence of International Taxation*, 81 COLUM L. REV. 1151 (1981) (discussing the interdependency of U.S. and foreign income tax systems); Keesling, Note, *Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code*, 89 HARV. L. REV. 1202 (1976) (discussing the relative advantages and disadvantages of the separate-entity and unitary theories of accounting) quoted in Kristen Schlenger, *State Worldwide Unitary Taxation: The Foreign Parent Case*, 23 COLUM J. TRANSNAT'L L. 445, 459 (1985).

179. See *supra* notes 43-48 and accompanying text (discussing the WWCR taxation method).

180. *Tax Treaties with the United Kingdom, Republic of Korea, and the Republic of the Philippines: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. (1977), quoted in Schlenger, *supra* note 178, at 468 n. 146. See *British Respond to Container with Retaliatory Bill*, STATE TAX REPORT 167 (JULY 26, 1983) (discussing a proposed amendment introduced in the House of Commons which would deny some U.S. companies a tax credit gained by the U.K. Tax Treaty), quoted in Schlenger, *supra* note 178, at 467 n. 145. See also *Multinationals Start Their Own Tax revolt*, BUS. WK., October 31, 1983, at 134 (Sony's letter to Florida claims that the state prompts it "to question the wisdom of keeping high-tech operations in" the state) quoted in Schlenger, *supra* note 178, at 468 n.147.

181. See *supra* note 180 (discussing international responses to state use of formula apportionment taxation on foreign unitary businesses).

182. Richard B. Eilder, *supra* note 166, at 821.

183. Peter J. Spiro, *Taking Foreign Policy Away from the Feds*, WASH. Q., No. 1, 1988, at 191, 202-3.

accomplishes no purpose necessary for the protection of the revenue of the taxing state.¹⁸⁴

In summary, it is very clear that for both reasons of logical case analysis and reasons of public policy, California's Franchise Tax Board should not be able to use WWCR, especially when taxing foreign-parent multinational businesses. California should follow the clear wishes of the federal government, as expounded by the executive branch.¹⁸⁵ States simply have never been allowed, and cannot now, freely disrupt cogent federal policies in the name of state sovereignty under federalism.

David Greenberg

184. *See supra* note 1 (discussing this statement made before the 1st Session of the 95th Congress).

185. *See supra* notes 101-102 and accompanying text (discussing the foreign policy tax formulation of the executive branch).

