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Constitutional Law: Due Process and Commerce Clause Concerns in State Taxation of Multinational Corporations in Wake of the Barclays Case

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COMMENTS

CONSTITUTIONAL LAW: DUE PROCESS AND COMMERCE CLAUSE CONCERNS IN STATE TAXATION OF MULTINATIONAL CORPORATIONS IN WAKE OF THE *BARCLAYS* CASE

*Beverly L. Hayes**

I. INTRODUCTION

Petitioners, Barclays Bank PLC ("Barclays") and Colgate Palmolive Co. ("Colgate"), claimed that the California franchise tax system unconstitutionally burdened foreign-based nationals and resulted in double international taxation in violation of the Commerce and Due Process Clauses of the U.S.

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* This comment is dedicated to the loving memory of my father, Leayres Hayes. I would like to thank my mother, Rose Hayes, and my sister, Bridgette Hayes, for their lifelong support of all my aspirations. Also, I would like to thank Mr. Charlie J. Jenkins, Jr. who has continually encouraged my writing.

Constitution.[1] This comment focuses exclusively on the action involving Barclays. Essentially, Barclays urged that the tax scheme impinged on the Commerce Clause because it inhibited the federal government's ability to speak with one voice with respect to regulating foreign governments.[2] Two members of the Barclays corporate family sought refunds in 1977 for franchise taxes paid to the State of California.[3] The Tax Board concluded that the members were part of a worldwide unitary business, the Barclays Group, and thus assessed an additional tax liability.[4]

Petitioners prevailed in the lower courts, yet the California Supreme Court reversed, holding the tax was not adverse to the Commerce Clause.[5] The California Supreme Court remanded the case to the Court of Appeal for the Third Appellate District to explore Barclays' claim that the compliance burden on foreign-based nationals imposed by California's taxing scheme violated the Due Process Clause, as well as the nondiscrimination requirement of the Commerce Clause.[6] Subsequently, the Court of Appeal decided the compliance burden issues against Barclays, and the California Supreme Court denied further review.[7] The U.S. Supreme Court granted certiorari and affirmed the California Court of Appeals decision.[8] The Court rejected Petitioners' arguments in totality and HELD the Constitution does not impede application of California's corporate franchise tax to Barclays and Colgate.[9]

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1. Barclays Bank PLC v. Franchise Tax Board, 114 S. Ct. 2268, 2272 (1994). This case was brought in a consolidated action with Colgate Palmolive Co. (Colgate is a U.S.-based parent company of a multinational manufacturing and sales enterprise.) Essentially, Colgate raised the same substantive issues as Barclays. *Id.* The Commerce Clause provides that "the Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several states." U.S. CONST. art. I, § 8, cl. 3. Throughout this Comment, the terms "double taxation" and "multiple taxation" will be used interchangeably to mean the phenomena of governments taxing an entity on the income that has been previously taxed by one or more governments.

2. *Barclays*, 114 S. Ct. at 2272 (quoting Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 439 (1979)).

3. *Id.* at 2274. The first member was Barclays Bank of California (Barcal), a California banking corporation wholly owned of Barclays Bank International (BBI). The second member was BBI, a United Kingdom corporation, which operated in the United Kingdom and in more than 33 other nations and territories. In 1977, Barcal, in computing its 1977 franchise tax, used income only from its own operations. Meanwhile, BBI reported income with the belief that it participated in a unitary business composed of itself and its subsidiaries, but not its parent corporation or that parent's other subsidiaries. *Id.*

4. *Id.* Barcal and BBI paid the additional taxes and sued for refunds. *Id.*

5. *Id.*

6. *Id.*; *see also* Barclays Bank Int'l, Ltd. v. Franchise Tax Board, 2 Cal. 4th 708, 829 P. 2d 279, *cert. denied*, 113 S. Ct. 202 (1992).

7. *Barclays*, 114 S. Ct. at 2274.

8. *Id.*

9. *Id.* at 2272.

II. THE CASE HISTORY LEADING UP TO THE *BARCLAYS* CASE

The U.S. Supreme Court has held that the Due Process and Commerce Clause preclude states from collecting income-based taxes from nonresidents for taxing value earned outside the taxing state's boundaries.[10] The challenge has been to find a solution to the problem of tax assessment of business organizations that operate in multiple taxing jurisdictions.[11] Some states have chosen to employ the "unitary business method" to figure corporate income-based taxes.[12] To apply the unitary business method, many states have adopted Worldwide Combined Reporting (WWCR).[13] The taxing state takes into account the total income earned by a related domestic and foreign[14] corporation, including subsidiaries, parent corporations, and all related affiliates that constitute a unitary business.[15] Consequently, this process includes revenue generated outside and inside the taxing jurisdiction.[16]

Next, the total income is distributed among the corporate entities by using a three-factor formula, such as sales, property, and payroll.[17] Hence, foreign income might by subjected to state income taxation.[18] As a result,

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10. *Id.* (citing ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1982)).

11. *See id.* (citing Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 164 (1983)). The Court observed that every method of assessment involves some element of arbitrariness. *Id.*

12. *Id.* The Court first considered the "unitary business principle" in Adams Express Co. v. Ohio State Auditor, 165 U.S. 194 (1897). *Barclays*, 114 S. Ct. at 2272 n.1. A business is unitary if there are the following: (1) unitary ownership;(2) unity in operation as evidenced by central purchasing, advertising, accounting, and management divisions; and (3) unity of use of its centralized executive force and general system of operation. Butler Bros. v. McColgan, 17 Cal. 2d 664, 678 (1941).

13. *See* James Kane, *International Tax Treaties and State Taxation: Can the Federal Government Speak with One Voice?*, 10 VA. TAX REV. 765 (1991). Kane gives a very good historical and analytical view of multinational taxation. The arm's-length, separate accounting approach to multinational taxation is by far the most popular method of taxing jurisdictions and is employed by a great number of countries. Reuven S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, 15 VA. TAX REV. 89, 89 (1995). The arms-length method has been codified in U.S. federal tax policy under Section 482 of the Internal Revenue Code. I.R.C. § 482 (1994). Essentially, under this method, the taxing authority treats each subsidiary or corporate affiliate within an enterprise as an entity unto itself. *Barclays*, 114 S. Ct. at 2273. As a result, each corporation must conduct its operations between the affiliated subsidiaries as arm's-length transactions. *See id.*

14. "Foreign" refers to outside the United States, not merely to outside of any particular state's borders.

15. Kane, *supra* note 13, at 766.

16. *Id.*

17. *Id.* at 766-67.

18. *See Container Corp.*, 463 U.S. at 163-64; *see, e.g.*, F.W. Woolworth Co. v. Taxation & Revenue Dept., 458 U.S. 354 (1982); Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980); General

this taxing scheme has been exposed to extensive constitutional litigation.[19]

A. Container Corp. of America v. Franchise Tax Board

In *Container Corp. of America v. Franchise Tax Board*,[20] the Court accepted the proposition that in a large enterprise many subtle transfers of value take place.[21] Relying on geographical accounting alone opened up the taxing scheme to widespread manipulation.[22] To apply the unitary business method, the taxing authority must first define what is the "unitary business."[23] Then, the total income of the unitary business is apportioned between the taxing jurisdiction and the rest of the world by using objective data of corporate activities both inside and outside the jurisdiction.[24]

Container Corp. involved a largely domestic company that owned twenty foreign subsidiaries.[25] In computing its 1969 taxes, Container Corp. treated its subsidiaries as passive investments rather than as a unitary business.[26] During an audit, the Tax Board applied the unitary business method to

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Motors Corp. v. Washington, 377 U.S. 436 (1964).

19. *Container Corp.*, 463 U.S. at 163, 164.

20. 463 U.S. 159 (1983).

21. *Id.* at 164-65. The problem cited by many jurisdictions is the problem of "transfer pricing" discrepancies. SOL PICCIOTTO, INTERNATIONAL BUSINESS TAXATION 171-229 (1992). The term transfer pricing means that the figures utilized as the accounting basis for recording transactions between multinational enterprises and its subsidiaries or affiliates. J.D.R. ADAMS & J. WHALLEY, THE INTERNATIONAL TAXATION OF MULTINATIONAL ENTERPRISES IN DEVELOPED COUNTRIES 161 (1977) For example, traded items might be components manufactured in one country by the parent corporation and then sold to the subsidiary for use in another stage of production in another country. *Id.* The problem occurs when a corporation and its subsidiaries fail to value the traded items at a fair price. *Id.* For instance, when a low price is charged on items sold by a parent to a subsidiary, the profit margin is higher for the subsidiary, but lower for the parent. *Id.* Thus, when considerable differences exist between the taxing jurisdiction, multinational corporations may manipulate a country's taxing scheme by transferring profits to a low-tax jurisdiction. *Id.* at 163; *see also* Joseph H. Guttentag & Toshio Miyatake, *Transfer Pricing: U.S. and Japanese Views*, *in* ESSAYS ON INTERNATIONAL TAXATION 165-66 (Herbert H. Alpert & Kees van Raad eds., 1993).

22. *Container Corp.*, 463 U.S. at 164-65. Taxing authorities face a challenge in valuating unique products, royalties, and the like. U.N. DEP'T OF ECONOMIC AND SOCIAL DEVELOPMENT, REPORT OF THE AD HOC GROUP OF EXPERTS ON INTERNATIONAL COOPERATION IN TAXATION MATTERS ON THE WORK OF ITS SIXTH MEETING at 13, U.N. Doc. ST/ESA/230, U.N. Sales No. E92.XVI.2 (1992). Further, in an increasingly complex world, the income arising from the transfer of technology is sure to exacerbate the transfer pricing dilemma. *Id.* This document provides a good general discussion of the difficulties in calculating royalties for technical services in areas such as patents and other forms of intellectual property.

23. *Container Corp.*, 463 U.S. at 164-65.

24. *Id.* at 171. Container Corp.'s percentage of ownership of the subsidiaries ranged between 66.7% to 100%. In those circumstances where it did not own 100% of the subsidiary, the rest was owned by local nationals. *Id.*

25. *Id.* at 174.

26. *Id.*

Container Corp., and as a result assessed an additional tax liability.[27] Container Corp. paid the liability and sued.[28] The trial court upheld the Tax Board assessments.[29] The California Court of Appeal affirmed, while the California Supreme Court declined to exercise discretionary review.[30] On appeal, the Court reasoned that because great deference is given to state courts in deciding what constitutes a unitary business, a taxpayer claiming a tax exemption bears the burden of establishing the basis for that exemption.[31]

Essentially, the Court narrowed the focus of the discussion to one of whether the state court applied the correct standard and whether the judgment was permissible.[32] Container Corp. asserted that prior to a finding that an enterprise is unitary, it must be characterized by a substantial flow of goods.[33] The Court found that the correct prerequisite for establishing a unitary business is a flow of value.[34] Thus, if a flow of value can be found, the unitary method is utilized.[35]

B. Allied-Signal v. Director, Taxation Division

This standard was successfully applied in *Allied-Signal v. Director, Taxation Division*.[36] In *Allied*, the petitioner, Allied (successor-in-interest to Bendix Corp.) contested the State of New Jersey's ability to tax funds Allied had realized from a sale of Asarco stock.[37] Bendix maintained four major operating groups and conducted business in all fifty states and twenty-two foreign countries.[38] Bendix bought 20.6% of Asarco stock on the open

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27. *Id.* Although the percentage of business attributable to California was less, the income (after including the subsidiaries) was substantially more, which accounts for the additional tax liability. *Id.*

28. *Id.* at 175.

29. *Id.*

30. *Id.*

31. *Id.* The Court here lays a suspect foundation both for the *Container Corp.* case and for subsequent due process jurisprudence. The Court expressed concern that legal certainty may be in jeopardy if we allow taxpayers to challenge any difference in taxation based on this method. *Id.* at 176-78. The Court noted that the State Court of Appeal had used a number of variables to determine whether Container Corp. and its subsidiaries composed a unitary business. *Id.* at 178.

32. *Id.* at 176-78.

33. *Id.* at 178.

34. *Id.*

35. *Id.*

36. 112 S. Ct. 2251 (1992).

37. *Id.* at 2255. Bendix was the party who initiated the buying of Asarco stock. *Id.*

38. *Id.* at 2256. Although each operating group had separate management, the chief executive officer of each group reported to the chairman and chief executive officer of Bendix. *Id.*

market and sold it three years later, realizing a gain of $211.5 million.[39] The New Jersey Supreme Court held it was constitutional to consider the gain as income earned in Bendix's unitary business.[40] Finding no evidence that Asarco was part of Bendix's unitary business, the U.S. Supreme Court held that New Jersey erroneously had included the proceeds from a sale of Asarco stock in New Jersey's apportionable tax base.[41] Thus, although two Bendix employees sat on Asarco's board of directors, it was stipulated that Asarco conducted its business independent of Bendix.[42]

C. Complete Auto Transit v. Brady

Throughout the last eighteen years, the U.S. Supreme Court has repeatedly cited to *Complete Auto Transit v. Brady*[43] in the discussion of interstate and multinational taxation. Complete Auto was engaged in the automobile transport business for General Motors Co.[44] Complete Auto received vehicles that were assembled and destined for Mississippi dealers within forty-eight hours of arrival in the state.[45] The state of Mississippi assessed a sales tax for the privilege of engaging and doing business in the state.[46] Complete Auto unsuccessfully challenged the tax in the lower court, and the Mississippi Supreme Court held the tax consistent with the Commerce Clause.[47]

The *Complete Auto* Court articulated the following four-part test: (1) whether the tax is applied to an activity with a substantial nexus with the taxing state; (2) whether it is fairly apportioned; (3) whether it avoids discrimination against interstate commerce; and (4) whether it is fairly related to the services provided by the state.[48] Against this background, the Court found the tax not adverse to the Commerce Clause and affirmed the Mississippi Supreme Court decision.[49]

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39. *Id.*
40. *Id.* at 2257.
41. *Id.* at 2264.
42. *Id.* at 2256.
43. 430 U.S. 274 (1977).
44. *Id.* at 276.
45. *Id.*
46. *Id.* at 275. More recently, the Court has reiterated its finding that interstate taxation must be connected to an activity and not to an actor the state proposes to tax. *See generally* Quill Corp. v. North Dakota, 504 U.S. 298 (1992) (involving the issue of whether North Dakota had the authority to tax Quill).
47. *Complete Auto*, 430 U.S. at 274.
48. *Id.* at 279.
49. *Id.* at 288-89.

D. Japan Line, Ltd. v. County of Los Angeles

Another concept that has permeated the multinational taxation issue is that the government must speak with one voice.[50] *Japan Line, Ltd. v. County of Los Angeles*[51] involved a challenge by Japan Line to the taxation of large cargo shipping containers.[52] Since Japan Line docked these containers temporarily in California for periods averaging no more than three weeks, their only use was as an instrumentality of foreign commerce.[53] California imposed an ad valorem property tax on property present in the state on a yearly basis.[54] Japan Line paid the taxes, sued, and ultimately won when the Court found that the tax violated the Commerce Clause.[55] The Court, in essence, expanded the standard set out in *Complete Auto* and held that the tax created a substantial risk of international multiple taxation and prevented the federal government from uniformly regulating foreign commerce.[56]

III. DISCUSSION OF THE MULTIPLE TAXATION CLAIM BY THE *BARCLAYS* COURT

The instant case, on the surface, appears to be another in a long line of corporate enterprise tax dispute cases. Indeed that is how it was first presented.[57] Alternatively, it could be analyzed as a continuation of issues left unanswered after *Container Corp.*[58] Among others, these issues include the treatment of domestic corporations with foreign parents or subsidiaries.[59] To begin its analysis, the Court relied on the criteria set out in *Complete Auto.*[60] Under this criteria, the Court found that the California tax scheme did not violate the Commerce Clause.[61]

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50. *See generally* Wardair Canada v. Florida Dept. of Revenue, 477 U.S. 1 (1986) (rejecting a Commerce Clause challenge to a tax on the sale of fuel to common carriers).

51. 441 U.S. 434, 436-37 (1979).

52. *Id.*

53. *Id.* at 437.

54. *Id.*

55. *Id.* at 451.

56. *Id.* The Court pointed that, by stipulation, U.S. containers were not taxed by Japan. *Id.* at 453. Further, California's tax might lead to Japan retaliating, and thus, affecting the entire nation. *Id.* More importantly, the Court responded to the threat to foreign trade presented by other states following the California tax scheme. *Id.*

57. *Barclays*, 114 S. Ct. at 2271.

58. *Id.*

59. *Id.*

60. *Id.* at 2276-78.

61. *Id.* at 2278. Additionally, the Court refused to consider Barclays aversion to California's reasonable approximations method, because Barclays failed to show that the Tax Board had ever rejected Barclays approximations. *Id.* The Tax Board allows reasonable

After applying the *Complete Auto* guidelines, the instant Court turned to the first of two considerations applied to foreign commerce.[62] The first was whether there existed an elevated risk of multiple taxation.[63] The Court rejected Barclays' argument that the mere risk of double taxation might result from the California tax scheme.[64] Instead, the Court reiterated that the *Container Corp.* holding relied in part on whether multiple taxation was inevitable and whether the alternative available could not eliminate the risk of double taxation.[65] However, under this analysis, it was not enough to merely show that multiple taxation sometimes occurred.[66] Furthermore, the Court asserted that other methods, such as separate accounting, do not necessarily lessen the risk of multiple taxation.[67] Thus, Barclays' argument failed.[68]

Secondarily, the instant Court probed the question of whether WWCR, as applied to Barclays, impaired foreign federal uniformity in the area of foreign commerce.[69] In essence, the concern was whether the California tax scheme survived constitutional scrutiny under the Commerce Clause, because it differed fundamentally from that of the federal government.[70] The Court drew from Congress' silence a defacto acceptance of tax schemes such as California's.[71] Justice Ginsburg, writing for the majority, referred to the history of litigation and proposed legislation in the area of foreign entity taxation.[72] Moreover, she indicated that Congress had declined to enact legislation to prevent WWCR.[73] As a result of this congressional unwillingness, the Court refused to make policy judgments about foreign

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approximations of data used in compliance with filing of tax returns. *Id.* This method is allowed because in some cases data required by the Tax Board is not kept in the regular course of business. *Id.* It is worth noting that Barclays compliance costs were nominal during the years prior to 1977, ranging from $900 to $1250 a year. *Id.* at 2278 n.13.

62. *Id.* at 2279.

63. *Id.*

64. *Id.* at 2280.

65. *Id.* "Alternative" refers to some other form of taxation method, *e.g.*, separate accounting or arms-length method.

66. *Id.*

67. *Id.*

68. *Id.* at 2281.

69. *Id.*

70. *Id.* at 2273. Justice Scalia appeared somewhat skeptical of the majority's finding congressional inaction should be interpreted as permission for the states to restrict foreign commerce. *Id.* at 2287 (Scalia, J., concurring in part and concurring in the judgment). As well, Justice Scalia voiced a similar concern of the "speak with one voice" analysis because he believes that this would give the President authority to interpret state law. *Id.*

71. *Id.* at 2283-89.

72. *Id.* at 2282-83.

73. *Id.* at 2284. Congress has introduced several pieces of legislation. However, to date, there has been no action with respect to multinational taxation. *Id.*

commerce.[74]

Similarly, the Court commented on the President's role in multinational taxation.[75] The Court pointed out that the President has certain powers independent of Congress.[76] Having asserted that executive branch communications lack the force of law, the Court noted that letters, press releases, and amicus briefs are a wholly ineffective means of modifying or eliminating multiple taxation.[77]

In contrast, Justice O'Connor, writing for the dissent, argued that because foreign taxpayers are barred access to the political process, differential treatment is necessary.[78] Further, she commented that states must have express congressional consent to adopt a taxation system that produces multiple taxation.[79] Relying on Justice Powell's dissent in *Container Corp.*, Justice O'Connor reasoned that this position might occasion discrimination of domestic corporations.[80]

IV. ARGUMENTS, CONSIDERATIONS, AND OPTIONS AVAILABLE TO MULTINATIONAL CORPORATIONS

A. *The Effects of the* Barclays *Holding*

The instant case presented the opportunity for the Court to resolve and refine the principles by which it would be guided in multinational taxation controversies. However, in the face of compelling conceptual dispute, the Court declined the privilege to reconsider or modify *Container Corp.* and left foreign taxpayers without judicial relief.[81] For purposes of avoiding multiple taxation, the Court expressly disregarded the notion that any particular taxation computing methods were better than any others.[82]

By returning to and affirming *Container Corp.*, the Court has spoken on the issue of multinational taxation of foreign corporations, parents, and subsidiaries.[83] The results are most likely to fall hardest on small, growing foreign companies attempting to penetrate the United States. Additionally, foreign companies with minimal contacts in the United States will be

74. *Id.* at 2284-85.
75. *Id.* at 2286.
76. *Id.*
77. *Id.*
78. *Id.* at 2289.
79. *Id.*
80. *Id.*
81. *Id.* at 2284-86.
82. *Id.* at 2280.
83. *Id.* at 2280-86.

disproportionately affected.[84]

B. *Lobbying the U.S. Congress and Political Considerations*

As the dissent points out, foreign corporations may not invoke the U.S. political process.[85] Instead, they must resort to indirect means, such as writing diplomatic notes and amicus briefs.[86] In light of Justice Ginsburg's statements in the instant case, the effect of these communications are unknown.[87]

However, there are many factors indicating that successful lobbying of Congress could produce anti-WWCR legislation that would pass constitutional muster. First, one may reexamine the Barclays decision. The *Barclays* Court spoke at length on the subject of Congress' implicit decision to allow WWCR.[88] Second, the Court concluded that there was no intent by Congress to bar California's tax scheme.[89] Third, the Court remarked that all past double-taxation bills introduced in Congress had failed.[90] Thus, this line of analysis indicates that federal legislation could eliminate WWCR and apportionment formulas.

Thus, notwithstanding the problem of securing Congressional votes, corporate taxpayers must consider the role of the President and the Solicitor General in the double-taxation debate.[91] With respect to the *Barclays* case,

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84. The dissent points out that Barclays does 98% of its business in countries other than the United States. *Id.* at 2288.

85. *Id.* at 2289.

86. *Id.* at 2281. Amicus briefs were written in support of Barclays from the Governments of the United Kingdom and the Member States of the European Community, and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden, and Switzerland. *Id.* at 2283 n.22.

87. *Id.* at 2286.

88. *Id.* at 2284.

89. *Id.* at 2283.

90. *Id.* at 2283-84. For the most part, attempts to enact federal legislation to abolish WWCR and apportionment methods have been fruitless. Kane, *supra* note 13, at 788. In 1965, attempts were made to enact the Interstate Taxation Act, which required state corporate income taxes to comply substantially with federal income as computed by the Internal Revenue Code. *Id.* The bill was defeated, rewritten, and defeated at least twice. *Id.* Then in 1979, Senator Charles Mathias, Jr. introduced two bills dealing with national standards for state taxation and states' taxation of worldwide income. *Id.* at 789. Although his bills were defeated, Senator Mathias joined with Senators Pete Wilson and Paula Hawkins in introducing the Unitary Tax Repealer Act in 1985. *Id.* at 788. Also, under pressure from the United Kingdom, a bill was introduced in June 1993 that would have terminated the California apportionment scheme. Richard M. Hammer, *Will the Arm's Length Standard Stand the Test of Time? The Spector of Apportionment, in* ESSAYS ON INTERNATIONAL TAXATION 201, 203 (Herbert H. Alpert & Kees van Raad eds., 1993).

91. Kristen A. Norman-Major, *The Solicitor General: Executive Policy Agendas and the Court*, 57 ALB. L. REV. 1081, 1107 n.21 (1994); *see also* Marcia Coyle, *Solicitor General Indirect Target of International Lobby*, NAT'L L.J., May 31, 1993, at 23.

the Justice Department initially argued that the California tax scheme was unconstitutional.[92] However, during the 1992 Presidential campaign, President Clinton said that he would support California in the *Barclays* dispute.[93] Thus, when the *Barclays* case reached the Supreme Court, the Solicitor General was silent.[94] Moreover, it is difficult to argue that politics are not a factor in the Justice Department when one-third of the lawyers in the Solicitor General's office left shortly after President Clinton took office and were replaced with liberal lawyers.[95]

C. *Attacking the Validity of the Taxing Scheme*

The instant case decision leaves open other avenues for multinational taxpayers to pursue. For example, *Allied-Signal* suggests that income not attributable to the unitary business is not subject to state taxation schemes.[96] As a result, foreign companies may continue to attack the taxation of specific income by claiming that it is non-unitary.[97] Also, by setting up wholly independent companies, foreign taxpayers may avoid the effects of WWCR.[98]

D. *The Viability of Multinational Taxation Treaties*

Many double-taxation complications may be resolved through the use of international tax treaties.[99] For the mutual good, a tax treaty allows a relaxation of the domestic taxing rules of both the residence and origination States. As a result of treaty obligation, two principles arise.[100] First, a treaty has the status of existing law, thus trumping any state law.[101] Second, courts will, wherever practical, interpret a domestic regulation in

92. Norman-Major, *supra* note 91, at 1107 n.21.
93. *Id.*; *see also Solicitor General Indirect Target, supra* note 91, at 23.
94. Norman-Major, *supra* note 91, at 1107 n.21.
95. *Id.* at 1107.
96. *Allied*, 112 S. Ct. at 2256.
97. *Id.*
98. *Id.* at 2260.
99. Richard L. Doernberg, *Preparation of IRS International Examines for Treaty-Based International Issues*, *in* ESSAYS IN INTERNATIONAL TAXATION 105 (Herbert H. Alpert & Kees van Raad eds., 1993). Additionally, the Organization of Economic Development (OECD) has been an influential force in the development of international tax relationships. VITO TANZI, TAXATION IN AN INTEGRATED WORLD 83 (1993). Among Member States, over 200 treaties have been entered into based on the OECD Model Convention. Hugh J. Ault, *The Role of the OECD Commentaries in the Interpretation of Tax Treaties*, *in* ESSAYS ON INTERNATIONAL TAXATION 61 (Herbert H. Alpert & Kees van Raad eds., 1993). Importantly, the OECD Model Treaty contains a provision specifically designed to reduce the incidents of double taxation. ADAMS & WHALLEY, *supra* note 21, at 79.
100. PICCIOTTO, *supra* note 21, at 311.
101. *Id.*

ways compatible with treaty obligations.[102]

Because tax treaties offer favorable State treatment of multinational corporations, tax treaty proponents have espoused their use.[103] By using tax treaties to require State consistency in the application of the arms-length accounting method, three goals may be accomplished. First, in taxation matters, the United States may indeed speak with one voice.[104] Second, the threat of retaliation of the WWCR method may be avoided.[105] Third, tax treaties may help to enforce other commitments between the United States and its trading partners.[106] This is especially true in light of recent agreements, such as the North American Free Trade Agreement[107] and the General Agreement on Tariffs and Trade.[108]

E. *Considerations in Light of the Distinguishing of* Japan Line

By emphasizing that *Japan Line* involved taxation of instrumentalities of foreign commerce rather than income tax of a foreign company, the Court found a Commerce Clause violation.[109] However, under the *Complete Auto* criteria, the *Japan Line* Court found the risk of multiple taxation and the Commerce Clause issue to be the only difficulties present.[110] Due to the failure of the *Japan Line* Commerce Clause argument, foreign taxpayers must rethink arguments purporting that WWCR prevents the U.S. government from speaking with one voice.[111]

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102. *Id.*

103. *See* sources cited, *supra* note 99 and accompanying text.

104. *See* sources cited, *supra* note 13 and accompanying text (discussing the widespread use of the arms length method of accounting).

105. Kane, *supra* note 13, at 796.

106. *Id.* at 797.

107. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 278.

108. *General Agreement on Tariffs and Trade: Multilateral Trade Negotiations Find Act Embodying the Results of the Uruguay Round of Trade Negotiations*, Apr. 15, 1994, 33 I.L.M. 1125. The need for change has become even more apparent as experts have begun to compare tax schemes, such as those of California and those located in the GATT provisions. *Unitary Taxes, California Unitary Tax Could Be Found in Violation of GATT, Expert Warns*, DAILY BUSINESS EXECUTIVE, Dec. 14, 1994, at 238. One expert has commented that a GATT Panel is considering the possibility that tax schemes such as California's will indicate a conflict. *Id.* In fact, Robert Stumberg, a Georgetown University law professor, stated that he believes the California unitary tax scheme will be challenged due to GATT. *Id.* Further, a GATT Panel reasoned that varying tax laws in different states amounts to tax discrimination. *Id.*

109. *Barclays*, 114 S. Ct. at 2280 n.18 (citing *Japan Line*, 441 U.S. at 451).

110. *Japan Line*, 441 U.S. at 445-49.

111. *See generally* Walter Hellerstein, *State Taxation of Corporate Income from Intangibles; Allied-Signal and Beyond*, 48 TAX L. REV. 739 (1993). This author briefed and argued on behalf of Allied in *Allied-Signal*. In his article, Hellerstein provides an excellent discussion of the increasing difficulties of Commerce Clause arguments. *See, e.g.*, Wardair Canada v. Florida Dep't of Revenue, 477 U.S. 1 (1986) (where the Court rejected a

V. CONCLUSION

Given the current Court's tendency to defer to state governments in multinational taxation issues,[112] foreign taxpayers have three choices. They may litigate narrow issues, such as a particular state apportionment formula or the particular income included in the apportionment factor. On the other hand, they may push for fundamental change by collectively lobbying Congress to dismantle either the unitary business method or WWCR.[113] The instant Court is correct in not yielding to political pressures, because though foreign corporate taxpayers present a compelling argument, the U.S. Supreme Court is the wrong forum. Lastly, taxpayers may appeal to the President of the United States[114] and claim that WWCR has a detrimental effect on foreign trade with the United States. At least one commentator suggests that a tax treaty is appropriate.[115] The majority's comments in this area suggest that this is a viable solution.[116] The clarity and firmness of the instant case is indicative, in some respects, of the future of multinational taxation.

Commerce Clause challenge to a tax on the sale of fuel to common carriers).

112. *Allied Signal*, 112 S. Ct. at 2258.
113. *Barclays*, 114 S. Ct. at 2282-83.
114. *Id.* at 2286. For further discussion see *supra* text accompanying notes 91-95.
115. *See generally* Kane, *supra* note 13.
116. *See Barclays*, 114 S. Ct. at 2283-89.