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State Taxation of Foreign Source Income through Worldwide Combined Reporting

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NOTE

STATE TAXATION OF FOREIGN SOURCE INCOME THROUGH WORLDWIDE COMBINED REPORTING

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I. INTRODUCTION TO WORLDWIDE COMBINED REPORTING

State taxation of the income of multinational enterprises gives rise to an array of complex issues, including the proper method

for arriving at a corporation's taxable base.[1] Worldwide combined reporting is one method used to determine a corporation's taxable base for state corporate income tax. Essentially, worldwide combined reporting computes a corporation's taxable base by adding the income of all the corporation's enterprises[2] throughout the world that comprise a "unitary business."[3] Thus, worldwide combined reporting includes in a domestic corporation's apportionable tax base the nonrepatriated foreign source income[4] of the foreign subsidiaries[5] of the domestic corporation's United States parent. Similarly, the tax base of a United States subsidiary would include the foreign income of the corporation's foreign parent.[6]

A 1982 study for the United States Treasury Department[7] indicates that the use of worldwide combined reporting generates ad-

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1. A corporation's taxable base is the amount of the corporation's income subject to apportionment. 1 J. HELLERSTEIN, STATE TAXATION, CORPORATE INCOME AND FRANCHISE TAXES, ¶¶ 7.2, 7.3 (1983).

2. Combined reporting typically excludes intercompany dividends, intercompany sales, and other intercorporate transfers from the combined income tax base of a "unitary business." For a definition of combined reporting, see Keesling, *A Current Look at Combined Report and Uniformity in Allocation Practices*, 42 J. TAX'N 106, 107 (1975). Consolidated reporting is the combination of income of related corporations for federal tax purposes. The taxing state can require consolidated reporting only if it has jurisdiction over all the taxpayer corporation's related corporations. *See* Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Groups*, 25 TAX L. REV. 171, 197-98 (1970). Otherwise, use of consolidated reporting would violate due process.

3. *See generally* Rudolph, *supra* note 2, at 194-97.

4. Foreign source income is income earned in a country other than the corporation's country of domicile. Nonrepatriated foreign source income is foreign source income that is not returned to the corporation's country of domicile.

5. *See, e.g.*, Appeal of Grolier Society, Inc., 4 CAL. TAX REP. (CCH) ¶ ¶ 205-301 (Aug. 19, 1975) (taxable income base included the foreign subsidiaries of a non-California domiciled parent corporation operating a California subsidiary), *discussed in* Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?*, 20 SANTA CLARA L. REV. 123, 133-34 (1980).

6. *Id.* (citing Appeal of Beecham Inc., 4 CAL. TAX REP. (CCH) ¶ ¶ 205-635 (Mar. 2, 1977)) (taxable income base included the foreign parent corporation's other foreign subsidiaries).

7. *See* COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE, REPORT TO THE HOUSE COMM. ON WAYS AND MEANS, KEY ISSUES AFFECTING STATE TAXATION OF MULTIJURISDICTIONAL CORPORATE INCOME NEED RESOLVING 16 (1982) [hereinafter cited as 1982 GAO REPORT].

ditional tax revenue for state governments.[8] Most notably, because of its large economy and strict application of worldwide combined reporting, California has generated, and continues to generate, at least an extra 500 million dollars of tax revenue each year.[9] Conversely, a corporation in a state using worldwide combined reporting typically will pay more state income tax than a corporation taxed in a state that uses an "arm's length" system to determine where the corporation generated its revenue.[10]

To increase revenue, states using a corporate income tax[11] or a franchise tax measured by net income[12] often prefer to adopt

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8. If the Court invalidated worldwide combined reporting, states would receive less tax revenue:

> Seven states responding to a questionaire distributed by the Multistate Tax Commission on behalf of the Treasury Department furnished revenue loss estimates as follows: California, $500 million; Colorado, $12 million; Idaho, $16-17 million; Montana, $3 million; New York, $75 million; North Dakota, $3.5-5.5 million; and Utah, $16 million.

Brief Amicus Curiae of the Confederation of British Industry at 10, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983) [hereinafter cited as British Industry's Brief Supporting Container Corp.](citing Multistate Tax Commission, *Summary of State Responses to Treasury Department Questionaire on Use of Unitary Method and Taxation of Dividend Income* 5 (May 11, 1982)).

9. N.Y. Times, June 28, 1983, at A1, col. 5, D8, col. 4.

10. *See infra* text accompanying notes 115-18. The different methods used by states to calculate taxable income can also result in multiple tax burdens. *See* 1982 GAO REPORT, *supra* note 7, at 10 (only 34 states having a corporate income tax begin their calculation with federal taxable income).

11. *See infra* note 61. The burden of state corporate income taxes varies considerably. Although Oklahoma imposes a 4% corporate net income tax, Connecticut has an 11.5% rate, and New Hampshire has an 8% rate. ALL STS. TAX GUIDE (P-H) 129-30 (Mar. 13, 1984); *see also id.* at 131 (Dec. 20, 1983) (New Hampshire also has a temporary 13.5% surcharge). *See generally* Wheaton, *Interstate Differences in the Level of Business Taxation*, 36 NAT'L TAX J. 83 (1983). For an historical perspective on state tax rates see Gold, *Recent Developments in State Finances*, 36 NAT'L TAX J. 1 (1983).

12. Most states need to impose new or higher taxes to raise revenue for their fiscal 1983 and 1984 budgets. *See* S. GOLD & K. BENKER, STATE FISCAL CONDITIONS ENTERING 1983 (report based on a survey of legislative fiscal officers conducted in Dec. 1982 and Jan. 1983), *summary reprinted in Financial Plight of States Called 'Exceedingly Grim,'* 18 TAX NOTES 559 (1983). As of June 6, 1983, 26 states either had raised taxes in 1983 or had extended "temporary" taxes. Idaho, New Mexico, New York, Ohio, Rhode Island, Utah, Washington, and West Virginia elected to raise corporate income or other business taxes. Wisconsin had a corporate income tax increase pending. *See* Merry, *It's Taxing Time for States as Drive to Limit Levies Slows*, Christian Sci. Monitor, June 8, 1983,

worldwide combined reporting, or an alternative plan to broaden their definition of a corporation's tax base,[13] rather than raise domestic tax rates.[14] States often elect worldwide combined reporting, therefore, because it usually has little immediate effect on the state citizenry.[15] This tax policy, however, may cause the public to suffer hidden costs if the increase in state taxes, coupled with the additional administrative burdens imposed upon corporations, discourages further corporate investment in the state.[16]

In *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*,[17] the United States Supreme Court addressed the legality of state taxation based on a corporation's worldwide income. Bass, the corporate taxpayer, imported ale from Great Britain and sold it in New York. New York imposed a franchise tax on an apportioned share of Bass' worldwide net income. The Court upheld the tax,[18] approving state apportionment of the corporation's nonrepatriated foreign source income. Subsequently, states have relied implicitly on *Bass* as authority for requiring a unitary business to determine its income based on worldwide combined reporting.[19]

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at 4.

13. Because businesses operate in more than one geographic location through the use of computers and other advances in communications technology, corporations find more states claiming that the business activities in their state provide the source of business income. *See, e.g., infra* text accompanying notes 124-27.

14. This concept is commonly called "exportation of state taxes." *See generally* Hellerstein, *State Tax Discrimination Against Out-of-Staters*, 30 NAT'L TAX J. 113, 120 (1977).

15. The incidence of state corporate income taxes is difficult to determine accurately. *See* McLure, *The Elusive Incidence of the Corporate Income Tax: The State Case*, 9 PUB. FIN. Q. 395 (1981); Long & Settle, *Tax Incidence Assumptions and Fiscal Burdens by State*, 35 NAT'L TAX J. 449 (1982).

16. *See infra* notes 176, 186. Some California representatives argue that repeal of worldwide combined reporting would increase investment in California, thereby stimulating California's economy and eventually producing more state revenues by generating a larger tax base in the state. *See infra* note 324.

17. 266 U.S. 271 (1924).

18. *Id.; cf.* Hoeper v. Tax Comm'n of Wisconsin, 284 U.S. 206, 215 (1931) (prohibiting combined reporting of family income but not of corporate income).

19. *See* Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947); Montana Dep't of Revenue v. American Smelting & Ref. Co., 173 Mont. 316, 567 P.2d 901 (1977), Coca Cola Co. v. Dep't of Revenue, 271 Or. 517, 533 P.2d 788 (1975).

One accountant believes that courts have sanctioned the unitary business

California,[20] Oregon,[21] and Alaska[22] pioneered the use of worldwide combined reporting. Nine other states currently use worldwide combined reporting.[23] These states contend that the method fairly generates more revenue by preventing intercompany shifts of income to avoid taxes.[24] Illinois and New York also used world-

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worldwide combined reporting concept "because taxpayers have failed to prove that it taxes purely extraterritorial values." Zagaris, *'Joint U.S./Dutch Meeting' of the International Fiscal Association*, 36 TAXES INT'L 15, 16 (1982) (paraphrasing statement of Carl B. Sullivan, an accountant for Peat Marwick, an international accounting firm).

20. "California pioneered the unitary method in the 1930s to prevent . . . Hollywood movie studios from escaping California taxes by transferring assets out of the state." N.Y. Times, June 28, 1983, at A1, col. 5, D8, col. 4. *See also McColgan*, 30 Cal. 2d at 472, 183 P.2d at 16 (1947). California extended this unitary business principle to worldwide operations in the early 1970s and applied it retroactively to corporate income earned in the 1960s. *See, e.g., State Taxation of Interstate Commerce and Worldwide Corporate Income: Hearings on S. 983 & S. 1688 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance*, 96th Cong., 2d Sess. 721, 724 (1980) (statement of William L. Strong, Executive Vice President, Firestone Tire & Rubber Co.) [hereinafter cited as *1980 S. State Tax'n Hearings*]. *See also* CAL. REV. & TAX. CODE ANN. § 25101 (West 1979 & Supp. 1984).

21. Oregon adopted the unitary business concept in 1955 and applied it to a multinational enterprise's worldwide income in the early 1960s when the state opened its New York auditing office. *See Tax Treaties with the United Kingdom, the Republic of Korea, and the Republic of the Philippines: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. 162 (1977) (statement of Theodore W. DeLooze, Chief Tax Counsel, Oregon Dep't of Justice) [hereinafter cited as *1977 S. Hearings on Tax Treaties*].

22. *See* 124 CONG. REC. 18,428 (1978) (statement of Sen. Pell). Alaska, however, has restricted substantially its use of worldwide combined reporting because it has found more lucrative ways of computing taxable income. *See* Hulihan, *British Firms Hope Reagan Will Back Bid to End State Taxes on World-Wide Profit*, Wall St. J., Sept. 12, 1983, at 28, col. 5.

23. The nine other states effectively taxing worldwide income are Colorado, Florida, Idaho, Indiana, Massachusetts, Montana, New Hampshire, North Dakota, and Utah. *See* 2 WEEKLY TAX REP. (BNA) 372 (1983).

Florida added worldwide combined reporting after the Court's *Container* decision. *See infra* text accompanying notes 287-91. The Colorado Supreme Court upheld the use of worldwide combined reporting without a specific statute authorizing the method. *See* Joslin Dry Goods Co. v. Dolan, 614 P.2d 16 (Colo. 1980).

24. *Cf. 1980 S. State Tax'n Hearings, supra* note 20, at 428, 430-32 (statement of William D. Dexter, General Counsel of the Multistate Tax Commission) (federal legislation prohibiting states from using worldwide combined reporting would allow a "corporate shell game" for tax avoidance purposes).

wide combined reporting for a short time.[25] These two states decided to eliminate the tax in the face of intense opposition from the business community. Fearing double taxation[26] and excessive administrative burdens, corporations threatened to flee to states offering more favorable business and tax climates. More significantly, worldwide combined reporting could influence corporations to decide not to expand their operations in states that use the method, with a resulting loss of potential jobs and tax revenue.

The primary alternative to worldwide combined reporting is the method used by the United States Government — the arm's length method of taxing foreign source income. Following the explanation of the arm's length method, this Note will outline briefly the due process and commerce clause limitations on a state's jurisdiction to tax and will describe the methods states have chosen to apportion the business income of a unitary business in order to comply with the commerce clause. The impact of worldwide combined reporting depends upon the apportionment formula adopted by the state and the state's definition of the terms "unitary business" and "business income." This Note will attempt to detail the problems posed by worldwide combined reporting from the perspectives of states, corporations, and foreign governments. In addition, this Note will consider the effect of the 1983 Supreme Court decision, *Container Corporation of America v. Franchise Tax Board*,[27] which finally addressed the issue of

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25. *See* ST. TAX REV., Dec. 7, 1982, at 1 (new Illinois tax law). New York agreed to drop worldwide combined reporting for multinational oil companies in a tax dispute settlement. *See* N.Y. Times, June 21, 1983, at A1, col. 1, A26, col. 1.

In most states, worldwide combined reporting increases taxes for almost all corporations. In North Dakota and California 75-85% of the corporations pay higher taxes; 90% of the corporations pay higher taxes in Colorado. *See* Multistate Tax Commission, *Summary of State Responses to Treasury Department Questionnaire on Use of Unitary Method and Taxation of Dividend Income* 5 (May 11, 1982), *cited in* British Industry's Brief Supporting Container Corp., *supra* note 8, at 10 n.11.

26. "Whenever profit rates are higher in foreign affiliates than in domestic activities, the unitary system allocates too much income to the domestic member or members of the group. The result is tantamount to taxation by a state government of the foreign income of a foreign corporation." *1977 S. Hearings on Tax Treaties*, *supra* note 21, at 34 (prepared statement of Laurence N. Woodworth, Assistant Secretary of Treasury for Tax Policy).

27. 103 S. Ct. 2933 (1983). Justice Stevens took no part in the *Container*

whether states could extend the *Bass* principle—taxation of a corporation's worldwide income—to tax the worldwide combined income of a unitary business having a United States parent corporation and foreign subsidiaries.

II. Taxation of Foreign Source Income Generally

Foreign source income is income derived from activities in a country other than the country in which the domestic subsidiary or parent corporation is domiciled.[28] Most countries use the separate accounting, arm's length method[29] to determine what income they may tax.[30] Many countries attempt to minimize international double taxation with bilateral tax treaties[31] or foreign tax

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decision. *Id.* at 2957.

28. *Accord* I.R.C. § 882(b) (1982) (United States source income rules).

29. An alternative method of determining a corporation's tax base is to combine a unitary business' United States source income. The twelve states using this method are Arizona, Illinois, Kansas, Kentucky, Maine, Minnesota, Mississippi, Nebraska, New Mexico, North Carolina, Oklahoma, and West Virginia. *See* 2 Weekly Tax Rep. (BNA) 373 (1983). Combining domestic income poses several problems, including adapting the financial accounts from the United States federal tax accounting system to state tax rules.

"[The unitary business worldwide combined reporting concept] is incompatible with the principles accepted by all [Organization of Economic Cooperation and Development] member [countries] . . . based on dealing at 'arm's length' between the subsidiary and related enterprises." Letter from Paola Paran Cedessia, Ambassador of Italy, on behalf of the European Economic Communities, to the Dep't of State (Mar. 19, 1980), *reprinted in State Táxation of Foreign Source Income: Hearings on H.R. 5076 Before the House Comm. on Ways and Means*, 96th Cong., 2d Sess. 359, 360 (1980) [hereinafter cited as *1980 H. Foreign Source Income Hearings*]. More recently, over 230 members of the European Parliament, representing all ten member states of the European Economic Community, adopted a stronger position calling for retaliatory action if some of the United States continue to use worldwide combined reporting. *See* 2 Weekly Tax Rep. (BNA) 828 (1983). *See generally* OECD Model Convention for the Avoidance of Double Taxation With Respect to Taxes on Income and Capital, art. 9(1) (1977), *reprinted in* 1 Tax Treaties (CCH) ¶ 151 (1980).

30. For an overview of corporate taxes levied by various countries, see Price Waterhouse, Corporate Taxes—A Worldwide Summary (1983).

31. *See, e.g.*, Convention for the Avoidance of Double Taxation, July 22, 1954, United States-West Germany, 5 U.S.T. 2768, T.I.A.S. No. 3133; as amended by Protocol, Dec. 27, 1965, 16 U.S.T. 1875, T.I.A.S. No. 5920:

> Where an enterprise of one of the contracting States is engaged in trade or business in the other State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it

credits, which permit a dollar for dollar reduction of domestic taxes in accordance with taxes paid to a foreign government.[32]

Although neither the United States Constitution nor any federal statute expressly prohibits international double taxation,[33] multinational corporations claim that the underlying goal of all United States treaty efforts to promote world trade has been to minimize double taxation of multinational enterprises.[34] The United States Government officially supports the internationally accepted arm's length, separate accounting tax principle,[35] claiming that it minimizes double taxation of multinational enterprises and promotes world trade.[36] Many tax experts believe that some states use the worldwide combined reporting method of taxation in contravention of this fundamental government policy.[37] According to the United States Government, however, federal tax treaties using the arm's length principle do not govern state taxation because the states are sovereign taxing entities. Thus, the federal tax treaties have little effect on a state's choice of taxing method.[38]

> were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

Id., art. 3, § 2.

32. *See generally* PRICE WATERHOUSE, *supra* note 30.

33. *See generally* Brief of Amicus Curiae Multistate Tax Commission and Participating States at 4-6 nn.7-9, 9, Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 103 S. Ct. 3562 (1981), *dismissing appeal from* Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981).

34. *See, e.g.*, Brief for Sony Corp. Keidanren (Japan Fed'n of Econ. Orgs.), Kankeiren (Kansai Econ. Fed'n), Electronic Indus. Ass'n of Japan, Horiba Int'l Corp., Kyoto Ceramic Co., Matsushita Elec. Indus., Nippon Elec. Co. as Amici Curiae in Support of Appellant, *Caterpillar Tractor.*

35. *See* Memorandum for the United States as Amicus Curiae at 2, *Caterpillar Tractor* [hereinafter cited as Solicitor General's Brief].

36. *See id.* at 3.

37. *See, e.g.*, *1980 H. Foreign Source Income Hearings*, *supra* note 29, at 259, 260 (statement of William O. Hetts, tax partner of Deloitte, Haskins & Sells, an international accounting firm).

38. The international community succeeded in eliminating a variation of worldwide combined reporting used by France after the First World War. *See 1980 S. State Tax. Hearings*, *supra* note 20, at 89, 126-28 (1980) (statement of John S. Nolan, British National Committee, International Chamber of Commerce). The United States, however, had to negotiate a bilateral treaty to circumvent the French tax. *See* Convention for the Avoidance of Double Taxation, Apr. 27, 1932, United States-France, 49 Stat. 3145, T.S. No. 885. Although the

The United States Government taxes nonresident aliens only on United States source income.[39] Government audits and rules permitting the reallocation of income discourage tax evasion by multinational enterprise transfer pricing.[40] In contrast, the United States taxes its citizens and residents on all income from whatever source derived,[41] including income earned abroad.[42] Consequently, earnings of a foreign subsidiary are treated as income of the United States parent corporation and fall within the jurisdiction of the United States for tax purposes.[43]

United States tax policy on foreign source income could change,

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titles of United States tax treaties continue to reflect this primary goal of eliminating transnational double taxation, *see generally* TAX TREATIES (CCH) (collection of United States tax treaties), tax treaties serve several other purposes: combating international tax evasion, regulating intercompany transfer pricing, and initiating joint audits. *Cf.* Brown, *Tax Treaties from a Canadian Perspective*, 25 CAN. TAX J. 638 (1977) (Canada's tax treaties have similar purposes).

Foreign parent corporations often claim that Friendship, Commerce and Navigation (FCN) Treaties also prohibit worldwide combined reporting as applied to foreign parent corporations. *See, e.g.*, Convention of Establishment, Nov. 25, 1959, United States-France, art. IX(4), 11 U.S.T. 2398, T.I.A.S. No. 4625 (sometimes called the FCN Treaty) (limiting state taxation of French companies to income "directly related to their activities within those territories"). *See also* Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir.) (holding that the foreign parent corporate plaintiff has no standing to invoke FCN treaty provisions and had no more rights than its United States subsidiaries), *cert. denied*, 104 S. Ct. 537 (1983). For further discussion of this case, see *infra* note 280. For a discussion of FCN treaty arguments, see Brief of the Union of Industries of the European Community as Amicus Curiae, at 8-10, *Caterpillar Tractor*.

39. *See* I.R.C. § 882(b) (1982) (gross income of a foreign corporation includes only United States source income).

40. *See* I.R.C. § 482 (1982). For a critique of the effectiveness of § 482, see generally 1982 GAO REPORT, *supra* note 7. *See also infra* note 163. Transfer pricing is the cost assigned to the sale of goods between related corporations.

41. I.R.C. § 61 (1982).

42. *See* 2 W. GIFFORD & E. OWENS, INTERNATIONAL ASPECTS OF U.S. INCOME TAXATION, pt. 3, at 4 (1982). *See generally* I.R.C. § 61 (1982).

43. A corporation defers payment of taxes on foreign source income until its earnings are either repatriated to the United States as dividends, *see* I.R.C. § 61(a)(7) (1982), or are deemed to have been repatriated under the Internal Revenue Code, *see* I.R.C. §§ 861-864, 881-882 (1982). Three major exceptions to the general federal rule permitting deferral of foreign source income are the special rules governing foreign tax havens, I.R.C. §§ 951-964 (1982), foreign personal holding companies, I.R.C. §§ 551-558 (1982), and reallocation of income, I.R.C. § 482 (1982). *See generally* Note, *Comparative Analysis of Systems of Domestic Taxation of Controlled Foreign Corporations*, 14 VAND. J. TRANSNAT'L L. 99 (1980).

however. In 1978, President Carter proposed eliminating deferral of tax payments on foreign source income.[44] Some tax reformers have suggested replacing the foreign tax credit[45] with a foreign tax deduction[46] because they believe that United States taxation of foreign source income is inequitable. They argue that only large multinational corporations are able to benefit from deferral and the foreign tax credit. Some critics, however, claim that the reforms proposed by President Carter and other tax reformers would discourage United States participation in overseas markets, diminish corporate net income, and eliminate productive United States jobs in manufacturing and selling trades.[47]

Federal tax policy and federal treaties generally may influence, but do not restrict state tax practices. Congress, however, has the power to circumscribe state taxation through legislation and set a precedent for future congressional regulation of state taxation by enacting Public Law 86-272.[48] This law restricts a state's ability to tax the net income of a foreign corporation unless the corporation exceeds a minimum threshold of interstate activities within that state.[49]

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44. President Carter's January 30, 1978, Tax Proposal included a three-year phase-out of the deferral for foreign source income. TAX PROPOSAL, H.R. Doc. No. 283, 95th Cong., 2d Sess. 16 (1978).

45. I.R.C. § 901(a) (1982); *see* I.R.C. §§ 901-908 (1982) (treatment of foreign source income).

46. *See generally* W. GIFFORD & E. OWENS, *supra* note 42, 129-71 (1982) (discusses the controversy of deferring United States tax on foreign source income). For the reaction of foreign countries to any proposed elimination of deferral, see, for example, Brown, *U.S. Tax Reform Proposals—Threat to Canada*, 26 CAN. TAX J. 68, 74 (1978) ("Taxation of Foreign Subsidiaries: A Declaration of Economic War").

47. Elimination of deferral would discourage United States investment abroad. *See, e.g., Taxation of Foreign Earned Income: Hearing on S. 2283, S. 2321, S. 2418 Before the Subcomm. on Taxation and Debt Management Generally of the Comm. on Finance*, 96th Cong., 2d Sess. 164 (1980) (statement by Fred C. Culpepper, Jr., President, U.S. & Overseas Tax Fairness Committee, Inc.).

48. 15 U.S.C. §§ 381-384 (1976).

49. 15 U.S.C. § 381(a)(2). For a congressional finding of protected activities under P.L. 86-272, see 1 J. HELLERSTEIN, *supra* note 1, at ¶ 6.10 n.103. Subsequent court decisions interpreting Public Law 86-272 effectively have overruled the law by severely limiting its application to the mail-order industry. *See* Note, *Public Law 86-272: Legislative Ambiguities and Judicial Difficulties*, 27 VAND. L. REV. 313 (1974).

III. DUE PROCESS LIMITATION ON STATE TAXATION

In the 1959 landmark case of *Northwestern States Portland Cement Co. v. Minnesota*,[50] the Supreme Court first recognized a state's authority to tax income resulting from interstate commerce activities that have a connection to the state.[51] Before this case, taxation of these activities was considered a violation of the commerce clause.[52] A state, however, can tax only corporate income earned within its jurisdiction.[53] The due process clause of the fourteenth amendment[54] provides the primary basis for attacking state taxation of extraterritorial income.[55] The Supreme Court has created a two-prong test, which establishes the threshold requirement for the taxing jurisdiction, to determine if due process requirements are met in the taxation of an out-of-state corporation.[56] First, the taxing state must have a sufficient nexus or a rational relationship with the corporation it seeks to tax.[57]

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50. 358 U.S. 450 (1959).

51. The Court reasoned that interstate commerce must carry "its fair share of the costs of state government in return for the benefits it derives from within a state." *Id.* at 462. Corporate outrage over the Court's decision led Congress to enact Public Law 86-272. 15 U.S.C. §§ 381-384 (1976). This law limited states' jurisdiction to tax mail-order businesses whose only connection with the taxing state is personal advertising solicitations in the state. Additional activities by salesmen would provide jurisdiction for a state to tax. *See* P. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION §§ 6.11-.15 (1981).

52. Originally, the Court held that Congress had exclusive power in regulating "direct burdens" on interstate commerce, such as state taxation. *See, e.g.*, Minnesota v. Blasius, 290 U.S. 1, 9 (1933); *see also* P. HARTMAN, *supra* note 50, §§ 2.9-.14. Although the Court briefly liberalized this approach under a "multiple burdens" analysis during the late 1930s and early 1940s; *see, e.g.*, Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938); the Court returned to its conclusion that states could not tax interstate commerce. *See* Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951); Freeman v. Hewit, 329 U.S. 249 (1946).

53. The Constitution does not permit a state to "project the taxing power of the state plainly beyond its borders." Norfolk & W. Ry. v. Missouri St. Tax Comm'n, 390 U.S. 317, 325 (1968) (quoting Nashville, C. & St. L. Ry. v. Browning, 310 U.S. 362, 365 (1940)).

54. U.S. CONST. amend. XIV, § 1 ("nor shall any State deprive any person of life, liberty, or property, without due process of law . . . ").

55. *See generally* P. HARTMAN, *supra* note 51, § 2.3 (1981).

56. *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978).

57. *See* Miller Bros. Co. v. Maryland, 347 U.S. 340, 344-45 (1954), *quoted in Northwestern Cement*, 358 U.S. at 464-65. For a brief discussion of *Northwestern Cement*, see *supra* note 51.

The Court has described this relationship as "some minimum connection, between a state and the person, property or transaction it seeks to tax."[58] Second, the taxing state must be offering some benefits for which it reasonably can expect something in return.[59] Among the more common benefits a state provides are limited liability, police protection, and the privilege of doing business in that state. In most instances, therefore, states automatically meet this second prong.[60]

Applications of this test for jurisdiction vary among the forty-six states that impose a corporate net income tax.[61] A 1982 General Accounting Office study found nine different criteria for determining jurisdiction to tax: deriving income from property in the state,[62] owning property in the state,[63] owning or leasing property in the state,[64] maintaining an office in the state,[65] carrying on a business in the state,[66] doing business in the state,[67] deriving income from activity in the state,[68] deriving income from sources in the state;[69] and having income apportioned to the state.[70] The

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58. *Miller Bros.*, 347 U.S. at 345.

59. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

60. *Cf.* Western & S. Life Ins. Co. v. State Bd. of Equalization, 451 U.S. 648 (1981) (California retaliatory insurance taxation did not violate the equal protection clause).

61. *See* ALL STS. TAX GUIDE (P-H) 129-30 (Mar. 13, 1984), 131-32 (Dec. 20, 1984). Nevada, South Dakota, Washington, and Wyoming are the four states that do not impose a corporate net income tax. Most states tax repatriated foreign source income as dividends to corporations domiciled in their state. Florida and Ohio tax only some foreign source dividends. *See* Appellant's Brief at 5a (app. B), Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) [hereinafter cited as Mobil's Brief]. Only half the states provide a dividend received deduction for foreign source income. *See* Carlson, *State Taxation of Corporate Income From Foreign Sources*, in ESSAYS IN INTERNATIONAL TAXATION 247, 284 (interpreting U.S. Treasury Dep't, *Tax Policy Research Study No. 3,* (Tables 2, 3) (1976)), *quoted in* 1 J. HELLERSTEIN, *supra* note 1, § 7.5 n.55. For a comprehensive discussion of state taxation by the preeminent authorities in the field, see P. HARTMAN, *supra* note 51; 1 J. HELLERSTEIN, *supra* note 1; and J. HELLERSTEIN & W. HELLERSTEIN, STATE AND LOCAL TAXATION (4th ed. 1978).

62. 1982 GAO REPORT, *supra* note 7, at 59-60 (Ala., N.M., & W. Va.).

63. *Id.* (Ga., Hawaii, Minn., N.J., Ohio, & Wis.).

64. *Id.* (Ky. & N.Y.).

65. *Id.* (N.J. & N.Y.).

66. *Id.* (Hawaii & Md.).

67. *Id.* (Ala., Ark., Cal., Ga., Iowa, Kan., Miss., N.C., Okla., Tenn., N.J., N.Y., Ohio, Pa., & S.C.).

68. *Id.* (Mont. & W. Va.).

69. *Id.* (Ala., Cal., D.C., Fla., Idaho, Kan., N.D., Okla., Or., R.I., Va., & W.

United States Supreme Court has given broad deference to state court findings of the necessary minimum contacts to establish jurisdiction to tax.[71] In addition to these due process requirements, state taxation must not transgress negative commerce clause restrictions.

IV. COMMERCE CLAUSE RESTRICTIONS ON TAXING INTERSTATE COMMERCE

The commerce clause grants Congress the power to enact federal legislation to govern commerce among the states and with foreign governments.[72] This clause also implicitly prohibits states from enacting legislation that violates federal policy in an area in which federal uniformity is essential. This restriction, known as the negative commerce clause because of its negative implication, disallows abusive state taxation.[73] The four-part negative commerce clause test, applied by the Supreme Court in *Complete Auto Transit, Inc. v. Brady*,[74] requires the taxing state to have a

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Va.).

70. *Id.* (Me., Mont., & Utah). Six states have no formal rules to determine their taxing jurisdiction. *Id.* (Alaska, Ariz., Del., Ind., La., & Vt.).

71. *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). This deference may not extend much past jurisdiction. The due process clause, the commerce clause, the equal protection clause, the import-export clause, and the supremacy clause can be used to invalidate state corporate income taxes or other business taxes. Also, the privileges and immunities clause can be used to invalidate state taxes other than state corporate income taxes. Recently, the Court applied the first amendment to find a state tax unconstitutional. Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue, 103 S. Ct. 1365 (1983) (tax on newspaper publisher's paper and ink violates the first amendment).

72. U.S. CONST. art. I, § 8, cl. 3.

73. The commerce clause, by its negative implication, is an independent limit on state power. The judiciary acts as a surrogate for Congress when a court applies the negative commerce clause. *See* Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective*, 29 VAND. L. REV. 335 (1976).

74. 430 U.S. 274 (1977). Mississippi had imposed a 5% sales tax on a taxpayer's transportation of new automobiles from Michigan to Mississippi dealers "for the privilege of doing business in the State." The taxpayer argued that under the "tax free haven for interstate commerce" doctrine established in Spector Motor Service, Inc. v. O'Connor, 181 F.2d 150 (2d Cir. 1950), Mississippi could not tax this activity. The Court overruled the *Spector* doctrine and upheld the Mississippi tax. *See id. See generally* Hellerstein, *State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication*, 75 MICH. L. REV. 1426 (1977). The Court has not always made a sharp

substantial nexus with the corporate activity,[75] and the tax to be fairly apportioned,[76] nondiscriminatory,[77] and fairly related to the services provided by the taxing state.[78] In addition, there are two other negative commerce clause tests for state taxation of foreign commerce. These tests were articulated in *Japan Line v. County of Los Angeles.*[79] They are the enhanced risk of multiple taxation and the impairment of federal uniformity in the regulation of foreign commerce.

Complete Auto's four-part negative commerce clause test differs from the due process clause test only in that the *Complete Auto* test also prohibits discriminatory taxes. The Court has not differentiated the substantial nexus prong of the negative commerce clause test from the sufficient nexus requirement under the due process clause.[80] The fairly related prong is similar to the due process rational relationship or sufficient nexus test. Even if a court determines that a tax discriminates against foreign corporations,[81] it must consider what practical effect the discrimination

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distinction between the commerce and due process clauses. P. HARTMAN, *supra* note 51, § 9.7.

75. The taxing state must have a nexus to both the unitary business and its income subject to apportionment. See *infra* text accompanying notes 95-116, 141-61.

76. For a list of cases discussing fair apportionment, see *Complete Auto*, 430 U.S. at 274, 278 n.6.

77. If the statute facially discriminates against out-of-state businesses, the state must prove both a compelling state interest, such as the state's need to raise revenue, and the lack of less discriminatory alternatives. Because states always have several alternative means of raising revenues, a facially discriminatory state tax is effectively illegal per se. *Cf.* 1 J. HELLERSTEIN, *supra* note 1, ¶ 4.6[1][b] (explaining Austin v. New Hampshire, 420 U.S. 656 (1975), which invalidated a tax on commuters under the privileges and immunities clause). *See generally* Blumstein, *Some Intersections of the Negative Commerce Clause and the New Federalism: The Case of Discriminatory State Income Tax Treatment of Out-of-State Tax Exempt Bonds*, 31 VAND. L. REV. 473 (1978).

78. In Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), the Court explained that the "fairly related" test of the commerce clause applies only to the measure of the tax, not to the amount of benefits. *See id.* at 628. Justice Blackmun's dissenting opinion argued that under the majority's opinion, the "fairly related" test became meaningless. *Id.* at 645 (Blackmun, J., dissenting). Jerome Hellerstein agrees with Justice Blackmun. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 4.13[1][d].

79. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979). For a discussion of *Japan Line*, see *infra* text accompanying notes 234-40.

80. *See supra* text accompanying notes 57-58.

81. "A taxing statute that nominally treats all trade alike might discriminate

has on the corporation's tax burden,[82] as analyzed under the fairly apportioned prong, before it can determine whether the tax discrimination is unconstitutional.

V. Mechanics of Worldwide Combined Reporting

Because worldwide combined reporting apportions business income to a taxing state for state tax purposes, this aspect of worldwide combined reporting must meet the negative commerce clause requirement that the apportionment not burden interstate or foreign commerce by allocating more than the appropriate amount of business income to a particular taxing state. Over-apportionment would discourage interstate commerce. This Note will show that apportioning a unitary business' business income, by definition, meets the fairly apportioned prong of the *Complete Auto* negative commerce clause test of state taxation of interstate commerce. To understand the fairly apportioned prong of the *Complete Auto* negative commerce clause test, which also overlaps with territorial due process,[83] it is necessary that this Note examine in further detail the various methods of accounting, the standard three-factor apportionment formula, a unitary business,

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in practical operation against interstate commerce by providing local business with a competitive advantage." Blumstein, *supra* note 77, at 513; *see, e.g.*, Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977). New York imposed a transfer tax on securities that effectively favored the sale of stock on the New York Stock Exchange. "No state, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" *Id.* at 329, *quoting Northwestern Cement*, 358 U.S. at 458 (deletion in *Boston Stock Exch.*).

82. *See, e.g.*, *Commonwealth Edison*, 453 U.S. at 609. Out-of-state consumers shouldered the burden of Montana's even-handed severance tax on coal. The taxpayer argued that the tax had a discriminatory effect. The Court upheld the tax because it was even-handed and therefore had a similar effect on all coal mining operations in the State.

The Court will find discrimination by effects when state regulation increases costs enormously only for nonresident consumers. *See* Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333, 348-54 (1977). If regulation is even-handed with only incidental effects on interstate commerce, the legitimate local purpose must be furthered by the least discriminatory means.

83. The fair apportionment prong of the *Complete Auto* test partially overlaps with the due process clause test because, if the taxing state has not justly determined the income earned within the state by fair apportionment, the state violates territorial due process by taxing income not connected with the taxing state.

and business income.

A. Accounting Methods

The three different accounting methods used to calculate the amount of corporate income attributable to a state are separate accounting, specific allocation, and formula apportionment. Separate accounting differentiates all corporate income depending upon the location in which the income was earned or the product group from which it was derived. Historically, states approved use of the separate accounting method for state taxation purposes if the corporation maintained individual accounting records for the income earned in each state.[84] States gradually turned to specific allocation and formula apportionment as better measures of income attributable to the taxing state.[85]

The specific allocation method is similar to the separate accounting method because it assigns income to a specific state, and is implemented by statutes or regulations that determine what income will be allocated to the taxing state.[86] For instance, several states use specific allocation for attributing interest and dividends to the taxpayer's commercial domicile.[87] Similarly, most nations use the specific allocation method to attribute income to its source,[88] which is usually defined as the location of the income producing property.[89]

A majority of states avoid the due process prohibition on taxing extraterritorial income and meet the negative commerce clause requirement of fairly apportioning the tax by using the standard

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84. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 8.3. Alaska still requires the petroleum industry to use separate accounting. *See* State Dep't of Revenue v. Amoco Prod. Co., 676 P.2d 595, 597-98. (Alaska 1984). *See infra* note 163 (critique of separate accounting).

85. Only a few states apportion rather than allocate all taxable dividends. These states are Delaware, Maryland, Massachusetts, New Hampshire, New Jersey, Rhode Island, Vermont, and Wisconsin. *See* Mobil's Brief, *supra* note 61, at 4a, 5a (app. B).

86. *See* ALL STS. TAX GUIDE (P-H) 140 (Dec. 20, 1983), *reprinted in* 1 J. HELLERSTEIN, *supra* note 1, Table 9-2, at 618-20.

87. States that allocate all taxable dividends to the commercial domicile include: Arizona, California, Louisiana, Minnesota, Mississippi, Oklahoma, and South Carolina. *See* Mobil's Brief, *supra* note 61, at 4a, 5a (app. B).

88. *See supra* note 29 (comparing worldwide combined reporting with the arm's length method).

89. For a discussion of source of income problems, see Kingson, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1151 (1981).

three-factor apportionment formula.[90] Corporations eventually began assigning income to states having low or no corporate income tax and began using other increasingly sophisticated methods to avoid taxation when states relied on the separate accounting method.[91] States that taxed corporate net income turned to the formula apportionment method to calculate their apportioned share of the corporation's income.[92] Professor Jerome Hellerstein, a leading authority in the field of state taxation, explained that "apportionment by formula grew out of necessity . . . because no other accounting method adequately attributes the proper amount of business income to the taxing state."[93] Thus, the allocation of business income is determined arbitrarily by formula apportionment. Most states believe, however, that formula apportionment, even though an arbitrary allocation, is a reasonable means of measuring income attributable to the taxing state, and courts have upheld formula apportionment.[94]

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90. The standard three-factor apportionment formula weighs equally payroll, property, and sales ratios. *See infra* notes 95-101. Two states do not use the three-factor formula: West Virginia uses a two-factor formula based on property and payroll, and Iowa apportions on the basis of sales. For statistical support of the equity of the standard three-factor apportionment formula, see Henszey & Koot, *Is a Three Factor Apportionment Formula Fair?*, 35 TAX EXEC. 141 (1983).

91. States criticize not only the reliability of the separate accounting arm's length concept in accurately determining income, but also the effectiveness of reallocation of income rules in preventing widespread tax avoidance that borders on tax evasion. *See 1977 S. Hearings on Tax Treaties, supra* note 21, at 93, 119-39 (attachment 3) (Position Paper, California Franchise Tax Board). *See also infra* note 164. *But see infra* note 170.

92. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 8.6.

93. *State Taxation of Interstate Commerce: Hearings Before the Subcomm. on State Taxation of Interstate Commerce of the Senate Comm. on Finance*, 93d Cong., 1st Sess. 151 (1973) (statement of Jerome Hellerstein, Adjunct Professor of Law, New York University).

94. The Supreme Court first approved formula apportionment in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920). A more recent case arose when Wisconsin began taxing an apportioned share of Exxon Corporation's oil production income, even though Exxon only retailed and did not produce oil in Wisconsin. *See* Exxon Corp. v. Wisconsin, 447 U.S. 207 (1980). Exxon brought suit arguing that the commerce clause prohibited Wisconsin from apportioning Exxon's oil production income because some oil producing states specifically allocate all the income. The Court rejected Exxon's argument because formula apportionment uses profitability to measure the enhanced value of the business operations attributable to the taxing state. Thus, the presence of different accounting treatments in different states that may result in multiple burdens does

The underlying premise of formula apportionment is that every dollar paid for wages, invested in property, or generated by sales produces the same amount of profit for the corporation in each jurisdiction.[95] The apportionment formula is based on the proportion of a unitary business' interest in state property,[96] payroll,[97] and sales[98] to total property, payroll, and sales. In the case of states using worldwide combined reporting, for instance, the apportionment formula would compare the value of the corporation's property within the taxing state to the value of the unitary business' (parent, subsidiary, and affiliated corporations), total worldwide property.[99] Generally, each factor is assigned an equal weight,[100] although an increasing number of states assign a fifty percent weight to the sales ratio and a twenty-five percent weight to both the property and payroll ratios.[101] This approach lowers the tax for local producers who sell products outside the state and increases the tax for out-of-state businesses that produce goods to sell in the taxing state. The double weighted sales ratio encourages out-of-state businesses to relocate in the taxing state.

Courts have imposed no constitutional restraints on a state's choice of apportionment formula. For example, an Illinois manufacturer selling goods in Iowa objected to Iowa's single-factor sales apportionment formula in *Moorman Manufacturing Co. v. Bair.*[102] The taxpayer argued that Iowa's formula attributed income to Iowa out of proportion to business actually transacted within that state.[103] In a six to three decision, the Supreme Court

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not violate the due process clause or the negative commerce clause test under *Complete Auto,* unless the state places a greater tax burden on the foreign corporation than it does on local business. This same approach for analyzing multiple burdens applies to several variations of states' formulas for apportioning income. *See id.*

95. For information on states' apportionment formulas, see ALL STS. TAX GUIDE (P-H) 140 (Dec. 20, 1983).

96. *See id.* 149 (Dec. 20, 1983), 151 (Oct. 25, 1983).

97. *Id.* at 145-46 (Nov. 8, 1983), 147-48 (Dec. 20, 1983).

98. *Id.* at 143-44 (Dec. 20, 1983).

99. *See, e.g.,* 1982 GAO REPORT, *supra* note 7, at 3.

100. *See* Factors of Apportionment Formulas, ALL STS. TAX GUIDE (P-H) 140-51 (Oct. 25, Nov. 8, Dec. 13, Dec. 20, 1983).

101. Connecticut, Florida, Massachusetts, New York, and Wisconsin place double weight on the sales ratio. *Id.*

102. 437 U.S. 267 (1978).

103. *Id.* at 271-72; *see* Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123 (1931). In *Hans Rees,* the Court invalidated North Carolina's

upheld Iowa's single-factor sales apportionment formula. The Court refused to review Iowa's formula, even though the Court recognized that Iowa's formula may not accurately measure the actual business income earned within Iowa. The Court grounded its refusal on the imprecision inherent in all methods of attributing income to the taxing state.[104] Concluding that Congress and not the courts should resolve problems of double taxation, the Court reasoned that Iowa's single-factor formula fairly apportioned the tax and was not invalid merely because it differed from the standard three-factor method of apportionment.[105]

The dissenting opinions in *Moorman* set forth a number of persuasive arguments against upholding the single-factor formula.[106] Justice Brennan's dissent contended that it is the commercial activity within the state, not the sales volume, that determines the state's power to tax and its apportioned share of the income.[107] Justice Blackmun's dissent stated that the "[s]ingle-factor formulas are relics of the early days of state income taxation. The three-factor formulas were inevitable improvements and while not perfect, reflect more accurately the realities of the business and tax world."[108] Justice Powell's dissent urged that Iowa's single-factor sales apportionment formula violated the commerce clause by subsidizing Iowa manufacturers who sell their goods outside the state.[109]

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single-factor apportionment formula. The formula apportioned about 85% of the company's income to North Carolina, although income attributed under separate accounting was only 20%. The Court found, therefore, that the apportionment formula led to "grossly distorted results." *Id.* at 135. Separate accounting evidence, used in *Hans Rees*, will not be sufficient to overturn a state's apportionment of unitary business income. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 8.10[1], 8.10[2] (1983). Although the Court also invalidated the District of Columbia's single-factor formula, that decision rested on statutory, rather than constitutional grounds. *See* General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965).

104. *Moorman*, 437 U.S. at 273.

105. *Id.* at 280.

106. *See id.* at 281-82 (Brennan, J., dissenting); *id.* at 282 (Blackmun, J., dissenting); *id.* at 283-97 (Powell, J., dissenting). Container Corporation relied on the dissents in *Moorman* for its fair apportionment argument. *See* Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983) (discussed *infra*, text accompanying notes 223-31).

107. *Id.* at 281-82 (Brennan, J., dissenting).

108. *Id.* at 282 (Blackmun, J., dissenting).

109. *Id.* at 283-97 (Powell, J., dissenting).

Even states using the three-factor apportionment formula can raise additional revenue to which the state arguably is not entitled. By manipulating the nature and valuation of the factors in their apportionment with a weighted formula, states can augment revenue without affecting in-state corporations.[110] The property factor, for instance, might include rental property, property in transit, or property under construction.[111] Also, the valuation of property will vary significantly depending on the method of assessment used: historical cost,[112] depreciated basis, or market value. Apportionment formulas may differ according to the source of payroll. For example, the tests for the source of the traveling salesperson's salary include: the state providing unemployment compensation; the place of business; or an allocation based on time spent in a state, customers contacted in a state, or miles travelled in a state.[113] The Court, however, has consistently refused to address the many significant differences among states in defining and calculating apportionment factors.[114]

Because states manipulate apportionment formulas and factors to claim a larger apportioned share percentage of a corporation's apportionable tax base, the total percentage of tax base claimed

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110. Two techniques used by many states to produce a more favorable sales ratio in the apportionment formula are the "throwback" and "throwout" rules. The throwback rule increases the amount of in-state sales by including in the numerator of the sales ratio the formula sales originally attributed to another state having no corporate income tax. The throwback rule also increases in-state sales by including any nontaxable sales to the federal government. *See* MTC Reg. IV. 16(b), ALL STS. TAX GUIDE (P-H) at 663. Some states, including California, even apply the throwback rule to sales in a foreign country. *See Interstate Taxation: Hearings on S.2173 Before the Senate Comm. on the Judiciary*, 95th Cong., 1st & 2d Sess. 44, 45 (1977-1978) (statement of Lyle Bethune, representative of Anderson, Clayton & Co., a Houston-based food company) [hereinafter cited as *1977-1978 S. Interstate Tax'n Hearings*]. The throwout rule increases a state's proportion of sales by eliminating from the apportionment formula corporate sales that escape attribution to a specific state. *See, e.g.*, CAL. REV. & TAX. CODE § 25106 (West 1979) (intercompany dividends).

111. Inventory in transit to California is included in the property ratio. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 9.15[2].

112. Most states value property at historical cost, but a few states use either net book value, *see* 1982 GAO REPORT, *supra* note 7, at 62-63, or federal tax net value, *see* 1 J. HELLERSTEIN, *supra* note 1, ¶ 9.15[4] n.339.

113. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 9.16 (value of payroll factor assigned to a state can vary based on time spent in the state or exclusion of executive compensation).

114. *See id.* ¶ 8.7.

by the taxing states often exceeds one hundred percent of the corporation's income.[115] In addition, the administrative burden associated with a corporation's need to apply different factors and formulas and to make different calculations for each state explains why large corporations object to the diversity among the states in applying the formula apportionment method to the very same business activity.[116] Although the states have great flexibility in choosing and applying an apportionment formula, the Supreme Court has attempted to bridle this flexibility by limiting applications of the formula to unitary businesses.

B. A Unitary Business

In *Mobil Oil Corp. v. Commissioner of Taxes*[117] the Supreme Court explained that a taxing state can attribute the business income of a foreign corporation to a domestic corporation only if the two comprise a unitary business. Due process requires a rational relationship between the taxing state and the income or added value the state seeks to tax. Otherwise, corporations would be deprived of property without due process of law.[118] In *Mobil Oil*, a New York corporation doing business in Vermont appealed from the Vermont Commissioner of Taxes' assessment of additional corporate income tax.[119] Although Vermont had not classified Mobil's foreign subsidiaries as part of a unitary business,[120] Vermont expanded its share of Mobil's taxable income by treating dividends received by Mobil from its foreign subsidiaries as income subject to apportionment, even though those subsidiaries did not conduct business in Vermont. Mobil argued that the due process and negative commerce clauses prohibited Vermont from apportioning the taxpayer's dividend income from its foreign subsidiaries, but Mobil failed to prove that its foreign subsidiaries

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115. *See, e.g.*, Japan Line, Ltd. v. County of Los Angeles, 411 U.S. 434, 436-39 (1979).

116. *See infra* notes 171 & 176 (discussion of administrative burdens).

117. 445 U.S. 425 (1980).

118. *See id.* at 442.

119. *See* Recent Decision, *State Corporation Income Tax—Foreign Source Dividends Included in State Taxation Base Under Unitary Business Enterprise Test*, 14 VAND. J. TRANSNAT'L L. 653 (1980) (discussing *Mobil Oil*).

120. Vermont treated Mobil as a discrete enterprise for purposes of determining the sales, property, and salary ratios in the calculation of the state's apportioned share of Mobil's income. *Mobil Oil*, 445 U.S. at 429 & nn.3, 4.

were not part of a unitary business.[121] Mobil's failure led the Court to bypass the unitary business issue altogether and hold that taxation of foreign source dividends received by a taxpayer within a state's taxing jurisdiction does not violate the Constitution.[122]

Despite the narrow holding in *Mobil Oil*, however, the Court's analysis in dicta of the relationship between apportionability and the concept of unitary business has become a recurrent theme in state taxation. The Court stated that "the linchpin of apportionability in the field of state income taxation is the unitary-business principle."[123] Observing that the privilege of conducting business in a state subjects a corporation to the taxing authority of that state,[124] the Court implied that it would prohibit state corporate income taxation on income that is not part of a unitary business having a nexus with the state. Because Mobil did not present evidence disproving Vermont's contention that its multinational enterprises constituted a unitary business, the Court reasoned that it could not determine whether the challenged statute reached extraterritorial income with which the state had no nexus.[125] The Court found that the foreign source of Mobil's dividend income was irrelevant because Mobil had conceded that New York, as the commercial domicile, could tax the income.[126] Thus, the Court upheld Vermont's apportionment of a nondomiciliary corporation's dividend income.[127]

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121. Walter Hellerstein believes there is serious doubt "whether the income attributed to Vermont by its apportionment formula was 'rationally related to values connected with the taxing state.'" *See* Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on* Mobil, Exxon, *and H.R. 5076*, 79 MICH. L. REV. 113, 127 (1980) (quoting *Moorman*, 437 U.S. at 273).

122. 445 U.S. at 449. For a discussion of the Court's commerce clause analysis in *Mobil Oil*, see P. HARTMAN, *supra* note 51, § 9.26, at 555-59 (1981).

123. *Mobil Oil*, 445 U.S. at 439.

124. *Id.* at 436-37.

125. *Id.* at 437.

126. *Id.* at 447. Given that New York could have taxed the income, the dividends are clearly a domestic, not foreign, source of income.

127. *Id.* at 446. The Court cautioned, however, that its holding did not indicate that:

> all dividend income received by corporations operating in interstate commerce is necessarily taxable in each State where that corporation does business, where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing State, due process considerations might well preclude apportionability because there would be

The *Mobil Oil* Court emphasized the need to assess the underlying activity of the related corporations, not the form of investment in subsidiaries, to determine the existence of a unitary business. Typically, states define all operations within a corporation as a unitary business[128] rather than recognize discrete business enterprises or divisions within the corporation.[129] Moreover, in a few states a unitary business is defined to include all the corporation's subsidiaries and affiliates.[130] Setting aside the concept of corporations as separate legal entities, the *Mobil Oil* Court implied that the interdependency of a corporation with its affiliates and subsidiaries provides benefits to each of the parties and renders them a unitary business.[131] Most corporations also argue that the basic operations of related corporations should be substantially interdependent before the courts deem them a unitary business.[132] These corporations vehemently object to states that char-

no underlying unitary business.

Id. at 441-42. For a recent example of a case discussing whether a domiciliary state should apportion or allocate dividends and interest by related corporations to a corporation doing business in the taxing state, see Lone Star Steel Co. v. Dolan, 668 P.2d 916 (Colo. 1983).

128. During the 1870s, states first applied the unitary method in taxing interstate railroads. *See* State Railroad Tax Cases, 92 U.S. 575 (1875). States later applied the unitary method to corporate income taxes. *See* Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920). In the 1940s, a few states extended the unitary principle to include domestic subsidiaries. *See, e.g.,* Edison Cal. Stores v. McColgan, 30 Cal. 2d 472, 183 P.2d 16 (1947). In the 1970s, a few states extended the unitary business principle further to include foreign subsidiaries. *See supra* notes 5, 6.

129. *Cf.* IRS determinations of a unitary business for the proposed Treas. Reg. § 1.355(c), 42 Fed. Reg. 2,697; 2,698 (1977) (to be codified at Treas. Reg. § 1.355-3) (proposed Jan. 13, 1977) (still proposed as of Mar. 1, 1984, *see* FED. TAXES (P-H) ¶ 70,003 (Mar. 8, 1984)) (the Treasury recognizes that two divisions in the same corporation might not comprise a unitary business).

130. States' statutes usually permit state taxing authorities to use another method if the result does not reflect fairly the amount of business activity in the state. *See, e.g.,* CAL. REV. & TAX. CODE § 25137 (West 1979); *see also* Boren, *Equitable Apportionment: Administrative Discretion and Uniformity in the Division of Corporate Income for State Tax Purposes,* 49 S. CAL. L. REV. 991 (1976).

131. *See Mobil Oil,* 445 U.S. at 439 ("it appears that these foreign activities are part of appellant's integrated petroleum enterprise").

132. *See, e.g.,* Brief of Appellant at 11-12, ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982). In December 1983, the Supreme Court agreed to hear a case challenging further extension of the unitary business principle. *See* Armco, Inc. v. Hardesty, 303 S.E.2d 706 (W. Va. 1983), *prob. juris. noted,* 104 S.

acterize a company with de facto control of another corporation through significant stock ownership as a unitary business.[133]

Courts have used several different tests to determine when a parent corporation and its subsidiaries constitute a unitary business.[134] The Supreme Court has looked at management controls, functional integration, and economies of scale.[135] The best known approach is the three unities test, which suggests that a unitary business exists if the parent and subsidiary share common ownership, common management, and common operations.[136] When one company directly or indirectly owns fifty percent of another corporation's stock or exercises a strong controlling position in that corporation, the common ownership requirement is met.[137] Interlocking boards of directors or the exchange of key personnel indicates the presence of common management.[138] Common financing, trademarks, research, or other significant activities evidences common operations.[139] Another commonly used test is the dependency test. Courts employing this test focus on whether a corporation's enterprises within the taxing state depend upon or contribute to the operation of the corporation's out-of-state business.[140]

Ct. 547 (1983) (West Virginia imposed a business and occupation tax on all employees of a company that had employees of only one division doing business in the state).

133. *See, e.g.*, Brief of Appellant at 14, *ASARCO.*

134. *See* Hellerstein, *supra* note 121, at 149 (citing other tests created by state courts).

135. *See, e.g.*, F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354, 364 (1982); ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317 (1982); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980); Butler Bros. v. McColgan, 315 U.S. 501, 508-09 (1942).

136. In *Butler Bros.*, the Court used the three unities test for the first time. 315 U.S. at 508.

137. Frank Keesling, the father of the extended unitary business concept, has advocated that "all income from commonly-owned business activities should be combined and apportioned by a single formula without inquiry whether such activities are unitary. Such a policy is simple to administer and will promote uniformity." Keesling, *A Current Look at the Combined Report and Uniformity in Allocation Practices*, 42 J. TAX'N 106, 109 (1975).

138. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 8.11[3] (1983).

139. *See* J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 61, at 508-09.

140. *See* Edison Cal. Stores, Inc. v. McColgan, 30 Cal. 2d 472, 481, 183 P.2d 16, 21 (1947). States also might look at whether the related corporations operate similar businesses or have substantial intercorporate transactions.

The existence of substantial intercorporate transactions is the primary crite-

C. Business Income

A state's classification of income as business income or nonbusiness income necessarily follows the determination that a company is a unitary business, because only the business income of a unitary business is apportionable.[141] States need not be consistent with other states in their classifications; income classified as business income in one state may be classified as nonbusiness income in another state.[142] Thirty-eight states categorize this distinction as being between income subject to allocation and income subject to apportionment.[143] Income subject to allocation is nonbusiness income, which is usually defined to include dividends, interest, and capital gains.[144] A state generally allocates the entire amount of taxable nonbusiness income to itself, if the corporation receiving the income is domiciled within the state. Income subject to apportionment is business income. To this income the state applies an apportionment formula and taxes only that income to which the state has a legitimate claim. Twenty-eight states apply the characterizations of business and nonbusiness income found in the Uniform Division of Income for Tax Purposes Act (Uniform Act).[145] The Uniform Act defines business income as income

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rion for New York's determination of a unitary business. *See* Buresh & Weinstein, *Combined Reporting—The Approach and its Problems*, 1 J. ST. TAX'N 5, 8 (1982). *Cf.* National Geographic Soc'y v. California Bd. of Equalization, 430 U.S. 551, 556 (1977) ("[o]ur affirmance of the California Supreme Court is not to be understood as implying agreement with that court's 'slightest presence' standard of constitutional nexus [in applying a sales tax]").

141. *See 1977-1978 S. Interstate Tax'n Hearings*, *supra* note 110, at 904 (Bartlett, *Results of a Survey on the Uniformity of State Tax Laws*). The eight states that have a corporate income tax and do not differentiate types of income are Delaware, Maryland, Massachusetts, New Hampshire, New Jersey, Rhode Island, Wisconsin, and Vermont. Instead, these states apportion the corporation's taxable income. *See* Mobil's Brief, *supra* note 61, at 4a.

142. *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 279 n.15 (1978).

143. *See, e.g.*, CAL. REV. & TAX. CODE § 25123 (West 1979).

144. Other types of nonbusiness income can include royalties from patents, copyrights, or similar intangibles. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶¶ 9.8, 9.9, 9.13.

145. UNIF. DIVISION OF INCOME FOR TAX PURPOSES ACT, § 1(a), (e), 7A U.L.A. 91 (1978) [hereinafter cited as UNIFORM ACT]. "The UDITPA [Uniform Act] distinction between 'business' and 'nonbusiness' corporate income appears to lack any rational basis and has created confusion for taxpayers and tax administrators alike." Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 VAND. L. REV. 401, 407 (1976). For a recent example of what constitutes business income, see James v. International Tel. & Tel., 654

that arises from the taxpayer's regular course of business, including income from tangible and intangible property that is acquired, managed, and disposed of as an integral part of the taxpayer's regular trade or business.[146] Nonbusiness income is understood to be all income not included within the definition of business income.[147]

In *ASARCO Inc. v. Idaho State Tax Commission,*[148] the Supreme Court effectively limited the business income concept to income from intangibles and operating income earned by a unitary business.[149] In *ASARCO,* the taxpayer, a New Jersey corporation, argued that Idaho had erred in two respects. First, ASARCO contended that the Idaho court erred in classifying

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S.W.2d 865 (Mo. 1983). The ten states that apportion some income, allocate other income, and do not use the business/nonbusiness income distinction are Arizona, Connecticut, Delaware, Georgia, Louisiana, Maryland, New York, Ohio, Oklahoma, and Virginia. *See* 1982 GAO REPORT, *supra* note 7, at 66.

146. UNIFORM ACT, *supra* note 145, § 1(a). Only eighteen states have regulations interpreting the Uniform Act. Those regulations substantially conform to those of the Multistate Tax Commission, a voluntary association of states created to limit federal restrictions on state taxation. The Multistate Tax Compact created the Multistate Tax Commission to promote uniform and equitable state tax treatment of multinational businesses. Multistate Tax Compact, art. I, *reprinted in* 1 ST. TAX GUIDE (CCH) ¶ 356 (June 1982). The Multistate Tax Compact proved to be an inefficient and costly means of state tax administration. For a list of the members and associate members to the Multistate Tax Compact, see ALL STS. TAX GUIDE (P-H) 447 (Aug. 2, 1983).

147. *See* UNIFORM ACT, *supra* note 145, § 1(e); *see also,* 1 J. HELLERSTEIN, *supra* note 1, § 9.10[1] (discussing whether interest income constitutes business income).

148. 458 U.S. 307 (1982).

149. Idaho requested the Multistate Tax Commission to audit ASARCO. The Multistate Tax Commission found that five of ASARCO's eleven subsidiaries were distinct business enterprises. The Idaho State Tax Commission adopted the Multistate Tax Commission's conclusions. Idaho defines business income to include "income from . . . intangible property, [the] acquisition, management, or disposition of which constitute[s an] integral or necessary part of the taxpayers' trade or business operations." *See* IDAHO CODE § 63-3027(a)(1) (1976 & Supp. 1983). The state district court overruled the Commission's determination that the intangible income constituted business income because ASARCO did not obtain the income from an integral part of its trade or business. The Commission appealed to the Idaho Supreme Court, which reversed. American Smelting & Refinery Co. v. Idaho State Tax Comm'n, 99 Idaho 924, 592 P.2d 39 (1979), *vacated and remanded sub nom.* ASARCO Inc. v. Idaho State Tax Comm'n, 445 U.S. 939 (1980), *rev'd per curiam on remand,* 102 Idaho 38, 624 P.2d 946 (1981), *rev'd* 458 U.S. 307 (1982).

some of its foreign subsidiaries as part of a unitary business. Second, according to ASARCO, the court improperly treated the taxpayer's intangible income from investments in these subsidiaries as business income subject to apportionment.[150] The Supreme Court held that the Constitution does not permit a state to include in the taxable income of the parent corporation doing business in the state the intangible income the corporation receives from its foreign subsidiaries.[151] The *ASARCO* Court repeated its *Mobil Oil* pronouncement that "the linchpin of apportionability . . . is the unitary business principle"[152] and then distinguished *Mobil Oil* on the ground that Mobil, unlike ASARCO, did not prove that its subsidiaries and affiliates constituted discrete business enterprises.[153] Repeating the state court's finding that the management contract of ASARCO's foreign subsidiaries prevented ASARCO from controlling the subsidiaries,[154] the Court found insufficient connections to uphold Idaho's classification of ASARCO and its subsidiaries as a unitary business.[155] The Court also rejected Idaho's proposal that corporate purpose should define a unitary business.[156] In so doing, the Court held what it had stated previously in *Mobil Oil*'s dicta: "[o]ne must look principally at the underlying activity, not at the form of investment, to determine the propriety of apportionability."[157] The *ASARCO* decision placed the first effective restraint on states' historic propensity to define a unitary business broadly. More important, however, the Court did not permit a state to include in the nondomiciliary corporation's tax base foreign source dividends from a nonunitary business to the corporation doing business in the taxing state.

Justice O'Connor dissented, concluding that ASARCO had failed to show that the investments in its subsidiaries were unrelated to its business operations.[158] Arguing that the subsidiaries

150. *See generally* Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on* ASARCO *and* Woolworth, 81 MICH. L. REV. 157 (1981).

151. 458 U.S. at 327-29.

152. *Id.* at 317 (quoting *Mobil Oil*, 445 U.S. at 439).

153. *Id.* at 329 n.24.

154. *Id.* at 322.

155. *Id.*

156. *Id.* at 326-28.

157. *Id.* at 330 (quoting *Mobil Oil*, 445 U.S. at 440).

158. 458 U.S. at 337 (O'Connor, J., dissenting).

offered significant business advantages in the form of greater profits, stability, and an assured supply of raw materials,[159] Justice O'Connor sought to uphold the Idaho Supreme Court's decision.[160] Had the majority agreed with Justice O'Connor's finding of a unitary business, the Court could then have addressed the merits of ASARCO's argument that a nondomiciliary state cannot tax intangible income.[161] The issues of a unitary business, business income, and methods of accounting become all the more complicated in the international realm, especially if a state attempts to use worldwide combined reporting.

VI. THE WORLDWIDE COMBINED REPORTING CONTROVERSY

States, corporations, and foreign governments have different perspectives on worldwide combined reporting and the problems it creates. Most states support worldwide combined reporting as a method that protects their autonomy in determining a state's fairly apportioned share.[162] Taxing states contend that the combined method forecloses corporate manipulation of income through cost allocation and intercompany transfer pricing,[163] and

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159. *Id.* at 342-44; *see also* Corn Prods. Ref. Co. v. Commissioner, 350 U.S. 46 (1955) (investments held for business purposes such as securing a source of supply are not subject to capital gains treatment because they constitute an integral part of the business); Hellerstein, *supra* note 150, at 180-81.

160. 458 U.S. at 353 (O'Connor, J., dissenting).

161. *ASARCO* holds that the source of dividends subject to inclusion in a corporation's tax base for a nondomiciliary taxing state is critical. The dividends must come from a corporation that is part of the taxpayer's unitary business. 458 U.S. at 307.

162. At least a few states, however, contend that "no hard evidence exists that the States' present practice is harmful to the national interest, and we do know that the present practice is rational from a tax accounting standpoint and is helpful to the states and their taxpayers." Letter from Richard D. Lamm, Governor of Colorado, to the U.S. Treasury Dep't (discussing S. 655 & H.R. 1983, the 1981 Congressional proposals to limit state taxation of foreign source income), *excerpt reprinted in The Digest*, 37 TAXES INT'L 30 (1982). Bruce King, Governor of New Mexico, has expressed similar beliefs. *Id.*

163. *See supra* note 40 (definition of transfer pricing). Discussion of intercompany transfer pricing is beyond the scope of this Note. For investigations into intercompany transfer pricing abuses, see COMPTROLLER GENERAL OF THE UNITED STATES, GENERAL ACCOUNTING OFFICE, REPORT TO THE HOUSE COMM. ON WAYS AND MEANS, I.R.S. COULD BETTER PROTECT U.S. TAX INTERESTS IN DETERMINING THE INCOME OF MULTINATIONAL CORPORATIONS (1981) [hereinafter cited as 1981 GAO REPORT]. *See also* Note, *Service Discretion and Burden of Proof in International Tax Cases Involving Section 482*, 15 CORNELL INT'L L.J. 203

thereby eliminates the need for states to reallocate income and expenses among closely related companies.[164] States have also argued that the use of worldwide combined reporting reduces state auditing costs.[165] Audits of the corporate intercompany transfer pricing transactions of multinational corporations are both time-consuming and exceedingly difficult.[166] In rebutting the charge that worldwide combined reporting results in double taxation, states highlight the corresponding potential benefit that arises from a corporation's ability to use its foreign losses to diminish its state tax burden.[167]

Most corporations, however, would prefer states to use the arm's length method rather than worldwide combined reporting because the former method usually results in a lower tax when the corporation has profitable foreign operations. Corporations insist that worldwide combined reporting permits a state to tax extraterritorial income[168] because the method grossly distorts the

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(1982); *Japan's Accounting Shake-up*, Bus. Wk., Apr. 25, 1977, at 112 (investigation of intercompany transfer pricing abuse led the Japanese Government to direct related corporations to file a consolidated return).

164. Thus, states using worldwide combined reporting contend that the system makes it impossible for multinational corporations to underreport their true income significantly. "Without the right to apply the unitary method to multinationals, as it is now applied to small business, the states would be at the mercy of accounting shell games designed to hide in-state profits from taxation." Letter from James C. Rosapepe, Washington Representative, Multistate Tax Commission, to the New York Times (Sept. 28, 1983) (*To Get Multinationals from Behind Foreign Skirts*), *reprinted in* N.Y. Times, Oct. 15, 1983, at 22, col. 5.

165. *See 1980 S. State Tax'n Hearings*, *supra* note 20, at 492, 499 (Position Paper, California Franchise Tax Board).

166. "In this age of the super company with its sophisticated pattern of worldwide operations and financial dealing, there is perhaps no more difficult problem for the tax administrator than the examination of the tax returns of multinational corporations." 1981 GAO Report, *supra* note 163, at 1. Internal Revenue examiners characterize audits of intercompany transfers as "high risk ventures" that may yield the government little additional revenue. *Id.*

167. *See, e.g.*, Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981), *appeal dismissed sub nom.* Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 103 S. Ct. 3562 (1983); *infra* note 271 and accompanying text. States contend that the number of disputes concerning the fair apportionment of income under the worldwide combined reporting system would be less than the number of suits filed because of intercompany transfer pricing disputes. Roemer, *The States' View of GAO Report*, 75 NTA-TIA Proc. 152, 154-55 (1982) (criticizing the 1982 GAO Report, *supra* note 7).

168. *See 1980 H. Foreign Source Income Hearings*, *supra* note 29, at 213,

source of income.[169] Furthermore, worldwide combined reporting allows corporations no credit or deductions for taxes paid to foreign governments.[170] Finally, worldwide combined reporting often forces corporations to pay penalties because they cannot comply with the extravagant requests for detailed information concerning the activities of affiliated corporations abroad, especially if those affiliated corporations are engaged in unrelated types of businesses.[171] Requests to produce foreign financial documents fre-

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214 (statement of Russell Schellenberger, Ass't Treasurer, FOSECO Inc.).

169. For a discussion of distortion of income in worldwide apportionment, see 1 J. HELLERSTEIN, *supra* note 1, ¶ 8.10[6]. Governments are often unable to verify information of foreign multinationals. *See 1980 S. State Tax'n Hearings, supra* note 20, at 492, 498-99 (Position Paper, California Franchise Tax Board).

The impact of California's worldwide combined reporting upon Lever Brothers presents a horror story. From 1967 to 1973, the effective state corporate income tax rate of 20.99% paid on Lever Brothers' federal taxable income approached three times California's average statutory rate of 7.27%. Kogels, *Unitary Taxation: An International Approach,* 37 BULL. INT'L FISC. DOC. 65, 66 (1981) (citing Unitary Tax Campaign Response to the U.S. Treasury Questionaire). Similarly, the United States subsidiary of Alcan Aluminum Ltd., a Canadian corporation, had a $140,000 federal tax loss, but California apportioned a share of Alcan's worldwide $102 million profit. *Id.* at 66 & n.5 (citing Alcan Aluminum Ltd. v. Franchise Tax Bd., 558 F. Supp. 624 (S.D.N.Y.) (deciding 539 F. Supp. 512 (S.D.N.Y. 1982) (deferral, pending disposition of other cases)), *aff'd without opinion* (2d Cir. June 17, 1983), *cert. denied,* 104 S. Ct. 705 (1984). "The California Franchise Tax Board claims that 'the separate corporate entities of the group are not disregarded by the use of the combined report approach.'" CALIFORNIA FRANCHISE TAX BOARD, GUIDE FOR CORPORATIONS FILING COMBINED REPORT 3, *cited in* Redmond, *The Unitary System of Taxation: Identification of the Source of Income,* 35 BULL. INT'L FISC. DOC. 99, 102 n.20 (1981). Notwithstanding this disclaimer, "the very foundation of the unitary system would seem to require tax authorities to look beyond corporate boundaries." *Id.*

170. Most states using worldwide combined reporting require adding all taxes back into net income, which can result in extreme distortions in the income base. *See* Development, *Supreme Court Upholds State Taxation of a Unitary Business,* ABA SECTION OF TAXATION NEWSLETTER, at 6 (Fall 1983).

171. "Corporate officials reported . . . that the cost of preparing State income tax returns averages 16% of State income tax liability." *See* 1982 GAO REPORT, *supra* note 7, at 16. This paperwork is particularly burdensome on foreign parent corporations that do not maintain records in English.

States contend that taxpayers' efforts to resist tax compliance cost much more than the expense of compliance. *See* Watson, *California Views: The* Container *Decision,* in STATE TAXATION OF MULTINATIONAL CORPORATIONS AFTER CONTAINER CORP. 123, 127 (1983). For a recent example of the paperwork burden of producing financial documents, see Anderson & Leslie, *The Storm Over Unitary Taxes,* NEWSWEEK, Dec. 19, 1983, at 74, 75 (Citicorp told the Florida Senate

quently involve an adjustment in the accounting method used by foreign subsidiaries to comply with United States accounting standards.[172] In particular, these requests force corporations to aggregate the income of foreign subsidiaries,[173] transcribe data from foreign languages, convert all financial statements using foreign currencies to dollars,[174] and overcome foreign secrecy laws that often prohibit the release of corporate documents.[175] Corporations have found support for their arguments against worldwide combined reporting from foreign governments.

Foreign governments, largely in response to the concerns expressed by foreign parent corporations, have also expressed oppo-

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that its worldwide combined reporting creates a need to establish new accounting systems in its foreign subsidiaries).

172. For differences in international accounting standards, see Choi & Bavishi, *Financial Accounting Standards: A Multinational Synthesis and Policy Framework*, 18 INT'L J. ACCT. 159, 173-83 (1982) (apps.).

173. *See 1980 H. Foreign Source Income Hearings, supra* note 29, at 222-25 (statement of Kirby Scott). *See generally* Buresh & Weinstein, *Combined Reporting: The Approach and Its Problems*, 1 J. ST. TAX'N 5 (1982).

174. To comply with Generally Accepted Accounting Principles, a corporation must remeasure its financial currency in terms of its functional currency. *See* Financial Accounting Standards Board Statement No. 52 n.3, *reprinted in* J. ACCT., Feb. 1982, at 125, 127. Then, the corporation must translate its functional currency into the reporting currency. *See id.* ¶¶ 12-14, *reprinted* at 127. The elaborate remeasurement and translation processes require the use of different rules for determining the appropriate times for fixing the applicable exchange rates. For instance, a United States parent corporation having a British affiliate doing most of its business in France would need to remeasure the affiliate's British pound financial statements in French francs before translating the value into United States dollars.

175. "Records outside the United States are seldom subject to United States jurisdiction; thus, absent the cooperation of foreign officials, secrecy laws make it virtually impossible to obtain data." STAFF OF SENATE COMM. ON GOVERNMENT AFFAIRS, 98TH CONG., 1ST SESS., CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES 14 (Comm. Print 1983). For instance, the United States is unable to obtain financial information from several Caribbean countries, Panama, Switzerland, and often even France. *Id.* at 92.

The state often responds by extrapolating from public financial records, such as annual reports designed for investors, which tend to overstate income. *See* Note, *Proposed Congressional Limitations on State Taxation of Multinational Corporations*, 1981 GA. J. INT'L L. 343, 353; *see also* Capitol Indus.-EMI, Inc. v. Bennett, 681 F.2d 1107 (9th Cir.) (British and Australian secrecy laws prohibited a foreign parent corporation from releasing corporate information to refute California's assessment of tax on the United States subsidiary), *cert. denied sub nom.* EMI, Ltd. v. Bennett, 103 S. Ct. 1189 (1982); 57 J. TAX'N 94 (1982).

sition to the use of worldwide combined reporting.[176] For exam-

176. Foreign parent corporations vehemently object to the unitary business worldwide combined reporting system of state corporate income taxation: "In a recent trip to Japan, the State Director of International Trade visited with 72 Japanese firms that are considering locating additional sites in the United States. In almost every case their first question was what are you going to do about the unitary method of taxation." *1977-1978 S. Interstate Tax'n Hearings, supra* note 110, at 415 (statement of Dennis Amundson, Deputy Director, Dep't of Economics and Business Development). Businesses object to this method of taxation for a variety of reasons, one of which is the extra cost associated with double taxation. The German Federation of Industries representative points out, however, that even when the corporate income tax owed to a state requiring worldwide combined reporting results in explicit transnational double taxation, the effective tax rate is not necessarily higher than the corporate income tax rate imposed by a state which does not use worldwide combined reporting. *See 1980 S. State Tax'n Hearings, supra* note 20, at 78 (statement of Lothar Griessback). Furthermore, because state taxes are deductible from the federal taxable income, I.R.C. § 164 (1982), the effective cost of the extra state taxes is practically reduced by half.

Because state taxation is only one of many business considerations, factors other than state taxation should determine whether a corporation will choose to do business in a state. State taxation, however, may have a significant influence on investment decisions: "What may be seen now as an acceptable additional operating expense can well become a significant adverse factor in determining the location of new or extended facilities." *1980 S. State Tax'n Hearings, supra* note 20, at 56, 60 (statement of the Hon. Charles McC. Mathias, Senator from Maryland, quoting the Tax Manager of BAT Industries of London).

The voluminous paperwork burden and related costs necessary to comply with assorted and intricate tax rules on interstate commerce, particularly as required by worldwide combined reporting, is a major business complaint. *See 1977-1978 S. Interstate Tax'n Hearings, supra* note 110, at 1 (opening statement of Sen. Mathias); *see also supra* note 171.

Another serious business concern about worldwide combined reporting is the resulting uncertainty concerning the amount of taxes that will be owed to the state, particularly for a business seeking to expand into a state with worldwide combined reporting. This uncertainty makes it more difficult for business planning. In 1979, the International Chamber of Commerce warned that the unitary business worldwide combined reporting concept "could easily become the most important threat to international trade." *See The Council of the Netherlands Federation of Employers UNO and NCW on the Unitary System of Taxation*, 35 BULL. INT'L FISC. DOC. 107, 108 (1981) (citing a resolution adopted in 1979 by the Executive Board of the International Chamber of Commerce) [hereinafter cited as *The Dutch Perspective*]. According to a former president of the International Fiscal Association, this method of taxation "has come up from the tax sewers, feeds on state greed and needs a few knights in shining armor to go forth and destroy it, before it does untold damage." Remarks of Alun Davies, President of the International Fiscal Association, Opening Address at the 1979 Copenhagen Congress, *quoted in* Kogels, *supra* note 169, at 68.

ple, Great Britain attempted to circumvent worldwide combined reporting in the mid-1970s by signing a tax treaty with the United States.[177] The proposed treaty specifically prohibited states from including the earnings of British corporations in the apportionable tax base used for state tax calculations.[178] The British argued that if each of the fifty states can determine its own tax policy concerning nonrepatriated foreign source income, United States tax treaties will fail in their goal to ameliorate tax problems between the two countries.[179] Although the United States Senate reserved approval of this proposed treaty provision,[180] the British Parliament ratified the amended treaty, urging Congress to take appropriate legislative action to restrict state use of worldwide combined reporting.[181] Congress failed to take legislative action, and in 1982 a member of Parliament urged Great Britain to adopt the worldwide combined reporting system stating: "[W]e cannot continue to accept the use of combined world-wide reporting systems by individual States . . . [without

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177. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, United States-United Kingdom, 31 U.S.T. 5668, T.I.A.S. No. 9682. The Federal Republic of Germany similarly sought to have its tax treaty with the United States regulate state taxation. *See* GUMPEL, TAXATION IN THE FEDERAL REPUBLIC OF GERMANY ¶ 11/5.3 (2d ed. 1969).

178. *Id.* art. 9(4). *See* Dexter, *Article 9(4) of the United Kingdom Tax Treaty Should be Reserved*, 6 TAX NOTES 403 (1978); Nolan, *The U.K. Tax Treaty Should Be Ratified Without Reservation*, 6 TAX NOTES 407 (1978); Dexter, *A Closing Response to Mr. Nolan's Views*, 6 TAX NOTES 412 (1978). All three articles are reprinted in 1980 *S. State Tax'n Hearings*, *supra* note 20, at 460-73.

179. *See* 979 PARL. DEB., H.C. (5th ser.) 194 (1980) (statement of Roger Moate, Member of Parliament, United Kingdom).

180. The Senate voted in favor of keeping article 9(4) in the treaty by a 49-32 vote, but this did not meet the required two-thirds majority vote. *See* 124 CONG. REC. 18,670 (1978). Several senators objected to article 9(4) primarily because they believed Congress should determine United States domestic tax policy: "The United States-United Kingdom treaty now before us represents legislative policy making by the executive through the device of a tax treaty." *Id.* at 18,416 (1978) (statement of Sen. Church). *See also id.* at 18,416-30, 18,652-70. *Cf.* 979 PARL. DEB., H.C. (5th ser.) 173-200 (1970) (British perspective on desirability of article 9(4)).

181. "We were assured, however, that the United States Congress would resolve the situation by legislation and that it [prohibiting worldwide combined reporting] was really just a hiccup in the Senate." 22 PARL. DEB., H.C. (6th ser.) 823 (1982) (statement of Michael Grylls, Member of Parliament, United Kingdom).

taking] our own legislative action to apply a combined world-wide reporting system to United States companies that operate in Britain."[182] Retaliation by the United Kingdom would affect more than ten percent of United States foreign investment.[183]

The Supreme Court has recognized the possibility that disadvantaged foreign nations might retaliate against United States companies operating in their jurisdictions. This retaliation could create problems for the entire nation rather than just the state using worldwide combined reporting.[184] The possibility that lesser developed countries will attempt to use the worldwide combined reporting method to tax multinational corporations operating in their country presents an ominous danger to the United States.[185] Furthermore, even if foreign countries do not adopt a retaliatory tax policy, foreign corporations may become less willing to invest in the United States,[186] and foreign countries will continue to raise the issue in foreign policy discussions.[187] Foreign govern-

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182. *Id.* at 825.

183. *See 1977 S. Hearings on Tax Treaties, supra* note 21, at 184, 190 (statement of John S. Nolan).

184. *See* Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 450-51 (1979). The Court expressed fear that some nations might retaliate automatically. *Id.* at 453 n.18.

185. Third world countries have considered taxing multinational corporations operating in their respective countries using worldwide combined reporting. *See* The Impact of Multinational Corporations on Development and on International Relations, Report of the Secretary-General, 56-57 U.N. ESCOR (plen. mtg.) at 93, U.N. Doc. E/5500/Rev.1(ST/ESA/6) (1974). Gerald Dennis, Deputy Chairman of BAT Industries, predicted that if other countries adopt unitary taxation based on worldwide combined reporting, "we can say goodbye to the fruits of 40 years of hard work spent negotiating tax treaties." *Britain: U.S. Unitary Taxes Attacked at CBI Conference,* COMMON MKT. REPTS. (CCH) Euromarket News, at 7-8 (Nov. 22, 1983).

186. Worldwide combined reporting has limited the development of International Banking Facilities in New York. *See* Roach & Ferst, *Foreign Banks in the U.S., Part II: International Banking Facilities,* PRICE WATERHOUSE INT'L TAX NEWS, Oct. 1982, at 4-5.

187. *See* Hulihan, *supra* note 22, at 28, col. 5. The British are not the only foreigners voicing objections. Donald C. Lubick, the Assistant Secretary of Treasury for Tax Policy, stated that worldwide combined reporting is "an irritant in the international relations of the United States." *See 1980 S. State Tax'n Hearings, supra* note 20, at 43, 44; *1980 H. Foreign Source Income Hearings, supra* note 29, at 303 (statement of Joseph Guttentag, Dutch Employer's Federation). Japan included the issue of worldwide combined reporting as one of its fourteen points of trade dispute with the United States in 1981. *See U.S. Will be Asked to End Non-tariff Barriers,* JAPAN ECON. J., Nov. 10, 1981, *reprinted in* Brief for

ments refrained from taking retaliatory measures while the Supreme Court deliberated the constitutionality of the worldwide combined reporting method in *Container Corporation.*[188]

VII. CONTAINER CORPORATION OF AMERICA V. FRANCHISE TAX BOARD

In *Container Corporation,*[189] the Supreme Court addressed the issue of whether the application of worldwide combined reporting to a unitary business having a domestic parent corporation was constitutional. The case arose in California where the legislature had enacted a corporate franchise tax on net income as determined by formula apportionment based upon worldwide combined reporting.[190] Container Corporation of America (Container), a Delaware corporation domiciled in Illinois, became subject to

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the International Bankers Association in California, Akai Electric Co., Ltd., as Amici Curiae in Support of Appellant, app., at 4-5, Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 103 S. Ct. 3562 (1983), *dismissing appeal from* Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981).

188. Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983).

189. *Id.*

190. California imposed a corporate franchise tax geared to income. This tax used the unitary business worldwide combined reporting concepts in apportioning income attributable to California. *See generally supra* text accompanying notes 90-161. During 1963 to 1965, the tax years in question, California's Revenue and Taxation Code read:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value, and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State.

CALIF. REV. & TAX. CODE § 25101 (1957) (amended 1966, 1980), *quoted in* Jurisdictional Statement at 2, *Container Corp.*

Container's management involved itself only in its foreign subsidiaries' major capital investment decisions. Although Container guaranteed a portion of the foreign subsidiaries' borrowings, the subsidiaries obtained more than two-thirds of their own financing. Container typically provided neither exchange of technology nor personnel. *See Container Corp.*, 103 S. Ct. 2943-44.

Container argued that the state court improperly relied on Container's mere potential to control the operations of its subsidiaries to find that Container's foreign subsidiaries constituted part of its unitary business. *Id.* at 2946.

California's taxing jurisdiction by doing business in the state.[191] California's Franchise Tax Board assessed additional corporate franchise taxes[192] against Container after having determined that Container and its foreign subsidiaries constituted a unitary business.[193] The California Superior Court upheld the assessment and the California Court of Appeals affirmed.[194] The United States Supreme Court also affirmed, holding that if a state court properly has determined that the multinational enterprises of several related corporations constitute a unitary business, formula apportionment is a constitutionally fair formula, worldwide combined reporting is neither prohibited "by federal law [n]or fatally inconsistent with federal policy,"[195] and worldwide combined reporting violates no treaties.

Justice Brennan structured the Court's majority opinion in accordance with the three issues the taxpayer presented for review.[196] First, Container argued that characterization of Container and its overseas subsidiaries as a unitary business resulted in state taxation of extraterritorial income and violated the due process and commerce clauses. Second, even if the Court upheld the finding of a unitary business, Container argued that fair apportionment, which is grounded in the premise that all markets have similar economies, does not exist when applying apportionment to a tax base calculated by worldwide combined reporting. Third,

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191. Container Corporation of America is a vertically integrated manufacturer of custom-ordered paperboard packaging. During 1963 to 1965, the years in dispute, Container owned controlling interests in 20 foreign corporations, located principally in Latin America. These subsidiaries engaged in the same line of business as Container but operated as fully integrated autonomous businesses and were incorporated in their country of operation. Appellant's Brief on the Merits at 2-3, *Container Corp.* [hereinafter cited as Container's Brief].

192. The dispute involved a relatively small amount of money: approximately $15,000 for 1963; $34,000 for 1964; and $23,000 for 1965. *See Container Corp.*, 103 S. Ct. at 2945 n.11. In contrast, Shell Petroleum recently had approximately $39,000,000 in dispute because of worldwide combined reporting. *See* N.Y. Times, Dec. 6, 1983, at 33, col. 5 (discussed *infra* note 280).

193. 103 S. Ct. at 2945.

194. Container Corp. of Am. v. Franchise Tax Bd., 117 Cal. App. 3d 118, 173 Cal. Rptr. 121 (1982).

195. *Container Corp.*, 103 S. Ct. at 2957.

196. The Court ignored Container's fourth argument that the Treaties of Friendship, Commerce & Navigation prohibit worldwide combined reporting because these treaty provisions do not apply to companies incorporated in the United States. *See supra* note 38.

Container contended that the commerce clause, as applied in the context of foreign commerce, requires states to apportion only United States source income and to use only the arm's length method of apportionment.[197]

A. Unitary Business of Foreign Subsidiaries

Container's overseas subsidiaries were relatively autonomous companies conducting similar custom-order paperboard packaging businesses. Container's contacts with its overseas subsidiaries involved overseeing major strategic planning decisions, guaranteeing loans, making loans, providing some uncompensated technical assistance, and occasionally procuring equipment for the subsidiaries.[198]

The Court approached the threshold unitary business issue[199] by noting its traditional deference to state courts' factual determinations on the issue of whether the enterprises qualified as a unitary business.[200] Also, the Court acknowledged the limited role of the federal courts, which includes assuring that state courts apply the proper standards and render their decisions under *ASARCO*'s "within the realm of permissible judgment" test.[201]

Container looked to *F.W. Woolworth Co. v. Taxation and Revenue Department*[202] as authority for its argument that the California courts had not applied the proper standards to determine whether Container and its foreign subsidiaries constituted a unitary business.[203] Woolworth, a New York corporation doing busi-

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197. *See* Container's Brief, *supra* note 191, at 25.

198. *See* 103 S. Ct. at 2944.

199. The Court's prior discussion of the law emphasized that it has long upheld the constitutionality of the unitary business formula apportionment method. *Container Corp.*, 103 S. Ct. at 2940. *See supra* text accompanying note 17.

200. 103 S. Ct. at 2945. The taxpayer has the burden to show, by "clear and cogent evidence," that the state tax reaches extraterritorial earnings. *Id.* at 2939-40.

201. *Id.* at 2946 & n.15 (citing ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982)).

202. F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), *rev'g* 95 N.M. 519, 624 P.2d 28 (1981).

203. The state maintained that "the only question is how do we measure container [sic] Corporation's tax." Official Transcript at 24, *Container Corp.* (1983) [hereinafter cited as *Container Corp.* Transcript]. The state was concerned about permitting the form of corporate operations to control over substance. *Id.* Justice White rejected this argument: "Well, on that basis, the whole

ness in New Mexico, appealed from an assessment of additional corporate income taxes by the New Mexico Taxation and Revenue Department.[204] New Mexico had treated the dividend income of Woolworth's wholly owned overseas subsidiaries, which did no business in New Mexico,[205] as business income subject to apportionment.[206] Woolworth argued that its overseas subsidiaries were not part of a unitary business,[207] because its overseas subsidiaries were relatively autonomous companies conducting a similar retail business.[208] The *Woolworth* Court rejected the state court's reliance on the relationship between Woolworth and its subsidiaries as determinative of whether a unitary business existed.[209] According to the Court, mere potential to control overseas subsidiaries by the ownership interest was not a proper standard for finding a unitary business. The Court stated that the potential to operate a company as part of a unitary business is not determinative when, looking at "[t]he 'underlying economic realities of a unitary business,'" the dividend income from the subsidiaries in fact is "derive[d] from 'unrelated business activity'" of the subsidiaries.[210] The *Woolworth* Court said the state court had applied an improper legal standard for a unitary business.[211] The proper standard, as set forth in *Mobil Oil*, requires analysis of the corporations' "functional integration, centralization of management, and

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unitary concept is meaningless anyway. . . . In any of these situations, you could do your work through divisions." *Id.* at 25.

204. A hearing examiner from the New Mexico Taxation and Revenue Department denied Woolworth's protest. The New Mexico Court of Appeals reversed as a matter of state law. F.W. Woolworth Co. v. Bureau of Revenue, 95 N.M. 542, 624 P.2d 51 (Ct. App. 1979). The New Mexico Supreme Court reversed, finding that the taxpayer's dividends from its subsidiaries met the New Mexico test. Taxation and Revenue Dep't v. F.W. Woolworth Co., 95 N.M. 519, 624 P.2d 28 (1981).

205. Woolworth and its subsidiaries are horizontally integrated chain stores. *See* Brief of Appellant at 3-6, *F.W. Woolworth*, 458 U.S. at 354.

206. *See* N.M. STAT. ANN. §§ 7-4-1 to 7-4-21 (1981). Woolworth also contested the "gross up" dividend received for calculating the federal foreign tax credit. *See* 458 U.S. at 359.

207. *See* I.R.C. §§ 901-908 (1982). Woolworth reported its dividend income from its subsidiaries as "'non-business income.'" *See* 458 U.S. at 358.

208. *See supra* notes 197-98 and accompanying text.

209. 458 U.S. at 362.

210. *Id.* (quoting Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 223-24 (1980) (quoting *Mobil Oil*, 445 U.S. at 441)).

211. 458 U.S. at 364 (citing *Mobil Oil*, 445 U.S. at 438).

economies of scale."[212] Although the Court recognized Woolworth's "occasional oversight—with respect to capital structure, major debt, and dividends—that any parent gives to an investment in a subsidiary,"[213] the Court concluded that there was neither adequate centralization of management nor sufficient functional integration of the overseas business activities to support a finding that the subsidiaries constituted a unitary business.[214] Thus, the *Woolworth* Court differentiated between the potential to manage and actual management of the subsidiary.[215]

In response to Container's argument that *Woolworth* controlled the instant case, the Court indicated that the state court in *Container* focused on the taxpayer's actual management of its foreign subsidiaries with "standard[s] of professionalism, profitability, and ethical practices."[216] The Supreme Court contrasted this conclusion with the finding of a potential to manage, and decided that the state court had applied the proper legal standards in *Container*. The Court therefore determined that it was not compelled to reconsider whether the actual intercompany relationships amounted to a unitary business.

Container next argued that the California court had exceeded the realm of permissible judgment when it accepted the presumption that corporations engaged in the same line of business constitute a unitary business. The Court, however, observed that because of the likelihood that the parent corporation will share its expertise with a subsidiary in the same type of business, California's presumption was reasonable.[217] Also, Container argued that the Court should find a unitary business only if there is "a substantial flow of goods" between the related corporations.[218] After

212. *Id.*

213. 458 U.S. at 369.

214. *Id.* at 371.

215. *Id.* Justice O'Connor's dissent, joined by Justices Blackmun and Rehnquist, concluded that the facts supported a finding of a unitary business. *Id.* at 374 (O'Connor, J., dissenting).

216. *Container Corp.*, 103 S. Ct. at 2946 (quoting 117 Cal. App. 3d at 998, 173 Cal. Rptr. at 127). In addition, the lack of a contract not to exercise control over the subsidiaries' boards of directors can indicate a unitary business. *See* 103 S. Ct. at 2948.

217. *Id.* at 2947.

218. *Id.* The Court noted that Jerome Hellerstein advocates "flow of goods" as a bright-line test. *See id.* at 2947 & n.17 (citing Container's Brief, *supra* note 191, at 47).

refusing to adopt this standard, the Court explained that the constitutional prerequisite for finding a unitary business is not a "flow of goods" test, but a more lenient "flow of value" standard.[219]

In applying this "flow of value" standard, the Court again compared *Woolworth* with *Container*, distinguishing Container's assistance to its subsidiaries on two critical factors. First, Container offered no evidence that it had conducted its loans and loan guarantees at arm's length as an investment function, rather than as an operational function for pushing expansion by overseas subsidiaries. Second, the presence of major long-term strategic plans and uncompensated assistance in technical services suggested that Container had an operational role in its subsidiaries not found in *Woolworth*. Because of these operational contacts, the *Container* Court held that the state court's finding of a unitary business was clearly "within the realm of permissible judgment."[220]

The Supreme Court appears to have strained the factual distinctions between *Container* and *Woolworth*; the primary reason for the difference in the outcome of the two cases rests upon the Court's view of its role. Because the state court in *Woolworth* did not apply the proper legal standard for finding a unitary business, the *Woolworth* Court had to apply its own assessment of the intercompany relationships.[221] In *Container*, however, the Court articulated that if a state court has applied the proper standards for finding a unitary business, the Court will limit its review to the determination of whether the decision was within *the realm of permissible judgment*. This limited review will likely foreclose most future litigation on the appropriateness of a state court's determination of a unitary business.[222]

The Court's unitary business analysis in *Container* is also significant for its liberal "flow of value" test. In applying the "flow of value" test, the Court relied on the nondomiciliary parent cor-

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219. *Id.* at 2947.

220. *Id.* at 2947-48 & n.19.

221. During the oral arguments in *Container*, Justice White distinguished California's method of taxation from the problems posed in Idaho (*ASARCO*) and New Mexico (*Woolworth*). *See Container Corp.* Transcript, *supra* note 203, at 10-11.

222. Ruurd Leegstra, chief of the state and local tax section of Coopers and Lybrand, a national accounting firm, has said: "They're giving the states a lot of flexibility here." Wall St. J., June 28, 1983, at 2, col. 3.

poration's assistance in providing loans and contributing standards of professionalism, profitability, and ethical practices. These measures are arguably weak indicators of any real transfer of value. This new test effectively undermines *ASARCO* and *Woolworth* and does little to restrain state courts from finding a unitary business under the guise of having applied the proper "flow of value" standard within the state court's broad realm of permissible judgment. Once the Court had determined the threshold issue—that Container constituted a unitary business—it was able to proceed to other issues.

B. Fair Apportionment Using Worldwide Combined Reporting

The *Container* Court began its discussion of the due process and commerce clause fair apportionment issue by emphasizing that the taxpayer has the burden of showing that "intrastate values of the enterprise" bear no rational relationship to the income attributed to the State.[223] To meet this burden the taxpayer must prove that the "income apportioned to California under the statute is 'out of all appropriate proportion to the business transacted in that State.' "[224]

At the outset, Container attempted to meet its burden by attacking the formula apportionment method of accounting. Container argued that because its foreign subsidiaries are more profitable than the domestic operations, application of California's three-factor apportionment formula to a tax base consisting of nonrepatriated foreign source income distorts the proper allocation of income between the taxpayer and its subsidiaries.[225] In rejecting Container's argument, the Court pointed out that the argument relies on the assumption that separate accounting is more appropriate. That method, according to the Court, has many weaknesses that led to the widespread acceptance of

223. *Container*, 103 S. Ct. at 2948.

224. *Id.* (quoting Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931)). The Court also rejected Container's attempt to distinguish its tax base, comprised of several companies classified as a unitary business, from Bass, Ratcliff & Gratton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924), in which only one company comprised the unitary business tax base. For discussion of *Bass*, see *supra* text accompanying notes 17-19.

225. Counsel for Container distinguished *Mobil Oil* because Mobil had disclaimed any dispute with the accuracy or fairness of Vermont's apportionment formula. *See* Container's Brief, *supra* note 188, at 10. *Mobil Oil*, 445 U.S. 425, 434.

formula apportionment.[226] Container also asserted that combining worldwide values for the apportionment formula results in excessive factor distortion and renders the mathematical calculation of the state's apportioned share meaningless because of different production costs among countries.[227] The Court was cognizant of the taxpayer's evidence of substantially lower production costs for operations in foreign countries, but the Court speculated that California's payroll subsidized the foreign operations and upheld use of the formula.[228]

The Court, however, was willing to concede that the three-factor apportionment formula is imperfect.[229] Because the taxpayer failed to show that the imprecision associated with the apportionment formula was any greater than the margin of error inherent in the separate accounting approach, the Court refused to invalidate the application of worldwide combined reporting to the corporation's tax base and apportionment formula ratios.[230] The Court has refused repeatedly to question the rationale supporting the standard sales, property, and payroll formula or to find an apportionment unfair. Normally, the Court will not question even a single-factor sales formula.[231] Therefore, it is doubtful that future litigants will have any success in attacking fair apportionment, especially when the Court does not rely on independent accounting evidence. Corporations contesting a state tax will have to challenge the tax on a ground more persuasive to the Court, such as whether state taxation unconstitutionally impedes foreign commerce.

C. State Taxation Affecting Foreign Commerce

The Court in *Container* next addressed the issue of whether the commerce clause requires states to use the internationally accepted arm's length method of corporate income taxation to cal-

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226. *See supra* text accompanying note 93; *infra* note 309. *See* Conrad, *An Effective Way to Limit Evasion*, N.Y. Times, Feb. 26, 1984, at 2F, col. 3. *But see supra* text accompanying notes 35-36.

227. *Container*, 103 S. Ct. at 2949.

228. *Id.* at 2950.

229. *Id.* at 2949.

230. *Id.* at 2949-50.

231. *See, e.g.*, Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978). *But see* Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123 (1931) (discussed *supra* note 103).

culate taxes on income earned abroad. The Court focused on the commerce clause considerations as they were articulated and applied to foreign commerce in *Japan Line*,[232] including the enhanced risk of multiple taxation and the government's need to speak with one voice.[233]

1. *Japan Line, Ltd. v. County of Los Angeles*

The United States Supreme Court in *Japan Line, Ltd. v. County of Los Angeles*[234] invalidated the *ad valorem* property tax that California had imposed on Japanese shipping vessels that unloaded their cargo at Los Angeles ports. The vessels had their home port in Japan, were domiciled in Japan, and paid an unapportioned property tax in Japan.[235] The Court found that California's property tax fulfilled the requirements of the four-prong negative commerce clause test as applied to interstate commerce.[236] The shipping vessels had a substantial nexus with California because some vessels were present in California port facilities at all times. California fairly apportioned the property tax by levying it only on the shipping vessels' average duration in California ports. Because the tax was applied equitably on all personal property in California, the property tax did not discriminate. Finally, the property tax was fairly related to the services provided by California, such as police and fire protection. Recognizing that no judicial body has the authority to force a foreign country to apportion its property taxes on vessels engaged in foreign commerce to avoid international double taxation, the *Japan Line* Court concluded that it must decide whether California's fairly apportioned and nondiscriminatory state tax enhanced the risk of double tax burdens—a risk not borne by domestic business.[237] Because Japan taxes the full value of its shipping vessels

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232. *Id.* at 2950 (citing Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 446 (1979)).

233. *Id.* at 2951 (citing *Japan Line,* 441 U.S. at 446, 448).

234. 441 U.S. 434 (1979).

235. *Id.* at 436.

236. *See supra* notes 72-82 and accompanying text.

237. *Id.* at 447-48. The Court noted that it was not deciding whether the standard of review for the state taxation enhancing the risk of multiple taxation test is stricter in cases involving foreign commerce. *See id.* at 452 n.17. The Court, however, noted that the drafters of the Constitution intended the commerce clause to give Congress broad powers concerning foreign commerce. *Id.* at 448 n.12. This suggests a stricter standard of review. No prior Supreme Court

the Court had no jurisdiction to compel fair apportionment. The Court also held that any California tax on these vessels would create an unconstitutional double taxation. The *Japan Line* Court also assumed an activist judicial role in determining the federal government's interests in thwarting the natural state tendency toward economic balkanization[238] and by deciding that the state tax impaired federal uniformity in foreign commerce. The Court found that a Customs Convention on Containers, signed by the United States and Japan,[239] prohibited information duties and evidenced a national policy to remove such impediments to foreign commerce, including those impediments created by California's property tax.[240]

In its application of *Japan Line* to the fact situation in *Container*, the Supreme Court first noted the factual similarities between the two cases. In each case the taxes resulted in actual double taxation,[241] the foreign tax methods were consistent with international practice,[242] and the federal government "seem[ed] to prefer the taxing method adopted by the international community."[243] The Court then discussed the differences between *Container* and *Japan Line*, noting that *Container* concerned an income tax rather than a property tax, that worldwide combined reporting does not inevitably produce double taxation,[244] and that

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decision applied a different commerce clause test in a case affecting foreign commerce, although dicta from prior cases has suggested that conclusion. *See* 1 J. HELLERSTEIN, *supra* note 1, ¶ 4.14[2] & n.309 (reprints relevant portions of the Court's dicta from earlier cases).

238. The process of balancing constitutional rights requires the Court to take an activist "special functions" role. This balancing approach is less deferential to state legislative judgments than the rational relation standard. Congress easily can overrule the Court's decision in a negative commerce clause case by passing an act stating its intention to override the Court's decision. *See generally* Blumstein, *supra* note 77.

239. Customs Convention on Containers, May 18, 1956, United States-Japan, art. I(b), 20 U.S.T. 301, 304, T.I.A.S. No. 6634.

240. 441 U.S. at 446 n.10.

241. *Container Corp.*, 103 S. Ct. at 2950-51. The Solicitor General's oral argument in *Caterpillar Tractor* stated that there was double taxation in *Container. See Container Corp.* Transcript, *supra* note 203, at 28.

242. 103 S. Ct. at 2952.

243. *Id.*

244. *Id.* California does not provide a way for corporations to take full advantage of foreign losses: "No deduction is allowed for net operating losses . . . for a non-United States member of a unitary group." *See* 800 ST. TAX GUIDE (CCH) (biweekly report letter) 4 (Aug. 5, 1983) (citation omitted) in 2 ST. TAX

the taxpayer in *Container* was a domestic corporation in contrast to the foreign corporation in *Japan Line*.[245]

2. *Enhanced Risk of Double Taxation Test*[246]

The Court relied upon a statement in *Japan Line* to support its assessment of whether California's use of worldwide combined reporting enhanced the risk of double taxation on the income from foreign operations or commerce and thereby created a burden not borne by local business. According to the *Japan Line* Court, "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned."[247] The *Container* Court qualified this statement, however, stating that it simply indicated the particular double tax situations that deserve close judicial scrutiny. Judicial scrutiny would then take into account "the context in which the double taxation takes place and the alternatives reasonably available to the taxing State."[248]

The Court applied this "context and reasonable alternatives" analysis to the actual double taxation in *Container* and found that all accounting methods designed to attribute taxable business income in the international context appear to pose the threat of double taxation.[249] Focusing on corporate abuse of transfer pricing and differences throughout the international community in reallocating income among affiliated corporations,[250] the Court stated that no method of state corporate income taxation could eliminate all risk of double taxation on net income.[251] This recognition of the unlikelihood that double taxation on corporate in-

GUIDE (CCH).

245. 103 S. Ct. at 2952.

246. Double taxation among the states, rather than among nations, is objectionable only if the income attributed to the state is "'out of all appropriate proportion to the business transacted in the state.'" Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274 (1978) (quoting *Hans Rees' Sons*, 283 U.S. at 135). *See supra* text accompanying notes 102-05. Similarly, an excessively burdensome amount of taxes does not violate the Constitution. *See* Pittsburgh v. Alco Parking Corp., 417 U.S. 369, 373-74 (1974).

247. *Japan Line*, 441 U.S. at 456, *quoted in Container*, 103 S. Ct. at 2953.

248. 103 S. Ct. at 2953.

249. *Id.* at 2953-55.

250. *Id.* at 2953-54.

251. *Id.* at 2954.

come can be eliminated contrasts with the Court's willingness to invalidate the property tax in *Japan Line* to foreclose the possibility of double taxation. The Court concluded that its inability to eradicate double taxation in *Container* allowed for a different result from the one in *Japan Line*.[252] Consequently, the Court found that California's application of the unitary business principle to multinational enterprises and their related corporations through worldwide combined reporting presented no enhanced risk of multiple taxation.[253]

In his vigorous dissent, Justice Powell, joined by Chief Justice Burger and Justice O'Connor,[254] concentrated solely on the Court's commerce clause analysis. Specifically, Justice Powell criticized the majority's failure to recognize the fundamental differences between actual double taxation under the formula apportionment method and the risk that would remain after accepting the alternative arm's length method.[255] Current double taxation by California, he argued, violates the commerce clause because it automatically creates double taxation that could be avoided by changing to the arm's length method. According to Justice Powell, double taxation arising under the arm's length system of taxation is largely due to disagreements on the application of rules for determining the source of income and could be resolved by international negotiation.[256] *Id.* at 2953. For Justice Powell's discussion of the standard of review mandated by *Japan Line*, see *id.* at 2957 (Powell, J., dissenting).

The majority opinion's acknowledgement of actual double taxation marks the first time the Court has recognized and upheld double taxation. The "enhanced risk of double taxation" test articulated by the Court in *Japan Line* presents the most obvious reason for holding the unitary business/worldwide combined reporting concept unconstitutional. Only Justice Powell's dissent, however, applies the "close scrutiny" standard of review mandated in *Japan Line*. The majority opinion dilutes that close scrutiny standard by announcing that the Court will "consider the [political] context in which the double taxation takes place and the [economic] alternatives reasonably available to the taxing

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252. *Id.* at 2953.
253. *Id.* at 2954.
254. *Id.* at 2957 (Powell, J., dissenting).
255. *Id.* at 2957-58.
256. *Id.* at 2959.

State."[257] Thus, the Court changed the standard for the "enhanced risk of double taxation" test of *Japan Lines* to prevent California and other states from losing the additional taxes generated by worldwide combined reporting.

3. *"Speaking with One Voice" Test*

In determining whether the state tax "impair[s] federal uniformity in an area where federal uniformity is essential,"[258] the Court reiterated the two-part analysis adopted in *Japan Line*: "[A] state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive."[259]

The Court set forth the following standard for the foreign policy test: "[i]f a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' "[260] Retaliation by offended foreign trading partners was the Court's most obvious foreign policy concern. Although cognizant of its limited competence to predict foreign responses, the Court articulated several factors weighing against the conclusion that worldwide combined reporting might provoke significant retaliation.[261] More important, the majority determined that worldwide combined reporting does not automatically create double taxation that might provoke foreign retaliation. The *Container* controversy also concerned a domestic parent corporation rather than a foreign parent corporation,[262] reducing the risk of double taxation. Thus, the Court concluded that the worldwide combined reporting method of taxation does not threaten United States for-

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257. *Id.* at 2953. For Justice Powell's discussion of the standard of review man dated by *Japan Line*, see *id.* at 2957 (Powell, J., dissenting).

258. *Japan Line*, 441 U.S. at 448. The Court in Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), expressed a similar need for the federal government to "speak with one voice when regulating commercial relations with foreign governments." *Id.* at 285 (state taxation on imported goods in transit violated the import-export clause). *See Japan Line*, 441 U.S. at 449 n.14.

259. *Container Corp.*, 103 S. Ct. at 2955.

260. *Id.* (quoting *Mobil Oil*, 445 U.S. at 448) (deletion in *Container).*

261. *Id.* at 2955-56.

262. *Id.* at 2952 n.26, 2955.

eign policy interests;[263] the method merely produces foreign resonances. The majority offered no criteria for determining when an action produces "foreign resonances," or when it "implicates foreign affairs." Therefore, this purported distinction appears to be a semantic one.

In deciding whether worldwide combined reporting conflicts with a clear federal tax policy, the Court made four observations: the taxpayer did not claim state preemption by federal tax statutes; federal tax treaties do not govern state taxes on domestic corporations; Congress had not enacted legislation to regulate state income taxes; and the Senate refused to ratify the treaty that would have outlawed worldwide combined reporting.[264] For these reasons, the Court concluded that neither formula apportionment nor worldwide combined income has significant foreign policy implications or violates clear federal tax policy. Therefore, worldwide combined reporting does not violate the foreign commerce clause.[265]

In his dissent Justice Powell argued that California's taxation scheme seriously " 'implicates foreign policy issues that must be left to the Federal Government.' "[266] He disapproved of the majority's emphasis upon the taxpayer as a domestic corporation because "it is unquestioned that California is taxing the income of the foreign subsidiaries."[267] Justice Powell predicted that taxation of these foreign subsidiaries probably would precipitate international disputes and discourage United States investment in foreign nations.[268] He noted that the majority opinion ignored the Solicitor General's amicus curiae brief in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*,[269] which opposed state use of

263. *Id.* at 2956. The Court also relied on the weaker arguments that the amount of tax paid by a corporation is more a function of a state's tax rate than its apportionment method; that the executive branch did not file an amicus brief opposing worldwide combined reporting in this case; and that Congress has not enacted legislation regulating state taxation of multinational corporations. *See id.*

264. *Id.* at 2956-57; *see supra* notes 177, 180.

265. 103 S. Ct. at 2956-57.

266. *Id.* at 2959 (Powell, J., dissenting) (quoting majority opinion, 103 S. Ct. at 2955).

267. *Id.*

268. *Id.* at 2960.

269. 103 S. Ct. 3562 (1983), *dismissing appeal from* Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 413 N.E. 2d 1343 (1981).

worldwide combined reporting.[270] In that case, Caterpillar and its related Illinois corporations sought a partial refund of their taxes following the use of worldwide combined reporting to recalculate their taxable income.[271] Chicago Bridge & Iron and fifteen other corporations intervened, seeking to prevent Caterpillar from using that method.[272] The intervenors, relying on *Japan Line*, argued that the use of worldwide combined reporting violated the foreign commerce clause.[273] The United States Solicitor General agreed with the intervenors, stating that worldwide combined reporting intrudes into an area where federal uniformity is essential.[274] Because the Court dismissed *Caterpillar Tractor* only after deciding *Container*, Justice Powell believed that the Court should have re-

270. *See* Solicitor General's Brief, *supra* note 35, at 9; *Container*, 103 S. Ct. at 2960 (Powell, J., dissenting). Justice Powell characterized the majority's suggestion that California could collect the same amount of tax by raising the tax rate as a theoretical notion that ignores political realities. *See id.*

271. Taxpayers incurred losses in their foreign operations, so worldwide combined reporting would lower the tax liability of Caterpillar and its subsidiaries. *Caterpillar Tractor*, 84 Ill. 2d 102, 417 N.E.2d 1343. The taxpayers argued that they had misapplied Illinois' apportionment formula because they had not applied it to their income as a group and presented evidence of a functionally integrated relationship between the parent corporation and its subsidiaries. Caterpillar Tractor had a strict policy "to maintain worldwide uniformity in all phases of its operations, including production, marketing and employer-employee relationships, all of which were kept subject to the central control of the parent corporation." *Id.* at 109, 417 N.E.2d at 1348.

272. Chicago Bridge & Iron argued that its dispute before the Illinois Director of Revenue concerned a related question of law: whether the United States Constitution permits worldwide combined reporting. *Id.* at 122, 123, 417 N.E.2d at 1353, 1354.

273. *Id.* at 122, 417 N.E.2d at 1353; *see Japan Line*, 441 U.S. at 434. The Illinois Supreme Court distinguished *Japan Line*, pointing out that the purpose of the apportionment formula is to determine the business income attributable to corporate activities in Illinois, not the income attributable to enterprises or the instrumentalities of foreign commerce. *Caterpillar Tractor*, 84 Ill. 2d at 122-23, 417 N.E.2d at 1353-54.

274. *See* Solicitor General's Brief, *supra* note 35, at 17. The Solicitor General took action at the behest of the Departments of State and Treasury, the Department of Commerce (acting at the request of the Commission of the European Communities), and the United States Trade Representative. In his memorandum the Solicitor General argued that the Illinois income tax violated the commerce clause. *See id.* at 9. Amicus briefs were also filed by 18 British companies, 5 Canadian companies, 8 Japanese organizations, the International Banking Association (representing approximately 100 foreign banks from 24 foreign countries operating in the United States) and the Union of Industries of the European Community. 27 TAXES INT'L 43 (1982).

garded the Solicitor General's brief in *Caterpillar Tractor* as the government's position in *Container*.[275]

Justice Powell is correct; the Solicitor General's position is clear and cogent evidence that the worldwide combined reporting method undermines federal foreign policy. Further evidence is the Federal Government's use of the internationally accepted arm's length system to tax only income deemed as United States source income. Moreover, the Senate has demonstrated its willingness to prohibit states from applying worldwide combined reporting to corporations. A treaty containing an express prohibition was not ratified only because enough Senators believed the treaty usurped a legislative function.[276] The Federal Government's uniform opposition to worldwide combined reporting presents the strongest indictment of the Court's decision in *Container*.

D. General Analysis

States can take comfort in the Court's *Container* decision because it preserves both the autonomy of state taxing practices and the revenue generated by worldwide combined reporting. *Container* also provides states with two benefits of greater significance. The flow of value standard qualifies more corporations for state taxation as unitary businesses, and the realm of permissible judgment test assures that the Court will defer to state decisions. Corporations discouraged by the Court's narrow reading of prior decisions in *ASARCO* and *Woolworth* received a further setback in *Container* when the Court refused to consider separate accounting evidence demonstrating formula apportionment distortion from worldwide combined reporting. Most surprising, however, was the Court's unwillingness to apply a rigorous *Japan Line* analysis. The Court chose not to strike down worldwide combined reporting either for enhancing the risk of multiple taxation or for preventing the Federal Government from speaking with the sole voice in matters of national concern.

By focusing on Container's status as a domestic corporation, the Court could ignore the national harm created by worldwide combined reporting. In his amicus curiae brief submitted in *Caterpillar Tractor*, the Solicitor General cautioned that "multiple

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275. *Container*, 103 U.S. at 2960 (Powell, J., dissenting).

276. *See, e.g.*, 124 CONG. REC. 18,427 (1978) (statement of Sen. Stevens); *see also supra* note 180.

tax burdens and the impairment to federal uniformity in international trade caused by the [worldwide combined reporting] state apportionment method will be more easily demonstrated in a case involving a corporate group with a foreign parent."[277] *Container* still may allow a different result for a foreign parent corporation.[278] The Court recognized that taxing a foreign parent corporation through a domestic subsidiary is more suspect than taxing a foreign subsidiary through a domestic parent.[279] Eventually the subsidiary must distribute its income to its parent corporation.

Since *Container*, however, the Court has denied certiorari in a case in which a foreign parent corporation challenged the imposition of worldwide combined reporting on its United States subsidiaries. This decision, *Shell Petroleum, N.V. v. Graves*,[280] does not foreclose future cases on this issue because the appeals court merely held that the lawsuit was premature.[281] As Justice Powell

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277. *See* Solicitor General's Brief, *supra* note 35, at 18.

278. *See generally*, Kogels, *supra* note 169 (focusing on foreign parent companies with subsidiaries located in the United States).

279. *Container Corp.*, 103 S. Ct. at 2956 n.32.

280. Shell Petroleum, N.V. v. Graves, 709 F.2d 593 (9th Cir.), *aff'g* 570 F. Supp. 58 (N.D. Cal.), *cert. denied sub nom.* Shell Petroleum, N.V. v. Franchetti, 104 S. Ct. 537 (1983). A foreign parent corporation sought declaratory and injunctive relief against California's use of worldwide combined reporting upon its subsidiaries. The district court dismissed the suit, holding that the foreign corporation did not have standing and that the controversy was not ripe for adjudication. *See* 570 F. Supp. at 66. The court of appeals affirmed, reasoning that a shareholder does not have standing on the basis of its investment in United States subsidiaries. The foreign parent corporation failed to allege an independent injury, thus, it did not have standing to sue. *See* 709 F.2d 593 (9th Cir. 1983).

A case similar to *Shell* is Alcan Aluminum, Ltd. v. Department of Revenue, 724 F.2d 1294 (7th Cir. 1984). In this case, a Canadian parent corporation had a wholly owned subsidiary doing business in Oregon, which was subject to Oregon's worldwide combined reporting unitary business tax. Oregon's audit, which challenged the amount of tax owed by the subsidiary, requested documents in the foreign parent's exclusive possession. The Canadian parent corporation alleged the fiscal and administrative burden of Oregon's audit was an independent injury, creating the justiciable controversy needed to challenge Oregon's use of worldwide combined reporting. *Id.* at 1296. The state court held, however, that the case was not ripe until Oregon actually imposed additional taxes on the subsidiary. *Id.* at 1299.

281. *See supra* note 272; *see also* Wall St. J., Dec. 6, 1983, at 4, col. 1. In 1984 the Court denied another foreign parent corporation's petition to acquire standing to contest a state tax that its United States subsidiaries must pay under worldwide combined reporting. *See* Alcan Aluminum, Ltd. v. Franchise

indicated in *Container*, if the Court were to strike down the application of worldwide combined reporting to foreign corporations only, then domestic parent taxpayers might validly claim that the different tax treatment accorded foreign and domestic parent corporations discriminates unconstitutionally against the origin of interstate commerce.[282] Even if the Court were to uphold the application of worldwide combined reporting to a foreign parent corporation,[283] in the case of a state-owned foreign parent corporation the tax would not simply produce "foreign resonances," but would affect governmental foreign affairs directly. The Court has sidestepped these difficult questions by refusing to hear these cases because the plaintiffs, foreign parent corporations, lack standing.[284]

The range of opinion in *Container* and other unitary business tax cases makes it difficult to predict the result of likely future litigation.[285] The *Container* decision[286] is significant not only for

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Tax Bd., 558 F. Supp. 624 (S.D.N.Y.), *aff'd without opinion* (2d Cir. June 17, 1983), *cert. denied*, 104 S. Ct. 705 (1984). *But see* Capitol Indus.-EMI, Inc. v. Bennett, 681 F.2d 1107 (9th Cir.), *cert. denied sub nom.* EMI, Ltd. v. Bennett, 103 S. Ct. 1189 (1982) (judicial remedies are available only to the actual taxpayer, the United States subsidiary of a foreign parent corporation).

282. *See Container Corp.*, 103 S. Ct. at 2960 (Powell, J., dissenting). Powell noted that invalidating worldwide combined reporting only as applied to an overseas parent corporation would allow California to discriminate against a domestic corporation in favor of an overseas corporation. Powell would not permit this discrimination unless explicitly authorized by Congress. *See id.* This suggests that Powell would also apply an equal protection analysis to cases similar to *Container* if the Court were to find worldwide combined reporting unconstitutional as applied to a foreign parent corporation.

283. Foreign parent corporations have greater burdens in complying with state demands to produce records on transactions having no nexus to activities in the United States. "It is asking the impossible of corporations, especially corporations with worldwide and extremely complex activities to calculate their tax according to the individual tax code of each state and each country . . . ." Letter from Makoto Utsumi, Minister for Financial Affairs, Embassy of Japan to the Washington Post, *reprinted in* Wash. Post, Oct. 28, 1983, at A22, col. 3.

284. *See* cases cited *supra* note 272.

285. Comparison of the Justices' positions in *ASARCO* and *Container* demonstrates the ideological division of the Court on this issue. Justice Powell and Chief Justice Burger consistently have spoken out against state abuses in corporate taxation. Justice Stevens, who objected to the Court's broad definition of a unitary business in *Mobil Oil*, did not participate in *Container*. Justice O'Connor dissented in both *ASARCO* and *Container*, deferring to the state factual findings of a unitary business, but opposing state taxation that affects foreign commerce. In contrast, Justices Brennan, White, and Stewart joined the

its judicial implications, but for the state legislative action it has prompted and for the presidential concern it has raised.

E. Reaction to *Container*

A few weeks after the *Container* decision, the Florida legislature enacted the worldwide combined reporting system.[287] Adoption of worldwide combined reporting[288] has angered businesses that are essential to the State's economy.[289] Florida's action will reduce its export trade because United States companies operat-

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majority in both cases; Justices Rehnquist and Blackmun have supported the State's position in both cases.

In oral testimony, Justice Rehnquist demonstrated his antagonism toward taxpayer challenges to state taxation when he asked counsel for Container "Venezuela and Colombia didn't require you to use separate accounting in California, did they?" *Container Corp.* Transcript, *supra* note 201, at 15. Justice White's questioning noted that California's apportionment formula includes Container's worldwide assets in apportionment factor ratios, unlike the apportionment formulas in *ASARCO* and *Woolworth. See id.* at 3-4. Justice White's concern suggests that he would invalidate apportionment formulas that tax a share of foreign source income but do not include foreign source assets in calculating the state's apportioned share. Justice White also implied that if a state applies worldwide combined reporting, it cannot require a corporation to include all foreign source income earned by a related corporation. *See id.* at 16. Justice White's positions are particularly important because he has been a swing vote in state taxation cases. Walter Hellerstein agrees that the Court's decisions lack a clear pattern in unitary tax cases. *See* Wall St. J., Feb. 8, 1984, at 31, col. 3. *See generally* Delap, *From* Moorman *to* Chicago Bridge: *U.S. Supreme Court Decisions Relating to "Unitary" Taxation,* 2 J. ST. TAX'N 197, 218 (1983) ("box score" on Justices' positions in the unitary tax cases).

286. The Court declined to rehear *Container.* 104 S. Ct. 265 (1983).

287. *See* 2 WEEKLY TAX REP. (BNA) 76 (1983). Tennessee, site of the Nissan assembly plant, which is the largest single Japanese investment in the United States to date, has worldwide combined reporting bills pending. *See* H. B. 4026, S. B. 4025, 93rd Gen. Assembly (1984).

288. "[T]he new method of taxation is designed to raise about $59,000,000 annually, essentially through the taxation of foreign source income that had been exempted from the state's 5% corporate income tax." *See* 2 WEEKLY TAX REP. (BNA) 76 (1983).

289. Florida's Secretary of State, George Firestone, believes that within a year Florida will not use worldwide combined reporting. *See* N.Y. Times, Oct. 26, 1983, at 24, col. 1, col. 5. Lieutenant Governor Wayne Mixson, has been quoted as saying "We've shot ourselves in the foot." Anderson & Leslie, *The Storm Over Unitary Taxes,* NEWSWEEK, Dec. 19, 1983, at 74, 75. Florida's worldwide combined reporting law, however, appears to have an international loophole that allows taxpayers to elect federal tax rules. *See* Wall St. J., Nov. 16, 1983, at 1, col. 5.

ing in Florida will earn fewer profits on their foreign businesses under a worldwide combined reporting system of taxation.[290] Future foreign investment in the State may decrease because a foreign company can no longer establish a Florida subsidiary and avoid paying state income tax until the subsidiary earns a profit.[291]

Despite the unanimous recommendation by President Reagan's economic advisers that the Administration support legislation prohibiting states from applying the unitary method of taxation to income earned outside the United States,[292] the President avoided taking a position on the issue.[293] Instead, he appointed a commission to study the worldwide combined reporting method of taxation. The commission, headed by Treasury Secretary Regan, will make recommendations on a federal foreign trade policy that respects states' measures to raise revenue.[294]

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290. *See* N.Y. Times, Aug. 3, 1983, at D4, col. 5.

291. British companies have reacted to the tax by cancelling a trade mission to Florida. "The London Chamber of Commerce and Industry . . . cit[ed] a massive decline in interest from its 8,000 member companies after [Florida enacted the unitary business worldwide combined reporting method of taxation]." Hulihan, *supra* note 22, at 2, col. 5; *see also* Todd, *Battle Threatens Over Tax on Multinationals*, EUROPE, Nov.-Dec., 1983, at 22; *supra* text accompanying note 169 (European perspective on or opposition to worldwide combined reporting).

292. *See* 2 WEEKLY TAX REP. (BNA) 372 (1983) (proposed "water's edge" approach to state taxation).

293. *See* Bacon, *Reagan's Delay on Unitary Tax Is Victory for States but May Spark Trade Problems*, Wall St. J., Sept. 26, 1983, at 8, col. 2. The business community wanted the Reagan Administration to file an amicus curiae brief in support of rehearing *Container* and "go the entire nine yards and support legislation." 2 WEEKLY TAX REP. (BNA) 248 (1984) (quoting Paul Huard of the National Association of Manufacturers).

294. *See* Bacon, *supra* note 293. The British resent the study as a delaying manuever. *See A California Tea Party*, THE ECONOMIST, Oct. 1, 1983, at 19 ("Britain is at war with America once again, and once again it is over taxation"). The commission staff reportedly is agreed on limiting state taxing authority to prevent states from requiring corporations to produce auditing information held outside the United States. The staff is split on whether a state may tax a domestic, nondomiciliary corporation's receipt of dividends from related foreign corporations. 3 WEEKLY TAX REP. (BNA) 440 (1984). This suggests that the staff will recommend prohibiting worldwide combined reporting. *See id.* at 441.

VIII. Proposed Congressional Solutions

In *Japan Line* the Supreme Court recognized that the states could not resolve the problems unilaterally and called upon Congress to regulate state taxation affecting interstate commerce.[295] The Court repeated its plea in *Mobil Oil*: "Absent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States."[296] Likewise, Justice Burger's concurrence in *F.W. Woolworth* and *ASARCO* repeated the call for congressional regulation of state corporate income taxes.[297] Characterizing the current system of state corporate income taxes as "a parochial hodge-podge of overlapping and conflicting tax levies,"[298] Justice O'Connor's dissent in *ASARCO* also called for congressional action:

> [O]nly Congress has both the ability to canvass the myriad facts and factors relevant to interstate taxation and the power to shape a nationwide system that would guarantee the States fair revenues and offer interstate businesses freedom from strangulation by multiple paperwork and tax burdens.[299]

The Court's decision in *Container* requests congressional action again. The 1982 General Accounting Office (GAO) Report recommends congressional action because the states cannot be expected to deal objectively with the problem, and the courts are able to address the issues only on a case-by-case basis. Only Congress has

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295. *See Japan Line*, 441 U.S. at 448.

296. *Mobil Oil*, 445 U.S. at 448.

297. Chief Justice Burger's brief concurrence in *F.W. Woolworth* reads: "I join the Court's opinions in these cases in reliance on the Court's express statement that the Court's holdings do not preclude future Congressional action in this area." *F.W. Woolworth*, 458 U.S. 354, 331 (Burger, C.J., concurring in *F.W. Woolworth* and *ASARCO*) (citing *ASARCO*, 458 U.S. at 307 n.23).

298. *ASARCO*, 458 U.S. at 331 (O'Connor, J., dissenting). Justice O'Connor expressed concern that the majority's "reliance on the Due Process Clause may deprive Congress of the authority necessary to rationalize the joint taxation of interstate commerce by the 50 States." *Id.* at 331. The majority opinion responded to this concern by stating that "[t]he question of federal authority . . . is not presented in this case, and we imply no view as to it." *ASARCO*, 458 U.S. at 328, n.23.

299. *Id.* at 331 (O'Connor, J., dissenting). Justice O'Connor cited a lengthy congressional critique of the judiciary's inability to deal adequately with state apportionment of corporate income taxes to provoke Congress into action. *See id.* at 351-52.

the abililty "to achieve a balance between States' authority to tax and the federal interest in interstate and international tax policy issues."[300] Under the commerce clause, Congress has the power to regulate state taxation of foreign source income when local corporate activity has a substantial economic effect on interstate commerce.[301] Congress has yet to take significant action,[302] even though a congressional study, known as the Willis Committee study, asserted that some congressional regulation of state taxation was appropriate, especially when international issues are implicated.[303]

The Willis Committee study, completed in 1965, concluded that the federal government should not allow states to tax the foreign source income of corporations using the worldwide combined reporting method.[304] Acting on the committee's recommendation for federal legislation, several states quickly adopted the Uniform Division of Income for Tax Purposes Act.[305] Unfortunately, this voluntary effort has not created a more uniform system of state taxation.[306] The 1982 GAO Report on state taxation concluded that "[t]he need for greater uniformity is more urgent today than it was . . . when the Willis Committee issued its report. Corporations continue to grow and expand their operations to more States and foreign countries."[307]

The GAO's tax experts advocate legislation that requires all

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300. 1982 GAO REPORT, *supra* note 7, at 22. "Our tax system, particularly State and local is inefficient. I do not believe it is happenchance that two of our primary trading competitors, Germany and Japan, are leaders in international tax harmonization." *1977-1978 Interstate Tax'n Hearings, supra* note 110, at 417 (statement of David L. Gibson, tax counsel, Crown Zellerback Corp.).

301. *Cf.* Wickard v. Filburn, 317 U.S. 111 (1942) (consumption of homegrown wheat affects interstate commerce).

302. *See* Hellerstein, *supra* note 121, at 113 n.3, 154-62; *Worldwide Combined Reporting: Recent Legislative Developments*, 1 J. ST. TAX'N 285 (1983) [hereinafter cited as *Legislative Developments*]. Thus far, Congressional studies have been undertaken. *See, e.g.*, WILLIS COMM. STUDY, *infra* note 303.

303. REPORT OF THE SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE OF THE HOUSE COMM. ON THE JUDICIARY, STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. No. 1480, 88th Cong., 2d Sess. (1964) (two volume); H.R. REP. No. 565, 89th Cong., 1st Sess. (1965); H.R. REP. No. 952, 89th Cong., 1st Sess. (1965) [all four volumes hereinafter cited as WILLIS COMM. STUDY].

304. *See id.* H.R. REP. No. 952 at 1155.

305. UNIFORM ACT, *supra* note 145.

306. For the history of voluntary efforts to make state taxation more uniform, see 1982 GAO REPORT, *supra* note 7, at 10-11.

307. *Id.* at 21.

states to apportion income using an equally weighted three-factor formula, and to follow the Uniform Act and the Multistate Tax Commission's regulations governing the calculation of the three-factor formulas.[308] States contend that this legislation would benefit only a few large corporations. Congress could permit multinational corporations to shift income to foreign affiliates,[309] thus preserving one last multijurisdictional loophole. Federal legislation also might produce "nowhere income"—income unattributable to any state.[310] To answer concerns about the potential underreporting of income, Congress should provide more money to train Internal Revenue Service (IRS) agents, allowing the IRS to audit multinational enterprises more effectively in the complex area of intercompany transfer pricing.[311] If the IRS provided its

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308. *Id.* at 47-48; *see also* Schoettle, *State Taxation of Income from Businesses in Interstate Commerce: Is There a Need for Federal Legislation?* (memorandum prepared for the General Accounting Office), *reprinted in 1980 S. State Tax'n Hearings, supra* note 20, at 816.

309. The Internal Revenue Service admits that it has little data on the extent to which multinational corporations successfully have avoided taxes by shifting corporate income to low tax jurisdictions. 1981 GAO REPORT, *supra* note 163, at xi; *see also* McLure, *The Economics of State Corporation Income Taxes: What Practitioners and Administrators Should Know,* 75 NTA-TIA PROC. 64, 69 (1982). "Tax experts and corporate taxpayers have suggested that Treasury [should] reconsider the appropriateness of the arm's length standard in an economic world more complex than that which existed when the standard was adopted in 1934." 1981 GAO REPORT, *supra* note 163, at x; *see 1977-1978 S. Interstate Tax'n Hearings, supra* note 110, at 442 (statement of Sterling Gallagher, Commissioner of Revenue, State of Alaska). "[U]sing the arm's-length method on a multinational company, there is no way of knowing whether they actually in reality did make a loss in California." *Id.* at 285 (statement of Paul Ryder, associate director, Ohio Public Interest Campaign). According to Mr. Ryder, Professor Zitman, who was on the Willis Committee, performed a study on the use of the separate accounting method in Alaska. Professor Zitman found that none of the companies reported any income in Alaska using the separate accounting method. *Id.* States have also raised objections based on federalism. "Minnesota strongly objects to [federal] restriction of the power of the state to require combined income." *Id.* at 336 (statement of Gerome Caulfield, representing Commissioner Ring, State of Minnesota). Similarly, Alaska's tax commissioner lobbied President Reagan's administration to oppose any limits on state taxation of foreign source income because federal legislation would conflict with the President's commitment to new federalism. *See Alaska's Tax Commissioner Urges Administration to Oppose Limits on State Taxation of Foreign Source Income,* 35 TAXES INT'L 37 (1982).

310. *See* Dexter, *supra* note 145, at 403.

311. The Internal Revenue Service is increasing the number of agents as-

audit information to the states it would be unnecessary for states to train international audit specialists.[312] Many legislators have proposed solutions to the problem of worldwide combined reporting, but thus far, Congress has accepted none of them.

Since 1965, bills to regulate in-state corporate taxation have been introduced in every session of Congress.[313] Although two of these bills passed the House, enormous state opposition blocked their passage in the Senate.[314] In 1983 Senator Mathias and Representative Conable reintroduced legislation prohibiting worldwide combined reporting.[315] Senator Mathias has asked Senator Dole, Chairman of the Senate Finance Committee, to hold hearings on this bill as soon as possible, asserting that "Congress currently has the opportunity, and clearly, the Court gave it the responsibility to act."[316]

The time has come to view state taxation issues from a wider perspective, addressing larger social concerns about jobs and industrial productivity.[317] Australia and Switzerland provide in-

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signed to international tax problems from 297 to 364. Carley & Taylor, *Marc Rich Tax Case is Tip of the Iceberg But Unlikely to Lead to Rash of U.S. Suits*, Wall St. J., Sept. 21, 1983, at 5, col. 2.

312. States are just developing audit programs. *See 1977-1978 S. Interstate State Tax'n Hearings*, *supra* note 110, at 445 (statement of Ted DeLooze, Chief Counsel, Tax Division, Oregon Dep't of Justice).

313. 1982 GAO REPORT, *supra* note 7, at 6; *see also* Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 VA. L. REV. 149, 153 n.22 (1976) (citing specific bills); Hellerstein, *supra* note 121, at 114 n.4.

314. H.R. 7906, 91st Cong., 1st Sess., 115 CONG. REC. 17,315 (1969); H.R. 2158, 90th Cong., 2d Sess., 114 CONG. REC. 14,423 (1968). Only the House passed these bills. *See* 115 CONG. REC. 17,323 (1969); 114 CONG. REC. 14,432-33 (1968). More recently, similar legislation has failed to pass. *See, e.g.*, 97th Cong., 1st Sess. (1981); *see also* 1 CONG. INDEX (CCH) 21,006; 34,502 (1982) (S. 655 and H.R. 1983).

315. H.R. 2918, S. 1225, 98th Cong., 1st Sess., 129 CONG. REC. H2,697; S6,145 (daily ed. May 5, 1983). The legislation would create a new Internal Revenue Code section entitled "Income of Corporations Attributable to Foreign Corporations." *See* S. 1225, 98th Cong., 1st Sess. (1983). This section would prohibit states or any political subdivision from taxing "any income or income attributable to any foreign corporation which is a member of any affiliated corporation and not in gross income. A domestic corporation could qualify as a foreign corporation if a dividend received from it would not be treated as income from sources within the United States." *Id.*

316. 2 WEEKLY TAX REP. (BNA) 248 (1983).

317. The United States Senate knows that worldwide combined reporting harms United States interests: "The time has come to raise the level of the de-

structive precedents for federal harmonization of conflicting and burdensome state taxation of interstate commerce. Australia replaced state taxation of interstate commerce with a national tax that fairly allocates the income.[318] Once the tax has been collected, the Australian government distributes the revenue to the states. Switzerland, too, has taken measures to avoid the extraterritorial application of its unitary method.[319] The United States Government could collect a national tax on the overseas income of multinational corporations and distribute the proceeds to the states under a uniform system of allocation.[320]

The Government Accounting Office explained that Congress need not write a mandatory model tax statute for all states to follow. Instead, Congress could set a "water's edge" restriction on the states' apportionment of corporate income taxes.[321] A similar method was included in the Mathias bill.[322] Even if one accepts the states' position that state laws governing the taxation of corporations engaged in interstate commerce are becoming more uniform, federal legislation is appropriate because differences among state corporate income tax systems continue to interfere with international trade.[323] Ideally, all states would follow the examples

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bate and talk frankly about the larger issues—about jobs, the national interest, and economic survival . . . ."

The Chairman of Lloyd's Bank of California stated [in California legislative hearings]: "Many businesses have failed to locate in California because of the danger of the application of the unitary tax. Others, including the Hong Kong and Shanghai Bank, have considered withdrawing from California because of it." *Oversight of U.S. Trade Policy: Joint Hearings Before the Subcomm. on International Trade of the Senate Comm. on Finance and the Subcomm. on International Finance and Monetary Policy of the Senate Comm. on Banking, Housing, and Urban Affairs,* 97th Cong., 1st Sess. (part I) 113, 115 (1981) (statement of Sen. Mathias).

At a September 1, 1983, press conference, a spokesman for the Japanese Ministry of Foreign Affairs emphasized that Japanese direct investment in the United States provides 100,000 jobs in the United States. "The state unitary system of taxation 'would greatly decrease the willingness of Japanese firms to enter the [United States] market.' " 2 WEEKLY TAX REP. (BNA) 342 (1983).

318. J. HELLERSTEIN & W. HELLERSTEIN, *supra* note 61, at 274 n.4.

319. *The Dutch Perspective, supra* note 176, at 109.

320. *Cf.* I.R.C. §§ 6361-6365 (1976) (procedures for federal collection of state tax).

321. 1982 GAO REPORT, *supra* note 7, at 28.

322. *See supra* note 314.

323. Multinational enterprises not having foreign losses wait desperately for Congress to provide a legislative remedy. Meanwhile, for purposes of tax plan-

of Illinois and New York and voluntarily abandon the worldwide combined reporting method.[324] Unless the states act with uncharacteristic speed, federal legislation will be needed to spare the United States from unnecessary commercial retaliation or reduced foreign investment.[325]

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ning, corporations should not permit a state that uses worldwide combined reporting to label a subsidiary or affiliate corporation operating in that state as part of the multinational enterprise's unitary business. Preventative measures include separating distinct lines of business as autonomous activities, limiting intercompany transactions among commonly owned businesses, allowing each subsidiary to develop its own accounting and administrative services to eliminate parent corporation management fees, and avoiding central purchasing. *See* COOPERS & LYBRAND, STRATEGIES: TAX AND FINANCIAL PLANNING 23-26 (1982).

324. A few members of California's legislature have tried to persuade state lawmakers to enact legislation exempting most foreign corporations and their subsidiaries from worldwide combined reporting. *See, e.g., Legislative Developments, supra* note 302, at 293-95 (discussing the Hughes Bills, A.B. 525 (1979) and A.B. 55 (1980)). Although the California Assembly passed A.B. 55, which prohibited applying the unitary method of tax accounting to the foreign operation of foreign-based multinational groups, the Senate cancelled its hearings on the bills because of insufficient support. *See id.* Alternatively, some legislators sought to limit the unitary method of apportionment to the domestic operations of all corporations meeting an 80% test. *See* A.B. 1238, *cited in id.* at 295. For the California bills introduced in 1983, see LeBeau, *Court Decisions,* 46 TAXES INT'L 51, 54 (1983) (A.B. 1081, 1082, 1083, & 2039). California appears reluctant to extend relief to domestic companies because there are substantially greater losses of revenue, and fewer problems auditing the subsidiaries and affiliate corporations of United States parent corporations. *See Legislative Developments, supra* note 302, at 295 (elimination of worldwide combined reporting for foreign-based parent corporations would be one-tenth the cost of eliminating worldwide combined reporting for all corporations).

If Congress does not pass legislation prohibiting worldwide combined reporting, retaliation by the United Kingdom appears imminent. At least 50 members of the House of Commons favor retaliation. *See* N.Y. Times, Nov. 28, 1983, at 26, col. 1.

325. *See* N.Y. Times, Jan. 11, 1984, at 28, col. 4 (spokesman for a European industry group presses for reprisal against United States if states are permitted to continue using worldwide combined reporting).

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