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Over the Edge: State Taxation of Multinational Corporations in the Wake of Barclays

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NOTES

OVER THE EDGE: STATE TAXATION OF MULTINATIONAL CORPORATIONS IN THE WAKE OF BARCLAYS

Under the Due Process and Commerce Clauses of the United States Constitution, states are not permitted to tax income of non-residents on "value earned outside the taxing state's borders." However, where there is a high degree of interrelationship between one corporation, usually a parent corporation and its corporate subsidiaries, the corporation will be deemed "unitary" for tax purposes. States are permitted to tax a unitary business on

1. U.S. Const. amend. XIV. The Fourteenth Amendment provides that no state shall "deprive any person of life, liberty, or property, without due process of law." Id.
2. U.S. Const. art. I, § 8, cl. 3. "The Congress shall have power to lay and collect taxes ... [t]o regulate Commerce with foreign Nations, and among the several States ..." Id. In addition, the United States Supreme Court has determined that the state has the power to choose what state tax to apply to interstate and multinational commerce under the Dormant Commerce Clause. Id.; see also Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2276 (1994).
4. See PMD Investment Co. v. State Dep't of Revenue, 216 Neb. 553, 556 (1984). Courts apply various tests to determine whether a business is unitary. See F.W. Woolworth Co. v. Taxation and Revenue Dep't of N.M., 458 U.S. 354, 364 (1982). "If factors of profitability arising from operation of business as a whole, such as functional integration, centralization of management, and economies of scale exist, [there is] evidence [of a] unitary business ..." Id.; Butler Bros. v. McColgan, 111 P.2d 334, 341 (Cal. 1941). Under one test, a business is unitary if there is: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use.
income derived from business activity with a "substantial nexus" to the taxing state.\(^5\) Hence, the "unitary/non-unitary" distinction presents a significant issue with respect to state taxation of a multistate or multinational corporation ("MNC").\(^6\)

When a business operates in more than one state or country, it is often difficult to determine what portion of its income is attributable to a particular state.\(^7\) Accordingly, a state employs one of two methods to determine what portion of income from the mul-

\(^5\) See Amerada Hess Corp. v. New Jersey Dep't of Treasury, 490 U.S. 66, 66 (1989) (arriving at conclusion that substantial nexus exists where each of company's in-state operations are part of integrated "unitary business"). Generally, any significant amount of contact with the taxing state is considered a "substantial nexus." See, e.g., D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24, 25 (1988) (finding substantial nexus where business, conducted outside state's borders, directly influences its presence within taxing state and business had significant presence in state with respect to number of stores and sales volume); Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734, 763 (1978) (holding that substantial nexus company avails itself of police and fire protection, among other benefits taxing state offers). But see Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1904 (1992) (stating that mere contact by mail or common carrier is not enough to show substantial nexus with taxing state).

\(^6\) See, e.g., Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 165-68 (1983) (holding business to be unitary where capital flow from taxpayer to its subsidiaries was significant and managerial role played by taxpayer in subsidiaries' affairs was substantial); Honolulu Oil Corp. v. Franchise Tax Bd., 386 P.2d 40, 46 (Cal. 1963) (concluding that California oil company with large amounts of production in California and limited operations outside of California was not unitary business); Superior Oil Co. v. Franchise Tax Bd., 386 P.2d 33, 39 (Cal. 1963) (holding that California corporation which sold all of its California produced petroleum in California and all of its petroleum produced outside of California was unitary and was therefore subject to California's unitary tax).

Through the years, the United States Supreme Court has distinguished between the various types of MNCs. See, e.g., Barclays Bank, PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2271 (1994). There are three types of MNCs—(i) Domestic-based MNCs: MNCs domiciled in the United States with overseas subsidiaries. See Container Corp., 463 U.S. at 162. (Container Corp. was a Delaware corporation doing business in several states with a number of overseas subsidiaries); (ii) Domestic MNCs with foreign parents. See Alcan Aluminium, Ltd. v. Franchise Tax Bd., 890 F.2d 688 (4th Cir. 1989), cert. denied, 114 U.S. 2737 (1994) (involving two foreign corporations—Canadian company and English company—with American subsidiaries domiciled in Ohio and Delaware, respectively, who were doing business in California); and (iii) Foreign corporations with foreign parents or foreign subsidiaries. Barclays, 114 S. Ct. at 2274 (Barclays was a foreign corporation suing on behalf of Barcal and BBI, two of its domestic subsidiaries). The Supreme Court has held that unitary taxation is constitutional when applied to all three types of MNCs. Barclays, 114 S. Ct. at 2286.

\(^7\) See Container Corp., 463 U.S. at 164. "[A]rriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." Id.
tijurisdictional business it is entitled to tax: the "arms-length/separate accounting" ("arms-length") method or the "unitary business/formula apportionment" ("unitary") method.\(^8\)

The arms-length method allows the state to tax an MNC only on income that the corporation reports on its own books, treating it as if it were an independent corporation involved in arm's length transactions with its affiliates.\(^9\) This method is employed by the federal government,\(^10\) a majority of states,\(^11\) and most foreign nations.\(^12\) However, critics claim that the arms-length method is unreliable because it taxes income derived from transactions between interdependent affiliates, which makes it impossible to separate arms-length transactions from closely-related transactions.\(^13\) Another criticism of the arms-length method is that it allows corporations to use manipulative accounting methods to shelter income in states or countries with lower tax rates.\(^14\)

Rather than using the arms-length method of taxation, a minority of states, including California,\(^15\) use the unitary method of taxation,\(^16\) which applies a "three-factor" model called the "worldwide combined reporting" ("WWCR") method to apportion income

\(^8\) See Barclays, 114 S. Ct. at 2272-73 (1994) (distinguishing arms-length taxation method from unitary taxation method).

\(^9\) See Container Corp., 463 U.S. at 185 (stating that arms-length method treats all businesses as separate entities for taxation purposes); Greenberg, supra note 4, at 466. The arms-length method treats the subsidiaries as if they were completely unrelated to the multinational corporation. Id. at 185. Hence, any income derived from transactions with the parent company is treated as income from outside sources. Id.

\(^10\) See Greenberg, supra note 4, at 466.

\(^11\) See infra note 17 (listing revenue codes of those states with unitary tax provisions). Only eight states currently have provisions for unitary taxation of MNCs in their codes. Id.

\(^12\) Id.


\(^14\) Id. at 1079 (discussing states' arguments against arms-length taxation method on ground that MNCs can shelter income). See Barclays, 114 S. Ct. at 2272. "[U]nitary taxation 'rejects geographical or transactional accounting,' which is 'subject to manipulation' and does not fully capture 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.'" Id. (quoting Container Corp., 463 U.S. at 164-65). For example, if an MNC has two subsidiaries, one in State A, where the tax rate is 20% and one in State B, where the tax rate is 30%, that MNC will attempt to manipulate its accounting records to show that the majority of its income was produced in State A, the state with the lower tax rate.

\(^15\) CAL. REV. & TAX. CODE § 25110 (West 1994).

\(^16\) See infra notes 17-27 and 99-103 and accompanying text (describing two methods of unitary taxation: worldwide combined reporting and water's edge method).
of multijurisdictional unitary corporations.\textsuperscript{17} Under the WWCR method, a state divides the property, payroll, and sales of the subsidiary operating within the taxing state by the property, payroll, and sales of the entire MNC.\textsuperscript{18} This percentage is then multiplied by the MNC’s total amount of worldwide income to determine the appropriate amount of income the state may tax.\textsuperscript{19}

For more than a decade, controversy has centered on states’ use of the unitary taxation method.\textsuperscript{20} States that employ the unitary

\textsuperscript{17} See Harris, supra note 13, at 1077-78. Alaska, California, Maryland, Minnesota, Montana, Nebraska, North Dakota, and Wisconsin still have unitary taxation provisions in their codes. Id.; see, e.g., ALASKA STAT. § 43.20.065 (1990); CAL. REV. & TAX. CODE § 25110 (West 1994); MD. CODE ANN. § 10-402 (1957 & Supp. 1994); MINN. STAT. ANN. §§ 290.17, 290.34 (West 1994); MONT. CODE ANN. § 15-31-301 (1974 & Supp. 1993); NEB. REV. STAT. § 77-2734.09 (1943 & Supp. 1993); N.D. CENT. CODE § 57-38-12 (1983 & Supp. 1991). But see Walter Hellerstein, Selected Issues in State Business Taxation, 39 VAND. L. REV. 1033, 1034-35 (1986) [hereinafter Selected Issues] (stating that, after Container Corp., many state legislatures adopted unitary tax legislation only to repeal it as result of pressure from business community). Colorado, Florida, Idaho, Indiana, Massachusetts, New Hampshire, Oregon, and Utah once had unitary taxation provisions in their codes, but no longer use the unitary method. See, e.g., COLO. REV. STAT. § 39-22-303 (1990); FLA. REV. STAT. ANN. § 220.135 (West 1984); IDAHO CODE § 6-3-2-2 (1990); MASS. GEN. L. ch. 63, § 38 (1986); N.H. REV. STAT. ANN. § 77A:3 (1986); OR. REV. STAT. §§ 314.280, 314.650 (1986); UTAH CODE ANN. § 59-13-78 (1986); see also Kristen Schlenger, State Worldwide Unitary Taxation: The Foreign Parent Case, 23 COLUM. J. TRANSNAT’L L. 445, 445 n.2 (1984). The “three part” formula used by the California Franchise Tax Board is one of the most commonly used by states implementing the unitary tax laws. Id. The “three part” formula is as follows:

\[
\text{Total Property} + \text{Total Payroll} + \text{Total Sales} \times \frac{\text{Total Corporate Income Taxable By The State}}{3}
\]

\textit{Id.} (citing Comptroller General Report, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving (Report to Chairman, House Committee on Ways and Means)).

\textsuperscript{18} See Harris, supra note 13, at 1080.

By way of example, if the property, payroll, and sales of the foreign MNC amount to $100,000 and the property, payroll, and sales of one of its subsidiaries based in the United States amount to $50,000, the subsidiary is deemed to represent 50% of the MNC. Accordingly, the subsidiary will be taxed on 50% of the aggregate income of the entire MNC, as opposed to being taxed on only the income that would otherwise be attributed to the subsidiary.

\textsuperscript{19} Harris, supra note 13, at 1080.

For example:

<table>
<thead>
<tr>
<th>Prop., Payrl., Sales</th>
<th>%</th>
<th>Actual Income (WWCR)</th>
<th>Tax Rate</th>
<th>Tax Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>MNC $100,000</td>
<td>n/a</td>
<td>20 mil.</td>
<td>30%</td>
<td>6 mil.</td>
</tr>
<tr>
<td>Subsid. 50,000</td>
<td>50%</td>
<td>4 mil.</td>
<td>30%</td>
<td>3 mil.</td>
</tr>
</tbody>
</table>

The income under the WWCR method is $6 million more than what the subsidiary would have otherwise claimed in income ($4 million). This is because it is deemed to represent 50% of the MNC and is therefore taxed on 50% of the MNC’s income. Note that the subsidiary would have only paid $1.2 million ($4 mil. x 30% tax rate) in taxes if the WWCR method had not been applied.

\textsuperscript{20} See Nicholas S. Freud & Walter M. Kolligs, U.S. Supreme Court Upholds Worldwide Reporting and Unitary Taxation, 5 J. INT’L TAX’N 340, 340 (1994) (stating that few controversies relating to United States tax policy have caused as much international friction as
taxation method claim that this method of taxation most closely resembles the actual activities of MNCs and is therefore the best way of avoiding tax evasion.\textsuperscript{21} However, the unitary taxation method is not without its problems. Arriving at a precise allocation of an MNC's income is often an unrealistic goal.\textsuperscript{22} Moreover, the unitary method could create multiple taxation because it taxes income that other jurisdictions may have already taxed.\textsuperscript{23}

California's liberal WWCR method is the most controversial of the unitary methods because it taxes unitary corporations based on a percentage of worldwide income, which tends to overestimate the corporation's domestic income.\textsuperscript{24} Recently, in \textit{Barclays Bank PLC v. Franchise Tax Board},\textsuperscript{25} the Supreme Court of the United States found California's unitary tax method constitutional as ap-

\textsuperscript{21} See Schlenger, \textit{supra} note 17, at 446-47. The states argue that the arms-length method allows MNCs to distort trade pricing. \textit{Id.} Thus, the states claim that the unitary method more closely resembles the activities of MNCs than the arms-length method. \textit{Id.} at 447; \textit{see also} Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 439 (1980) (stating that "[b]hep of apportionability in the field of state income taxation is the unitary-business principle"); Harris, \textit{supra} note 13, at 1077 (declaring that states believe arms-length method used by federal government is unreliable when applied to multistate or multinational corporations). Additionally, because unitary taxation is based on a proportion of a corporation's worldwide income, corporations cannot shelter income in states with lower tax rates. \textit{Id.}

\textsuperscript{22} See Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 164 (1983) (stating that determining MNC's precise income is elusive goal); \textit{see also} Mobil Oil, 445 U.S. at 430 (explaining that because profit is made throughout entire operation, it is misleading to identify one particular source of income).

\textsuperscript{23} See Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2279-80 (1994). MNCs argue that, more often than not, the unitary tax method results in double taxation. \textit{Id.}; \textit{see also}, Freud & Kolligs, \textit{supra} note 20, at 344; Harris, \textit{supra} note 13, at 1091. "Foreign-based companies, in the interest of economy and efficiency, often perform many functions outside the United States and relatively few activities within the United States." \textit{Id.} The author draws the distinction between income-producing activities "outside the borders of the state [or country]" and those inside the borders. \textit{Id.}

The threat of double taxation is greater for foreign-based MNCs than for domestic-based MNCs. \textit{See} Freud & Kolligs, \textit{supra} note 20, at 344. For example, in \textit{Barclays}, out of a group of 220 entities, only three companies did any business in the United States. \textit{Id.} at 344 n.15.

Although unitary taxation may be the best method for multistate corporations, some states believe this is unfair when applied to MNCs. \textit{See} Miss. \textit{Code Ann. \textsuperscript{24} See Greenberg, \textit{supra} note 4, at 466 (stating that no other state tax system has caused more friction between international business community and state taxing agencies than California's unitary apportionment formula).

\textsuperscript{25} 114 S. Ct. 2288 (1994).
plied to a foreign parent corporation. The Court held that California's WWCR method violated neither the Due Process Clause nor the Commerce Clause.

Nonetheless, due to a global attack and political pressure on the WWCR method, all unitary tax states have modified their revenue codes to allow MNCs to elect a “water's edge” approach to unitary taxation. The water's edge taxation method limits the income used to compute a property, payroll, and sales percentage to income earned within the United States, rather than worldwide. Although the water's edge method appears to be a middle ground between the arms-length and WWCR methods, some threat of foreign retaliation still remains. Therefore, it is possible that Con-

26 Id. at 2286. Prior to Barclays, the Supreme Court had only upheld the constitutionality of the unitary taxation method in cases involving United States parent MNCs and multistate corporations. See, e.g., Itel Containers Int'l Corp. v. Huddleston, 113 S. Ct. 1095, 1096 (1993) (upholding Tennessee sales tax on containers used by domestic corporation in international trade); Wardair Canada Inc. v. Florida Dept of Revenue, 477 U.S. 1, 3 (1986) (upholding Florida's unitary tax on MNCs); Container Corp., 463 U.S. 159, 159 (1983) (stating that California's application of its WWCR tax method on Container Corp., domestic MNC, was proper); ASARCO, Inc. v. Idaho State Tax Comm'n, 456 U.S. 307, 309 (1982) (Idaho Tax Commission levied tax on New Jersey corporation); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 427 (1980) (holding Vermont's tax on domestic corporation's dividends received from foreign subsidiaries constitutional); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 289 (1977) (holding constitutional Mississippi sales tax on Michigan multistate corporation); Bass, Rattcliff & Gutton, Ltd. v. State Tax Comm'n, 266 U.S. 271, 284 (1924) (upholding New York tax on MNC for doing business in New York); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120 (1920) (explaining unitary tax was constitutional, as long as its payment was not condition of carrying on business within state). But see Armco, Inc. v. Hardesty, 467 U.S. 638, 641 (1984) (arguing that unitary tax was unconstitutional because it unfairly discriminated against interstate commerce); Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 457 (1979) (holding unitary tax unconstitutional because it resulted in multiple taxation and was preempted by Congress's power to regulate foreign commerce). In Container Corp., the Supreme Court hinted that, if applied to a foreign parent MNC, the unitary method may violate the Foreign Commerce Clause. Container Corp., 463 U.S. 185-86; see also Greenberg, supra note 4, at 446. Yet, when the Court actually decided this issue in Barclays it declared unitary taxation constitutional when applied to both multistate and multinational corporations. Barclays, 114 S. Ct. at 2268.

27 Barclays, 114 S. Ct. at 2277-78 (stating that Barclays Bank did not demonstrate that California tax was unconstitutional).

28 Id. at 2273. The water's edge alternative was eventually adopted by all states that had previously used only the unitary taxation method. Id. California was nearly the last state to adopt the water's edge method. Id. It was not until 1993 that California modified its franchise tax statutes to allow for a water's edge election without the payment of a fee. Id. Hence, water's edge election was not an alternative for Barclays during the time period at issue in the Barclays case due to the state's unfair requirements. Id.; see also infra notes 99-103 and accompanying text (explaining water's edge method of taxation).

29 See Freud & Kolligs, supra note 20, at 341-42.

30 See id., at 344. Although “water's edge” taxation may provide a middle ground, it is probable that some foreign MNCs would rather be taxed under the arm's-length method.
gress will legislate in the future against state use of the unitary taxation method. 31

Part One of this Note reviews the United States Supreme Court decisions dealing with the constitutionality of unitary taxation methods. Part Two discusses the water's edge approach to unitary taxation and its effect on foreign relations. Finally, Part Three examines the possibility that Congress will legislate against unitary taxation and concludes that congressional legislation compelling states to abolish unitary taxation would be unconstitutional and therefore void as a matter of law.

I. CONSTITUTIONALITY OF THE UNITARY TAXATION METHOD

The Commerce Clause explicitly gives Congress power "to regulate Commerce with foreign Nations, and among the several States." 32 This clause has been interpreted as a source of protection against state legislation that restricts interstate commerce, even in areas where Congress has not acted. 33 The Commerce Clause, however, does not shelter interstate commerce from its fair share of the state tax burden. 34 The Supreme Court has developed various tests in response to disputes surrounding the constitutionality of unitary taxation. 35

In the 1977 case of Complete Auto Transit, Inc. v. Brady, 36 the United States Supreme Court held Mississippi's unitary taxation of multistate corporations on a "formula-apportionment" basis to be constitutional under the Commerce Clause. 37 Complete Auto Transit was a Michigan corporation transporting automobiles into

32 U.S. Const. art. I, § 8, cl. 3. See supra note 2 and accompanying text (discussing Commerce Clause).
33 See, e.g., Southern Pacific Co. v. Arizona ex rel. Sullivan, 325 U.S. 761, 769 (1945) (explaining that state legislature has some say under Commerce Clause when Congress has not spoken); South Carolina State Highway Dep't. v. Barnwell Brothers, Inc., 303 U.S. 177, 184-85 (1938) (stating that although Commerce Clause curtails some state power, it does not deny all state action in interstate commerce).
35 For a description of these tests, see supra notes 9-31 and accompanying text.
37 Id. at 288-89. The Court overruled its decision in Spector Motor Service v. O'Connor, 340 U.S. 602 (1951). Id. In Spector, the Court held that although a state can tax a corporation for the "privilege of doing business" in the state, it would be unconstitutional to tax a multistate corporation engaged solely in interstate commerce based on this "privilege of doing business" rationale. 430 U.S. at 289 (citing Spector, 340 U.S. at 609-10).
Mississippi for General Motors Corporation. The Mississippi Tax Commission assessed Complete Auto’s taxes to include Complete Auto’s sales of motor vehicles manufactured outside of Mississippi to dealers within that state. These tax assessments were derived from Mississippi’s tax code, which imposes a tax on businesses “privileged with doing business” in Mississippi. The amount of the tax was based on a percentage of Complete Auto’s total gross income. Complete Auto argued that the Mississippi tax on its sales of motor vehicles was unconstitutional as applied to interstate commerce. In holding Mississippi’s use of a unitary tax constitutional, the Court rejected the rule that a state may not tax interstate commerce because such a tax would violate the Commerce Clause. Rather, the Court held that a state unitary tax on interstate commerce does not violate the Commerce Clause unless it can be shown that one of the following circumstances exists: (1) the activity being taxed lacks a “substantial nexus” to the taxing state; (2) the tax is not fairly apportioned; (3) the tax discriminates against interstate commerce; or (4) the tax does not fairly relate to the services the taxing state provides. The Supreme Court held that the Mississippi tax was constitutional because none of these four circumstances existed.

In 1979, the Supreme Court established a more stringent test with respect to state taxation of a corporation involved in foreign commerce. Complete Auto argued that the imposition of this tax on multistate commerce created an unacceptable risk of discrimination and an undue burden. However, Complete Auto did not argue that its business did not have a substantial nexus to Mississippi, that the imposition of this tax would in fact discriminate against multistate corporations, that the tax was not apportioned fairly, or that it was unrelated to the services provided by Mississippi. The Supreme Court held that the Mississippi tax was constitutional because none of these four circumstances existed.

See Complete Auto Transit, Inc. v. Brady, 430 U.S. 276, 276 (1977). The automobiles were assembled outside of Mississippi by Complete Auto. Id. In addition, the Mississippi Supreme Court noted that Complete Auto had a large operation in Mississippi and was dependent upon Mississippi for police protection and other Mississippi services, the same as other citizens. Id. at 277 (quoting Complete Auto Transit, Inc. v. Brady, 330 So. 2d 268, 272 (Miss. 1971)).

40 Id. at 277-77. The Commission concluded that Complete Auto owed taxes and interest totaling $122,160.59 for the three-year period starting August 1, 1968 and ending July 31, 1971. Id. at 277.

41 See id. at 275. Complete Auto argued that the imposition of this tax on multistate commerce created an unacceptable risk of discrimination and an undue burden. Id. However, Complete Auto did not argue that its business did not have a substantial nexus to Mississippi, that the imposition of this tax would in fact discriminate against multistate corporations, that the tax was not apportioned fairly, or that it was unrelated to the services provided by Mississippi. Id. at 277-78; see also Miss. CODE ANN. § 27-65-13 (1972 & Supp. 1993).

42 Complete Auto, 430 U.S. at 277.

43 Id. at 287-89 (rejecting rule of Spector Motor Services, Inc. v. O’Connor, 304 U.S. 602 (1951) that state taxation on interstate commerce is per se unconstitutional).

44 Complete Auto, 430 U.S. at 279. (setting forth analysis necessary to determine whether taxation applied to interstate commerce is constitutional).

45 Id. at 289 (holding Mississippi tax on interstate commerce constitutional as applied).
commerce. In *Japan Line, Ltd. v. County of Los Angeles,* California applied an *ad valorem* property tax on containers owned by six Japanese shipping corporations, including Japan Line, Ltd. ("Japan Line"). The corporations used the vessels to accommodate containers owned by Japan Line. The Court concluded that California's tax on these companies led to "double taxation" because the property of these companies already was subject to taxation in Japan. In holding that it was unconstitutional to apply a state tax to these corporations, the Court reasoned that although California had met the *Complete Auto* criteria, the state was required to meet two additional criteria. To survive Commerce Clause scrutiny, the state unitary tax must not: (1) create a substantial risk of double taxation; or (2) prevent the federal government from "speak[ing] with one voice when regulating commercial relations with foreign governments." The United States Constitution gives Congress the power to "speak with one voice" in relation to foreign policy and affairs. A state law conflicts with Congress's power to "speak with one voice" when the state law directly

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46 See Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2276 (1994). "In 'the unique context of foreign commerce,' a State's power is further constrained because of 'the special need for federal uniformity.'" Id. (quoting Wardair Canada, Inc. v. Florida Dep't of Revenue, 477 U.S. 1, 8 (1986)); *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 446-47 (1979).


48 See, e.g., Callaway v. City of Overland Park, 508 P.2d 902, 907 (Kan. 1973) (defining *ad valorem* tax as tax imposed on property in proportion to its value based on assessment or appraisal).

49 441 U.S. at 436-37. There were six corporations, all were incorporated, domiciled, and had their principal place of business in Japan. Id. at 436. The corporation's containers, for which California imposed an *ad valorem* property tax, were used solely in foreign commerce. Id. at 437.

50 Id. The vessels and the containers were in constant movement and were only used in foreign commerce. Id. A container is permanent equipment used to facilitate the movement of goods in commerce. Id. at 436 n.1.

51 Id. at 438. The vessels and containers were based, registered, and subject to property tax in Japan. Id. at 437-38. The Court explained that the containers' stay in California was not permanent and only lasted for about three weeks. Id. at 437. In addition, the containers were not used in any activities while in California. Id. In fact, the containers stopped in California only as a continuation of international excursions related to the efficiency of Japan Line's commerce. Id.

52 Id. at 446 (setting forth additional considerations with respect to foreign commerce). See Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2276-77 (1994) (discussing considerations needed when challenging tax on multinational corporations).


impacts foreign relations and adversely affects the central government's power to deal with these relationships.  

In Container Corp. of America v. Franchise Tax Board, decided four years after Japan Line, the United States Supreme Court held California's unitary method of taxation constitutional with respect to a domestic-based multinational corporation doing business in the state. Container Corporation of America ("Container Corporation") was a largely domestic corporation in the business of manufacturing paperboard packaging. Container Corporation controlled twenty foreign subsidiaries located in four European and four Latin American countries. In filing its California income tax returns, however, Container Corporation did not include the income derived from any of its subsidiaries. The California Franchise Tax Board audited these tax returns and assessed that, under California's unitary tax laws, Container Corporation owed over $71,000 in taxes.

After concluding that Container Corporation was a unitary business subject to California's WWCR (three-factor formula),

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55 See id. at 441; see also Japan Line, 441 U.S. at 448. "In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." Id. (quoting Board of Trustees v. United States, 289 U.S. 48, 59 (1933)).


57 Id. at 159.

58 Id. at 171.

59 Id.

60 See Container Corp., 463 U.S. at 174.

61 See id. Container Corporation's calculations for the three years at issue were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Income</th>
<th>Percentage attributed to California</th>
<th>Amount attributed to California</th>
<th>Tax (5.5%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>$26,870,427</td>
<td>11.041</td>
<td>$2,966,764</td>
<td>$163,172</td>
</tr>
<tr>
<td>1964</td>
<td>28,774,320</td>
<td>10.642</td>
<td>3,062,221</td>
<td>168,442</td>
</tr>
</tbody>
</table>

Id. at 174 n.11. After treating Container Corporation's overseas subsidiaries as part of its unitary business, the Franchise Tax Board assessed Container Corporation's income at:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Income of unitary business</th>
<th>Percentage attributed to California</th>
<th>Amount attributed to California</th>
<th>Tax (5.5%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>$37,348,183</td>
<td>8.6886</td>
<td>$3,245,034</td>
<td>$178,477</td>
</tr>
<tr>
<td>1964</td>
<td>44,245,879</td>
<td>8.3135</td>
<td>3,673,381</td>
<td>202,311</td>
</tr>
<tr>
<td>1965</td>
<td>46,884,996</td>
<td>7.6528</td>
<td>3,558,012</td>
<td>197,341*</td>
</tr>
</tbody>
</table>

* These numbers have been rounded to the nearest dollar.

Id. at 175 n.12.

62 Id. at 184 (holding California's application of unitary taxation fair, despite fact that it differed from federal method of taxation).
the Court applied the *Japan Line* test to determine whether the additional taxes were constitutional under the Commerce Clause.\(^6^3\) In addressing the issue of multiple taxation, the Court concluded that multiple taxation was not the inevitable result of the California tax,\(^6^4\) and that the alternative which was reasonably available to the taxing state could not eliminate the risk of double taxation.\(^6^5\) The Court then determined that unitary taxation, as applied to domestic corporations with foreign subsidiaries, did not violate the "one voice" standard.\(^6^6\)

Accordingly, the Court found California's unitary taxation constitutional with respect to a domestic corporation with foreign subsidiaries.\(^6^7\) However, the Court in *Container Corp.* failed to address the constitutionality of the unitary method as it applied to

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\(^6^3\) See *Container Corp.* v. Franchise Tax Bd., 463 U.S. 159, 185 (1983). The Court noted that this additional scrutiny is required when the business at issue is international, rather than wholly domestic. *Id.*; see also *supra* notes 52-54 and accompanying text (discussing *Japan Line* test).

\(^6^4\) *Container Corp.*, 463 U.S. at 188. The Court stated: "[T]he double taxation in this case, although real, is not the 'inevitab[le]' result of the California taxing scheme." *Id.* (citing *Japan Line*, 441 U.S. at 447). The Court stated:

[W]e are faced with two distinct methods of allocating the income of a multi-national enterprise. The arms'-length approach divides the pie on the basis of a mathematical generalization. Whether the combination of the two methods results in the same income being taxed twice or in some portion of income not being taxed at all is dependent solely on the facts of the individual case. 463 U.S. at 188.

\(^6^5\) *Id.* at 191. Although most nations have adopted the arms-length method of taxation, the rules under which income is reallocated among affiliated corporations often differs substantially, and whenever that difference exists, the possibility of double taxation also exits. *Id.* Therefore, even if California were to adopt the arms-length approach, it could not eliminate the risk of double taxation, and could in some cases result in more serious double taxation than would occur under formula apportionment. *Id.*

\(^6^6\) *Id.* at 194-95. The Court distinguished *Japan Line*, noting that "the tax here does not create an automatic asymmetry." *Id.* The Court also noted that, unlike the tax in *Japan Line*, the tax in *Container Corp.* was imposed on a domestic, not foreign, corporation, therefore eliminating the threat of foreign retaliation that existed in *Japan Line*. *Id.* at 195. Finally, the Court stated:

[E]ven if foreign nations have a legitimate interest in reducing the tax burden of domestic corporations, the fact remains that [Container Corporation] is without a doubt amenable to be taxed in California in one way or another, and that the amount of tax it pays is much more the function of California's tax rate than of its allocation method. Although a foreign nation might be more offended by what it considers unorthodox treatment of [Container Corporation] than it would be if California simply raised its general tax rate to achieve the same economic result, we can only assume that the offense involved in either event would be attenuated at best. *Id.*

The Court also determined that there was no congressional intent to preempt California's unitary tax method. *Id.* at 196.

\(^6^7\) *Container Corp.*, 463 U.S. at 197 (concluding that California's taxation method is neither preempted by federal law nor inconsistent with federal policy).
domestic corporations with foreign parents or to foreign corporations with foreign parents, or foreign subsidiaries.\(^6^8\)

Recently, in \textit{Barclays Bank PLC v. Franchise Tax Board of California},\(^6^9\) the United States Supreme Court addressed the constitutionality of California’s unitary taxation of a foreign MNC.\(^7^0\) The Court held that the state’s unitary taxation did not expose foreign MNCs to “constitutionally intolerable multiple taxation”\(^7^1\) and did not “prevent the Federal Government from speaking with ‘one voice’ in international trade.”\(^7^2\)

Barclays Bank PLC (“Barclays”) is a United Kingdom Corporation in the Barclays Group, a multinational banking enterprise.\(^7^3\) Two of Barclays’ California branches, Barcal and Barclays Bank International (“BBI”), claimed that California’s unitary taxation burdened foreign-based multinationals and resulted in double taxation, in violation of the Commerce and Due Process Clauses by interfering with the federal government’s ability to “speak with one voice when regulating commercial relations with foreign governments.”\(^7^4\)

\(^6^8\) \textit{Id.} at 195 n.32. The Court stated:

We recognize that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests. We need not decide here whether such a case would require us to alter our analysis.

\(^6^9\) \textit{Id.} 114 S. Ct. 2268 (1994).

\(^7^0\) \textit{Id.} at 2286 (upholding California’s unitary tax and stating that Congress, not judiciary, should determine whether allowing unitary taxation is in nation’s best interest).

\(^7^1\) \textit{Id.} (refusing to favor separate accounting methods over unitary method because all result in some form of multiple taxation).

\(^7^2\) \textit{Id.} at 2284 (upholding California’s unitary tax in light of fact that Congress has not acted to abolish it).

\(^7^3\) \textit{Barclays,} 114 S. Ct. at 2271.

\(^7^4\) \textit{Id.} at 2274. Barclays Group consisted of 220 corporations doing business in 60 nations. \textit{Id.} The two members of Barclays that brought suit did business in California and were therefore subject to California’s franchise tax. \textit{Id.} Barclays Bank of California (“Barcal”), one of the taxpayers, was a California bank owned by Barclays Bank International (“BBI”), the second taxpayer. \textit{Id.} BBI was a United Kingdom corporation that did business in the United Kingdom and 33 other territories. \textit{Id.} Barcal reported only the income from its own operations on its 1977 tax return, and BBI reported its income “on the assumption that it participated in a unitary business composed of itself and its subsidiaries, but not its parent corporation and the parent’s other subsidiaries.” \textit{Id.}

California’s Franchise Tax Board assessed that both Barcal and BBI were multinational unitary businesses subject to additional tax liability of $1,678 and $152,420 respectively. \textit{Id.} The figures used by the Tax Board were:

<table>
<thead>
<tr>
<th>Worldwide</th>
<th>Calif. Formula Percentage</th>
<th>Business Income</th>
<th>Franchise Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barcal</td>
<td>$401,566,973</td>
<td>.0139032%</td>
<td>$5,583,066</td>
</tr>
<tr>
<td>BBI</td>
<td>$401,566,973</td>
<td>.0003232%</td>
<td>129,786</td>
</tr>
</tbody>
</table>
The United States Supreme Court found that both Barcal and BBI had clearly met the four criteria for state taxation of a multijurisdictional unitary business as set forth in *Complete Auto.* Next, the Court proceeded to determine whether the tax would pass the "additional scrutiny" required by *Japan Line* when a state attempts to tax foreign commerce. First, the Court considered "the enhanced risk of multiple taxation," relying heavily on its decision in *Container Corp.* to hold unitary taxation constitu-

*Id.* at 2274 n.6. After paying the assessments, Barcal and BBI sued for refunds. *Id.* at 2274.

California's lower courts ruled in favor of Barcal and BBI, but the California Supreme Court held that the tax did not interfere with the federal government's ability to "speak with one voice in regulating foreign commerce . . . and therefore did not violate the Commerce Clause." *Id.* Accordingly, the California Supreme Court remanded the case to the Court of Appeal for further development of Barclays' compliance claim. *Id.* (citing Barclays Bank Int'l, Ltd. v. Franchise Tax Bd., 2 Cal. 4th 708, cert. denied, 121 L. Ed. 2d 144 (1992)). In addition to its claim that California's tax interfered with the federal government's ability to "speak with one voice in regulating foreign commerce," Barclays claimed that "the compliance burden on foreign-based multinationals imposed by California's tax violated both the Due Process Clause and the nondiscrimination requirement of the Commerce Clause." *Barclays,* 114 S. Ct. at 2274.

On remand, the Court of Appeal decided the compliance issue in favor of the Tax Board, and the California Supreme Court denied further review. *Id.* The United States Supreme Court then granted a writ of certiorari to the California Court of Appeal. *Id.*

*75* Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2276 (1994). See supra notes 43-45 and accompanying text for *Complete Auto* criteria. The Court held that: the "nexus" requirement was met by the business each corporation conducted in California over the years in question; the "fair apportionment" requirement was satisfied by Barclays' failure to establish a lack of a "rational relationship between the income attributed to the State and the intrastate values of the enterprise"; and the income attributed to California was "fairly related" to the proportion of business conducted by the taxpayers in that state. *Barclays,* 114 S. Ct. at 2276.

However, Barclays claimed that California's WWCR method failed to meet the "anti-discrimination" component of the *Complete Auto* test for two reasons. *Id.* at 2277. First, Barclays asserted that the foreign parent corporation of a California taxpayer was forced to convert its worldwide accounting records into the language and currency of the United States at a "prohibitive" expense in order to comply with California's tax policy. *Id.* The trial court found that an accounting system capable of converting Barclays' records to conform to California's standards would cost more than $5,000,000 to set up and more than $2,000,000 per year to maintain. *Id.* at 2277 n.11. Barclays argued that foreign-based MNCs were at a competitive disadvantage to domestic-based MNCs, most of which already kept their records in United States language and currency, resulting in "economic protectionism." *Id.* at 2277. The United States Supreme Court, however, dismissed this claim on the premise that California's tax regulations provided that the Tax Board "shall consider the effort and expense required to obtain the necessary information and . . . may accept reasonable approximations," thereby alleviating the excessive compliance costs complained of. *Id.* at 2278. Barclays also argued that California's "reasonable approximations" policy violated due process because they had no standard against which to measure what approximations would be accepted as reasonable. *Id.* at 2272. The Court dismissed this claim as well, recognizing that California's tax policy allowed the taxpayer to request "an advanced determination" from the Tax Board with respect to the tax consequences of the taxpayer's actions. *Id.* at 2279.

*76* Barclays, 114 S. Ct. at 2279 (citing *Container Corp.*, 463 U.S. 159, 184) (applying *Japan Line* holding to facts in *Barclays*). See supra notes 52-54 and accompanying text for the requirements set forth in *Japan Line*.
tional. In Barclays, however, the Court distinguished Container Corp. on the ground that Container Corp. applied only to taxation of domestic-based corporations with foreign subsidiaries and not to foreign MNCs like Barclays. The Court noted that because foreign MNCs hold a larger share of their operations outside the United States than do domestic MNCs, a higher proportion of their income is subject to taxation by foreign sovereigns. Nevertheless, the Court concluded that this distinction was insufficient to justify different standards of taxation based on whether an MNC was domestic-based or foreign-based.

77 Barclays, 114 S. Ct. at 2279 (considering Barclays' argument that Container Corp. holding applies only to foreign subsidiaries of domestic corporations and therefore should not control their case) (quoting Container Corp., 463 U.S. at 185).

78 Barclays, 114 S.Ct. at 2274.

79 Id. at 2280. Barclays claimed that "the breadth of double taxation and the degree of burden on foreign commerce are greater than in the case of domestic multinationals," pointing to its own operations and noting that only three of more than 200 affiliates in the Barclays Group did business in the United States. Id. (citing Brief for Petitioner at 33, Barclays Bank, PLC v. Franchise Tax Bd., 114 S. Ct. 2268 (1994) (No. 92-1384)). In considering this argument, the Court relied on Container Corp.'s two-part holding. Id. (citing Container Corp., 463 U.S. at 188). First, the Container Corp. Court held that double taxation was not the "inevitable result" of California's unitary tax. 114 S. Ct. at 2280 (citing Container Corp., 463 U.S. at 188). The Court noted:

The double taxation in this case, although real, is not the "inevitable" result of the California taxing scheme . . . . We are faced with two distinct methods of allocating the income of a multinational enterprise . . . . Whether the combination of the two methods results in the same income being taxed at all is dependent solely on the facts of the individual case.

Container Corp., 463 U.S. at 188. Second, the Container Corp. Court held that the "alternative reasonably available to the State [that is the arms-length approach] could not eliminate the risk of double taxation" and could increase that risk. Barclays, 114 S. Ct. at 2280. The Court stated:

We do not question Barclays assertion that multinational enterprises with a high proportion of income taxed by jurisdictions with wage rates, property values, and sales prices lower than California's face a correspondingly high risk of multiple international taxation. But Container Corp.'s approval of this very tax, in the face of a multiple taxation challenge, did not rest on any insufficiency in the evidence that multiple taxation might occur; indeed, we accepted in that case the taxpayer's assertion that multiple taxation in fact had occurred.

Id. at 2279-80. The Court further noted:

Even though most nations have adopted the arm's length approach in its general outlines, the precise rules under which they reallocate income among affiliated corporations often differ substantially, and whenever that difference exists, the possibility of double taxation also exists . . . . California would have trouble avoiding multiple taxation even if it adopted the arm's length approach . . . .

Id. at 2280 (quoting Container Corp., 463 U.S. at 192).

80 114 S. Ct. at 2280 (holding that because arms-length accounting system does not necessarily decrease risk of multiple taxation of income earned by foreign affiliates of domestic-owned corporations, as decided in Container Corp., there is no reason to assume that arms-length method would decrease multiple taxation with respect to foreign affiliates of foreign-owned corporations).
Court held that California's tax scheme did not create a substantial risk of multiple taxation with respect to Barclays.\(^{81}\)

Next, the Court decided the most pressing issue presented in Barclays: whether California's WWCR method interfered with the federal government's ability to "speak with one voice in international trade."\(^{82}\) The Court relied on two cases to make this determination.\(^{83}\) First, the Court looked to Container Corp., where it found no specific indication of congressional intent to preempt California's tax.\(^{84}\) Second, the Court rejected the Commerce Clause challenge of state taxation that had been presented to the Court in Wardair Canada, Inc. v. Florida Department of Revenue.\(^{85}\) In Wardair, the Court noted that although there were federal policies and bilateral agreements that prohibited tax impediments to foreign air travel, those policies and agreements applied to the federal government, not to the states, and therefore did not interfere with the federal government's ability to "speak with one voice."\(^{86}\)

\(^{81}\) Id. "If... adoption of a separate accounting system does not dispositively lessen the risk of multiple taxation of the income earned by foreign affiliates of domestic-owned corporations, we see no reason why it would do so [with] respect [to] the income earned by foreign affiliates of foreign-owned corporations." Id.

\(^{82}\) Id. at 2280. The Court addressed whether California's WWCR method "impair[ed] federal uniformity in an area where federal uniformity is essential?" Id. (quoting Japan Line, 441 U.S. at 448)

\(^{83}\) 114 S. Ct. at 2279-81 (reviewing holdings in Container Corp. and Wardair Canada Inc. v. Florida Dept of Revenue, 477 U.S. 1 (1986)).

\(^{84}\) Barclays, 114 S. Ct. at 2281. "Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income." Id. (quoting Container Corp., 463 U.S. at 196-197). The Container Corp. holding was based on three facts: (1) federal tax statutes did not preempt California's tax methods; (2) although the United States had entered into various tax treaties with multinationals requiring that the federal government adopt arms-length taxation methods, that requirement was waived by the contracting multinationals with respect to domestic corporations; and (3) the restriction on arms-length taxation written into the tax treaties applied to the government, not to the states. 114 S. Ct. at 2281-82.

\(^{85}\) 477 U.S. 1 (1986). In Wardair, a Canadian airline challenged a Florida state tax on fuel to common carriers on all aviation fuel purchased in Florida, regardless of the amount of fuel the carrier consumed within the state. Id. at 4. The airline argued that there was a "federal policy of reciprocal tax exemptions for aircraft, equipment, and supplies, including aviation fuel, that constitutes the instrumentalities of international air traffic." Id. at 9.

\(^{86}\) Barclays, 114 S. Ct. at 2282 (discussing Wardair case); see also Schlenger, supra note 17, at 461. The United States has entered into an abundant number of bilateral income tax treaties. Id. The two goals of United States tax treaties are: (1) to avoid double taxation; and (2) to avoid discrimination of foreign investment. Id.; see also William C. Gifford, Permanent Establishment and the Nondiscrimination Clause in Income Tax Treaties, 11 CORNELL INT'L L.J. 51 passim (1978) (stating that all United States income tax treaties have nondiscrimination clauses except those treaties with Australia, Italy, and New Zealand).

The United States Senate has, in all tax treaties, expressly stated that the requirement of an arms-length separating accounting method does not apply to state or local governments as long as it does not interfere with the federal government's policies. See Schlenger, supra note 17, at 461.
Finally, the Court in *Barclays* noted that in the eleven years following *Container Corp.*, Congress was not silent regarding the WWCR method of taxation, but instead had considered the implications of the various tax methods in the past and had chosen not to legislate in the area.\(^8^7\) Hence, the Court found no congressional intent to preempt WWCR taxation and accordingly upheld the constitutionality of California's unitary tax.\(^8^8\) The Court reinforced its decision by stating that issues of state taxation with respect to "the conduct of foreign relations . . . are so exclusively entrusted to the political branches of government as to be largely immune from judicial inquiry or interference."\(^8^9\)

Justice Sandra Day O'Connor, with whom Justice Clarence Thomas joined, concurred in the *Barclays* judgment in part and dissented in part.\(^9^0\) Justice O'Connor agreed that, because the state had relied on the constitutionality of unitary taxation as set forth in *Container Corp.*, and because Congress had not yet legislated in opposition to that ruling, the Court properly upheld the *Container Corp.* decision.\(^9^1\) Justice O'Connor also agreed that because the legislature had not acted to disapprove the California tax, the need for federal uniformity did not prevent the state from applying the unitary taxation method to foreign corporations located in the state.\(^9^2\) However, she disagreed with the Court's finding that unitary taxation of foreign-based MNCs did not increase international multiple taxation.\(^9^3\) Justice O'Connor distinguished

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\(^8^7\) *Barclays Bank PLC v. Franchise Tax Bd.*, 114 S. Ct. 2268, 2283-84 (1994). The Court noted that Congress had been given the power to regulate foreign commerce under the Commerce Clause and, although many bills prohibiting the WWCR method of state taxation had been introduced to Congress, none had been passed. *Id.*

\(^8^8\) *Id.* at 2286. The Court upheld the constitutionality of California's unitary tax for four reasons: (1) *Barclays* had a substantial nexus with California; (2) WWCR resulted in taxes which were fair and nondiscriminatory; (3) the tax did not inevitably result in multiple taxation; and (4) Congress had not preempted state use of the unitary method of taxation. *Id.*


\(^9^0\) *Barclays*, 114 S. Ct. at 1187-90.

\(^9^1\) *Id.* Justice O'Connor stated that although she disagreed with the Court's decision in *Container Corp.*, it was necessary for the Court to uphold the constitutionality of unitary taxation because the state and private parties had justifiably relied on the *Container Corp.* holding and because Congress had not overruled the *Container Corp.* decision. *Id.*

\(^9^2\) *Barclays Bank PLC v. Franchise Tax Bd.*, 114 S. Ct. 2268, 2288 (1994) (noting that Congress, not Executive or Judiciary, has been given power to regulate commerce).

\(^9^3\) *Id.* Justice O'Connor pointed out that the trial court had found, as a matter of fact, that "[t]here was a definite risk of, as well as actual double taxation [in Barclays case]." *Id.* She also stated: "this double taxation occurs because California has adopted a taxing system that is inconsistent with the taxing method used by foreign taxing authorities." *Id.*
Container Corp. on the premise that the risk of multiple taxation greatly increases when using the unitary method to tax foreign-based corporations, as opposed to domestic-based corporations. She concluded that the Court could not guarantee full apportionment when one of the taxing entities was a foreign sovereign.

The Barclays decision reaffirmed the constitutionality of unitary taxation. As a result, the Supreme Court, in 1994, denied certiorari in five tax cases involving the use of the unitary tax method on MNCs. Thus, any corporation petitioning for certiorari to the United States Supreme Court on a unitary tax claim must attempt to obtain an appeal by showing that: (1) the corporation is not a unitary business by definition or (2) unitary taxation would distort the corporation's income.

94 Id. at 2289. When WWCR is applied to domestic corporations with foreign affiliates, as in Container Corp., income attributable to those foreign companies will be taxed by California, even though they are also subject to tax in foreign countries. Id. However, the domestic parent corporation—a corporation subject to full taxation in the United States notwithstanding the source of its income—bears the burden of the tax. Id. When a unitary tax is applied to a foreign corporation with both domestic and foreign affiliates, some of the income of the foreign companies will also be taxed by California. Id. The burden of the tax in such cases falls on a foreign corporation, even though the United States is entitled to tax only the income earned domestically. Id.

95 Id. at 2290 (quoting Japan Line, 441 U.S. at 447-48). The Court stated:

Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State, may subject foreign commerce to the risk of a double tax burden to which the commerce clause forbids.

114 S. Ct. at 2290.


97 See Alcan Aluminum Corp. v. Franchise Tax Bd., 899 F.2d 16, 16 (7th Cir. 1990) (Canadian corporation with California subsidiary challenged California's use of unitary tax), cert. denied, 114 S. Ct. 2737 (1994); Alcan Aluminum Corp. v. Franchise Tax Bd., 742 F.2d 1430, 1430 (2d Cir. 1984) (foreign corporation challenged California tax on income from its domestic subsidiary), cert. denied, 114 S. Ct. 2737 (1994); NCR Corp. v. New Mexico Dep't of Tax'n & Revenue., 856 P.3d 982 (N.M. Ct. App. 1993) (Maryland corporation contested New Mexico's taxation of its New Mexico branch based on percentage of worldwide income), cert. denied, 114 S. Ct. 2763 (1994); Reuters Ltd. v. Tax Appeals Tribunal, 180 A.D.2d 270, 270, 584 N.Y.S.2d 932, 932 (3d Dept. 1992) (United Kingdom corporation with branch office in New York City contested New York's unitary tax assessment, which was based on percentage of corporation's worldwide income), cert. denied, 114 S. Ct. 2737 (1994); NCR Corp. v. South Carolina Dep't of Revenue & Tax., 402 S.E.2d 666, 667-68 (S.C. 1991) (domestic MNC brought action to recover corporate income and license fees after South Carolina applied unitary tax to corporation's foreign subsidiaries), cert. denied, 114 S. Ct. 2763 (1994).

98 See Eric J. Cofill, Supreme Court in Barclay's Upholds California's Use of Worldwide Unitary Method Involving Foreign Parent Corporations, 94 Tax Notes Today 141-58 n.49 (1994). Factual unity and distortion are issues that will always arise in unitary taxation cases. Id. The author asserts that a California judicial court can decide whether a corporation is a "unitary business" by the two tests set forth in California's state law and the overriding federal constitutional dimension. Id. In addition to factual unity, if a corporation can prove that the unitary method in that state results in distortion or misappropriation of the income of the corporation, then the method will be held unconstitutional as applied to...
II. WATER’S EDGE AND FOREIGN RELATIONS

Prior to the Barclays decision, political pressure and threats of foreign retaliation persuaded the California legislature to revise its revenue code, allowing all unitary corporations to choose either the WWCR method or the “water’s edge” method of taxation. The water’s edge method appears to be a reasonable substitute for WWCR. Like the WWCR method, the water’s edge method computes income based on a percentage equal to the property, payroll, and sales of the subsidiary divided by the property, payroll, and sales of those branches of the MNC that operate within the United States. However, the water’s edge method differs from the WWCR method in that this percentage is then applied to the MNC’s income within the United States, rather than world-

that corporation. Id.; see also Tambrands, Inc. v. State Tax Assessor, 595 A.2d 1039, 1039 (Me. 1991). The Tambrands court stated that a Delaware corporation with foreign affiliates constituted a unitary business. Id. In Tambrands, Maine had applied the unitary method of taxation to one of Tambrands’ affiliates. Id. Tambrands argued that the application of the unitary method was unconstitutional. Id. at 1041. Maine had included dividend income derived from the foreign affiliates of Tambrands. Id. However, the state did not include the property, payroll, and sales that generated this income. Id. Thus, Tambrands argued that the apportionment ratio was higher than it should have been. Id. Further, it argued that this ratio had been applied toward higher income than the state was permitted to tax. Id. The court held that this application did distort the tax attributable to the state and was therefore unconstitutional. Id.


California first adopted water’s edge election in 1988 but required that a corporation meet stringent conditions before the election could be made. Id. Thus, many multistate and MNCs still paid taxes under the WWCR method. See Walter Hellerstein, Are Days of Worldwide Unitary Taxation by States Limited?, 72 J. Tax’n 172, 176 (1990).

In 1993, the California legislature, modified its previous water’s edge provisions. See New Developments, supra, at 480. This election allowed MNCs to choose an alternate method over the WWCR method. Id.; see also Greg Robb, More U.S. States May Try Unitary Tax After the Barclay’s Verdict, AFX News (1994). Under the new provision: (1) a corporation can make an election without paying a fee; (2) the Franchise Tax Board may not revoke an election; and (3) the election period was extended from five years to seven years. New Developments, supra, at 480. Additionally, the disclosure requirements, when choosing to elect water’s edge, were diminished, thereby making the election more appealing. Id. For example, prior to the amendment, MNCs that chose to make the election were required to disclose comprehensive information related to their identity, income, and tax liability in every state, and if a taxpaying company had assets of at least $200 million, it was required to provide a list of affiliates. Id.

100 See Harris, supra note 13, at 1081 (stating that those states retaining WWCR method allow corporations to choose water’s edge alternative).

101 See Barclays, 114 S. Ct. at 2273; see also Freud & Kolligs, supra note 20, at 341-42. Although the states still use a “three-part formula-apportionment” method based on property, payroll, and sales, the income of foreign subsidiaries, of foreign parents, or of foreign transactions are not in this formula. Id.
All state statutes that presently contain a unitary tax provision allow MNCs to select either the WWCR method or the water's edge method.\footnote{102 See Freud & Kolligs, supra note 20, at 342 (stating that under water's edge method, foreign MNCs can exclude apportionment factor from its foreign affiliates); Harris, supra note 13, at 1091.}

Although some states have adopted the water's edge method, the Barclays decision gives the states the authority to demand the WWCR method when taxing MNCs.\footnote{103 See Barclays Bank PLC v. Franchise Tax Bd., 114 S. Ct. 2268, 2273 (1994). All states have amended their tax systems to allow corporate election of some type that confines combined reporting to the United States. See Walter Hellerstein, Are Days of Worldwide Unitary Taxation by States Limited?, 72 J. Tax’n 172, 176 (1990) [hereinafter Days Limited]. California was one of the last states to adopt water's edge election. Id. The water's edge method seems to be a rational replacement for WWCR. See Harris, supra note 13, at 1091. "Foreign-based companies, in the interest of economy and efficiency, often perform many functions outside the United States and relatively few activities within the United States." Id. The author draws the distinction between income-producing activities "outside the borders of the state [or country]" and those inside the borders. Id.} Foreign nations are concerned that this decision will encourage California to repeal its 1993 water's edge provision and persuade other states to enact mandatory WWCR legislation.\footnote{104 See Barclays, 114 S. Ct. at 2266 passim.} Yet, such state action is not likely to occur due to the threat of retaliation by foreign nations.\footnote{105 More U.S. States May Try Unitary Tax After Barclay's Verdict., AFX News (1994). The Organization For International Investment ("OFII")—a trade group of multinational companies—has stated that "[t]he Supreme Court's decision [in Barclays] is either a footnote in U.S. Tax policy or a start of a new ominous chapter that threatens the future of not only foreign-owned U.S. corporations, but also U.S.-based corporations with operations abroad." Id.; see also Freud & Kolligs, supra note 20, at 344. "[T]he concern now is whether the Supreme Court's decision will embolden California to drop its 'water's edge election' relief mechanism and encourage other states to adopt a mandatory WWCR model for multinationals." Id.}

Many foreign governments have voiced their disapproval of states' WWCR requirements.\footnote{106 See Cofill, supra note 98, at 141-58 n.49 (stating that it is not feasible to return to mandatory worldwide combined reporting); Mark Milner & Larry Elliot, Global Tax Ruling Running Into Flak, VANCOUVER SUN, June 23, 1994, at D5 (stating that only time retaliation is necessary is when state adopts unitary method of taxation). The Barclays Court noted that a state violates foreign policy when it offends a foreign trade partner, which in turn causes the foreign government to retaliate. Barclays, 114 S. Ct. at 2285.} For example, in 1985, the British

\footnote{107 See Barclays, 114 S. Ct. at 2281-84 & n.22 (stating that foreign countries worldwide submitted amicus curiae briefs on behalf of Barclays); see also Freud & Kolligs, supra note 20, at 344 (stating that risk of retaliation was evident through records of complaints from foreign governments since California's enactment of WWCR method in 1970s). These complaints included "diplomatic notes from 'virtually every developed country in the world,' . . . protests sent directly to the President from Heads of state of Japan, Canada, and the UK; delays in bilateral income tax treaty negotiations; enactment in 1985 of retaliatory legislation by UK; and cancellation of a British trade mission to Florida . . . ." Id.; Brad Sherman, U.S. Supreme Court Rules for California in Unitary Tax Dispute, 94 STATE TAX NOTES 121-33, LEXIS *4 (July 23, 1994). These governments include the European Community such . . . .
Parliament established retaliatory legislation in response to the Supreme Court’s *Container Corp.* decision. This legislation, the Finance Act of 1985 (the “Act”), attacks any United States corporations that have operations in the United Kingdom. The object of the Act was to persuade MNCs to join in the disapproval of any state’s use of a unitary taxation method. After the *Barclays* decision in 1994, the British Chancellor expressed the United Kingdom’s disappointment in the decision. However, because California revised its unitary taxation legislation, the British Chancellor agreed not to take action against California, but stated that the United Kingdom would retain its retaliatory powers. Thus, it is likely that other countries that once voiced disapproval of unitary taxation have silently adopted the United Kingdom’s lead in taking a “wait-and-see” approach.

III. Preemption

Although water’s edge elections have decreased the chance of foreign retaliation in response to states’ use of unitary taxation, the *Barclays* decision invites Congress to “evaluate whether the national interest is best served by tax uniformity, or state auton...
If Congress determines that tax uniformity is in the nation's best interest, it may attempt to prohibit state unitary taxation. The federal government may preempt a state law through legislation of a federal domestic law or through an international agreement.

A. Preemption Through Legislation

The Supremacy Clause governs situations in which federal government regulations conflict with state law. Although the

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113 See generally Greenberg, supra note 4, at 446 (quoting Hearing Before the Senate Commission of Foreign Relations, 95th Cong., 1st Sess. (1977) (statement of Valentine Brooks, Partner, Brookes, Brookes & Vogel)). One goal of United States tax policy is to increase international investment. Id. Because WWCR results in decreased international investment, it is in variance with United States policy to allow states to continue applying this method. See Schlenger, supra note 17, at 459; Charles I. Kingson, The Coherence of International Taxation, 81 COLUM. L. REV. 1151, 1155 (1981). Thus, Congress may favor tax uniformity over state autonomy based on this rationale. See Yitzhak (Isaac) Hadari, Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise, 20 AM. J. COMP. L. 1151, 1155 (1981). Thus, Congress may favor tax uniformity over state autonomy based on this rationale. See Yitzhak (Isaac) Hadari, Tax Treaties and Their Role in the Financial Planning of the Multinational Enterprise, 20 AM. J. COMP. L. 1151, 1155 (1981).

114 See generally Paul Wolfson, Preemption and Federalism: The Missing Link, 16 HASTINGS CONST L.Q. 69, 70 (1988). A federal law that preempts state law is constitutional when Congress's reason for enacting the law is deemed "necessary and proper to exclude the states from a particular area." Id.

115 U.S. CONST. art. I., § 9, cl. 2. Congress may enact legislation domestically, requiring states to amend their revenue codes or they may expressly preempt state law. Id. Further, Congress may include provisions in international treaties, assuring foreign counterparts that unitary taxation will not be applied to income earned within the United States. U.S. CONST. art. II, § 2. Though the federal government has already attempted to curb unitary taxation by foreign treaty, such action has not yet been challenged by the states. See Greenberg, supra note 4, at 446. A proposed treaty between the United States and the United Kingdom, known as the Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, would have precluded the states from using a unitary taxation method on a United Kingdom MNC doing business in California. Id. See Convention Between the United States & United Kingdom for the Avoidance of Double Taxation, Dec. 31, 1975, U.S.-U.K., 21 U.S.T. 5620, 5677. However, the Senate rejected this version of the treaty and the treaty was ratified with a reservation that stated that the treaty would not apply to any United States political subdivision or local authority. Id.

116 U.S. CONST. amend. X. "When a Congressional regulation of commerce expressly precludes state regulation of the matter regulated, the supremacy clause controls." Id.; see also U.S. CONST. art. VI, § 2. The Supremacy Clause states that "all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby. . . ." Id. See generally Marilyn P. Westerfield, Comment, Federal Preemption and the FDA: What Does Congress Want?, 58 U. CIN. L. REV. 263, 263 (1989) (stating that "[f]ederal preemption requires that federal law take priority over state and local law").
Supremacy Clause provides that any federal law preempts a state law, this is not so where federal power to regulate in that area does not exist.\textsuperscript{117}

The Constitution specifically grants Congress a great deal of power in regulating commerce with foreign nations.\textsuperscript{118} However, congressional power is subject to constitutional limitations.\textsuperscript{119} The Tenth Amendment confirms that, in some instances, certain powers are reserved to the states.\textsuperscript{120} Congressional action which interferes with this right of state independence is therefore void.\textsuperscript{121} Hence, in ascertaining whether Congress has the power to require the states to regulate against unitary taxation, it is necessary to determine whether state sovereignty in this area is protected by a Tenth Amendment limitation on congressional power.\textsuperscript{122}

Although the Supreme Court has interpreted the Tenth Amendment narrowly when deciding whether Congress may subject a state's private citizens to generally applicable laws,\textsuperscript{123} a congressional action that regulates a state function poses a different con-

\textsuperscript{117} See Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947). It is to be presumed that the states' police power cannot be preempted by a federal law unless it is within the federal government's power and intent to do so. \textit{Id.}

\textsuperscript{118} See New York v. United States, 112 S. Ct. 2408, 2418-19 (1992) (discussing Congress's power under Commerce Clause); see also Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 448 (1979). “In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power.” \textit{Id.} (quoting Board of Trustees v. United States, 289 U.S. 48, 59 (1933)).

\textsuperscript{119} See Fry v. United States, 421 U.S. 542, 547 n.7 (1975). The Tenth Amendment “expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the states' integrity, or their ability to function efficiently in a federal system.” \textit{Id.; see also}, National League of Cities v. Usery, 426 U.S. 833, 842 (1976) (stating that Congress's power to preempt states is limited when exercising its power to tax and regulate commerce).

\textsuperscript{120} See New York v. United States, 112 S. Ct. 2408, 2417-18 (1992) (stating that what is not conferred to Congress is reserved for states). \textit{Id.}


\textsuperscript{122} See New York v. United States, 112 S. Ct. 2408, 2418 (1992) (noting that “[t]he Tenth Amendment . . . directs us to determine . . . whether an incident of state sovereignty is protected by a limitation on an Article I power”). \textit{Id.}

stitutional issue.\textsuperscript{124} By requiring states to alter their tax codes to comply with government taxation policies, Congress is using the states to regulate beyond its enumerated powers.

Recently, in \textit{New York v. United States},\textsuperscript{125} the Supreme Court held that the Tenth Amendment limits Congress's power to compel the states to regulate.\textsuperscript{126} In \textit{New York}, Congress had enacted legislation requiring states to provide for the disposal of radioactive waste.\textsuperscript{127} States failing to comply were obligated to take title to and possession of the waste, and would be liable for damages incurred by the owner of the waste.\textsuperscript{128} New York State challenged this legislation, claiming it overstepped the boundary between federal and state authority.\textsuperscript{129}

In \textit{New York}, the Supreme Court reaffirmed the notion that "Congress may not simply 'commandeer[r] the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program.' \textsuperscript{130} The Court held that the federal government could urge states to comply with federal policy by providing the states with incentives, because the ultimate decision is then left to the residents of the state.\textsuperscript{131} However, the Court reasoned, the federal government could not compel the states to regulate, as the accountability of both state and federal officials would be expelled.\textsuperscript{132} Accordingly, the Court in \textit{New York} held the federal legislation unconstitutional because it interfered with state legislative processes by directly compelling states to prescribe and enforce a regulatory program.\textsuperscript{133}

\textsuperscript{124} See \textit{National Leagues of Cities}, 426 U.S. at 844 (distinguishing between federal government's right to enact laws that regulate individuals from states' sovereign power to regulate state function).

\textsuperscript{125} \textit{Id.} at 2408 (1992).

\textsuperscript{126} \textit{Id.} at 2414, 2434 (holding that Tenth Amendment reserves to states power to decide whether to provide for disposal of radioactive wastes generated within its borders).

\textsuperscript{127} \textit{Id.} at 2414 (describing Congress's Low-Level Radioactive Waste Policy Amendment Act of 1985).

\textsuperscript{128} \textit{Id.} at 2416.

\textsuperscript{129} \textit{Id.} at 2412-14 (reviewing State of New York's contention that Tenth Amendment reserves power to regulate waste to states).


\textsuperscript{131} \textit{New York}, 112 S. Ct. at 2421 (explaining that state residents can effectively decide whether or not to accept congressional incentives through election of state officials).

\textsuperscript{132} \textit{Id.} at 2424. "Where Congress encourages state regulation rather than compelling it, state governments remain responsive to the local electorate's preferences; state officials remain accountable to the people." \textit{Id.}

\textsuperscript{133} \textit{Id.} at 2428. "Because an instruction to state governments to take title to waste, standing alone, would be beyond the authority of Congress, and because a direct order to
By remaining silent on the issue of state taxation of MNCs, Congress has given state residents the power to decide, through their elected officials, which form of taxation best fulfills their states' needs. By contrast, an act of Congress that would compel all states to employ arms-length taxation methods would curtail the accountability of state and federal executives, and would therefore be unconstitutional under the New York rule.\textsuperscript{134}

The New York rule confirmed that where the federal government seeks to impose its policies upon the states, it must do so by directly legislating its policies upon the states' citizens.\textsuperscript{135} The federal government, however, may not attempt to impose its policies upon a state's citizens by requiring the state to legislate in favor of federal policy.\textsuperscript{136}

B. Preemption by Treaty

In determining whether the federal government may expand its regulatory power to prohibit state unitary taxation through treaties, the courts must do more than refer to the Tenth Amendment, because treaties made under the United States are declared the supreme law of the land.\textsuperscript{137} Just as an act of Congress is the supreme law of the land only if it passes constitutional muster,\textsuperscript{138} a treaty is the supreme law of the land only when made under the authority of the United States.\textsuperscript{139} Nevertheless, there are limits to

regulate, standing alone, would also be beyond the authority of Congress, it follows that Congress lacks the power to offer the States a choice between the two." \textit{Id.}

\textsuperscript{134} \textit{Id.} at 2429. Although the United States argued that Tenth Amendment limitations on congressional directives to state governments can be overcome "where the federal interest is sufficiently important to justify state submission," the Court dismissed this argument, stating that no matter how important the federal government's interest is, the Constitution never gives Congress the authority to compel the states to regulate. \textit{Id.}

\textsuperscript{135} New York v. United States, 112 S. Ct. 2408, 2435 (1992). "The Federal Government may not compel the states to enact or administer a federal regulation program." \textit{Id.}

\textsuperscript{136} New York v. United States, 112 S. Ct. 2408 \textit{passim} (1992). \textit{But see id.} at 2443-47 (White, J., dissenting). The dissenting Justice disagreed with this rationale, arguing that Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985), should govern this case, even if it does not involve a congressional law applicable to both states and private parties. \textit{Id.} at 2443-44.

\textsuperscript{137} See U.S. CONST. art. VI; \textit{see also} Missouri v. Holland, 252 U.S. 416, 432 (1920) (stating that Article VI proclaims Constitution itself, any law pursuant to Constitution, and treaties supreme to all other laws made by state and local governments); Scandinavian Airline Sys. Inc. v. County of Los Angeles, 56 Cal. 2d 11, 36 (1961) (declaring that treaties are supreme law of land and are binding on all federal state courts).


\textsuperscript{139} See U.S. CONST. art. 1, \S 8, cl. 3. States do not have the power to negotiate treaties with foreign nations. \textit{Id.} Rather, the Constitution reserves this power for the executive branch. \textit{Id.}; \textit{see also} Missouri v. Holland, 252 U.S. 416, 432 (1920) (stating that treaty is not valid if it violates another constitutional provision).
the federal government's authority.\textsuperscript{140} The extent to which these limits exist, however, is not entirely clear.

The Supreme Court first examined the federal government's treaty-making power seventy-five years ago, in \textit{Missouri v. Holland}.\textsuperscript{141} In \textit{Missouri}, the United States had entered into a treaty with Great Britain, providing for the protection of migratory birds in the United States and Canada.\textsuperscript{142} Although Congress could not enact this legislation domestically due to powers reserved to the states under the Tenth Amendment, it essentially achieved the same result by entering into a treaty which controlled the killing of wild game within state borders.\textsuperscript{143} The states challenged this compact, claiming that Congress was simply doing by treaty what it was forbidden to do legislatively.\textsuperscript{144} The \textit{Missouri} Court held that where a treaty, by its terms, does something that the Constitution forbids, it is outside the federal government's power to enter into that treaty.\textsuperscript{145} The Court reasoned that if the treaty power was not limited by the Constitution, "the Federal Government itself, as well as the several States, would be at the mercy of the President and the Senate."\textsuperscript{146} Nevertheless, the \textit{Missouri} Court found that the treaty between the United States and Great Britain was valid because, by the construction of the treaty, the act of controlling the taking of wild animals from within state borders was not necessarily required by the treaty.\textsuperscript{147} Similarly, where Congress would be forbidden to act legislatively to prohibit states from employing unitary taxation methods,\textsuperscript{148} it should be precluded from attempting to achieve the same end by entering into a treaty that guarantees a foreign nation immunity from unitary taxation at the state level.

\textsuperscript{140} \textit{See Missouri v. Holland}, 252 U.S. 416, 433 (1920) (stating that there are qualifications to Congress's treaty-making power).

\textsuperscript{141} 252 U.S. 416 (1920).

\textsuperscript{142} \textit{Id. at} 416.

\textsuperscript{143} \textit{Id. at} 432. The United States enacted the Migratory Bird Treaty Act of July 3, 1918 which implemented a treaty that the United States entered into with Great Britain. \textit{Id. at} 431. The act "prohibited the killing, capturing or selling any of the migratory birds included in the terms of the treaty." \textit{Id.}

\textsuperscript{144} \textit{Id. at} 432. A federal act prohibiting the killing of such birds was struck down as unconstitutional in the United States District Court. \textit{Id.} (citations omitted).

\textsuperscript{145} \textit{Id.} (stating that "what an act of Congress could not do unaided, in derogation of the powers reserved to the States, a treaty cannot do").

\textsuperscript{146} \textit{Id.}

\textsuperscript{147} \textit{Holland}, 252 U.S. at 434-35.

\textsuperscript{148} \textit{See supra} text accompanying notes 81-96 (arguing that Congress may not enact legislation that compels states to change their tax policies with respect to taxation of MNCs).
Thirty-seven years after *Missouri*, the Supreme Court decided *Reid v. Covert*.\(^{149}\) In this case, Mrs. Covert was accused of killing her husband, a sergeant in the United States Air Force, at an airbase in England.\(^{150}\) The North Atlantic Treaty Organization Status of Forces Agreement, effective in Great Britain, gives Great Britain primary jurisdiction to try dependents accompanying American servicemen for those offenses which violate both the foreign nation's law and United States law.\(^{151}\) Accordingly, Mrs. Covert was tried for murder by a court-martial, pursuant to Article 118 of the Uniform Code of Military Justice.\(^{152}\) Mrs. Covert was found guilty of murder and was sentenced to life in prison.\(^{153}\) She challenged the decision in the United States District Court for the District of Columbia on constitutional grounds, claiming that the court-martial violated her right to a trial by jury.\(^{154}\) The District Court held the court-martial procedure constitutional, but the Supreme Court reversed, holding that although the Supremacy Clause provides that all treaties made under the authority of the United States are the supreme law of the land,\(^{155}\) such treaties must be consistent with the rights set forth in the Constitution.\(^{156}\) Accordingly, the Court held that Mrs. Covert, as a

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\(^{149}\) 354 U.S. 1 (1957).

\(^{150}\) Id. at 3. Mrs. Covert was staying with her husband on the military base. *Id.*

\(^{151}\) See *id.* at 16. The North Atlantic Treaty Organization ("NATO") Status of Forces Agreement, 4 U.S. Treaties and Other International Agreements 1792, T.I.A.S. No. 2846, gives Great Britain jurisdiction over military servicemen's dependents. *Id.* However, the Agreement also contains provisions requiring the foreign nation to provide procedural safeguards for United States citizens tried in foreign courts under the NATO agreement. *Id.*

\(^{152}\) *Id.* The court-martial asserted jurisdiction over Mrs. Covert under Article 2(11) of the Uniform Code of Military Justice, which provides: "The following persons are subject to this code: . . . (11) Subject to the provisions of any treaty or agreement to which the United States is or may be a party or to any accepted rule of international law, all persons serving with, employed by, or accompanying the armed forces without the continental limits of the United States . . . ." *Id.* at 3-4.

\(^{153}\) *Id.* at 4. The Air Force Board of Review affirmed this judgment, but was reversed by the Court of Military Appeals for prejudicial error. *Id.* While Mrs. Covert was being held in the United States pending retrial, her attorney filed a writ of habeas corpus with the United States District Court, challenging the trial on constitutional grounds. *Id.*

\(^{154}\) See *Reid v. Covert*, 354 U.S. 1, 5 (1957). The United States District Court held that the military trial of Mrs. Covert was constitutional because the provisions of Article III and the Fifth and Sixth Amendments, which require a trial by jury, "did not protect an American citizen when he was tried by the American Government in foreign lands for offenses committed there and that Congress could provide for the trial of such offenses in any manner it saw fit so long as the procedures established were reasonable and consonant with due process." *Id.*

\(^{155}\) *Id.* at 6.

\(^{156}\) *Id.* at 17-18. The Court stated: The treaty power, as expressed in the Constitution, is in terms unlimited except by those restraints which are found in that instrument against the action of the govern-
civillian, could not constitutionally be tried by a military court-martial. The Reid Court distinguished Missouri v. Holland on the ground that it concerned a Tenth Amendment right, which reserved power to the states, as opposed to the constitutionally enumerated right to a trial by jury addressed in Reid v. Covert.

Although the Reid decision suggests that inherent Tenth Amendment rights are afforded less protection than enumerated constitutional rights, the Missouri case was not decided on this premise. The Missouri Court found the disputed treaty constitutional because it did not require the states to take the action that was being challenged on constitutional grounds. The Court made this clear when it suggested that the federal government should not be allowed to do by treaty what it is forbidden to do by statute.

It is inconceivable that the Supreme Court would allow the federal government to do through a "back door" policy what it has prohibited through domestic legislation. Thus, a treaty entered into by the federal government which would, by its terms, forbid states from employing unitary taxation would likely be viewed by the Court as directly violating the inherent Tenth Amendment right the Missouri court was protecting.

Id. or of its departments, and those arising from the nature of the government itself and of that of the States. It would not be contended that it extends so far as to authorize what the constitution forbids . . . .

Id. at 41.

See Reid, 354 U.S. at 18. The Court stated:

There is nothing in State of Missouri v. Holland . . . which is contrary to the position taken here. There the Court carefully noted that the treaty involved was not inconsistent with any specific provision of the Constitution. The court was concerned with the Tenth Amendment which reserves to the States or the people all power not delegated to the National Government. To the extent that the United States can validly make treaties, the people and the States have delegated their power to the National Government and the Tenth Amendment is no barrier.

Id.

See Missouri v. Holland, 252 U.S. 416, 417 (1920). The Court noted:

If it had been suggested that, although Congress had no power to control the taking of wild game within the borders of any State, yet indirectly by means of a treaty with some foreign power it could acquire the power and by this means its long arm could reach into the States and take food from the tables of their people, who can for one moment believe that such a constitution would have been ratified?

Id.
IV. Conclusion

Unitary taxation has been criticized widely for unfairly taxing the income of multijurisdictional corporations. Nevertheless, the Barclays decision confirms the constitutionality of the unitary method of taxation with respect to foreign-based MNCs as well as multistate corporations and domestic MNCs. Although the Barclays holding may be criticized for creating a temptation for states to adopt unitary taxation in an effort to increase state revenues, the threat of foreign retaliation by foreign MNCs will likely dissuade states from taking such action. Furthermore, the availability of the water’s edge election provides a middle ground in an effort to prevent foreign retaliation against those states that are unwilling to adopt the federal government’s arms-length method of taxation.

Nonetheless, discontent with unitary taxation methods does still exist. Thus, it is possible that Congress will respond to political pressure in this area by enacting legislation domestically, requiring the states to abolish unitary taxation methods. Such action, however, would diminish the accountability of state and federal officials and would therefore violate the states’ Tenth Amendment rights. Alternatively, the federal government may attempt to evade unitary taxation by entering into treaties with foreign governments, guaranteeing that unitary taxation will not occur at the state level. Although the federal government has already entered into such a treaty, it has not yet been challenged by the states. It is probable, however, that the Supreme Court, based on precedent, would find that the federal government may not attempt to do by treaty what is prohibited by statute. Thus, any attempt by the federal government to abolish unitary taxation would necessarily be void as a matter of law.

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