
INTRODUCTION

In the past one-hundred years, technical advances in communication and transportation have served as a catalyst in the development of multistate and multinational corporations. These corporations, which respectively do business in more than one state, or in more than one country, have become part of the economic reality of a modern age. Although the problems presented by multistate corporations in the area of state taxation have been basically resolved by the courts, complex questions still remain regarding state taxation of multinational corporations.

Multinational corporations have unified the economies of various countries through the creation of a greater number of transnational interactions and relationships. Although multinational corporations have had a unifying effect upon international economies, they have also created conflicts among nations. Since these multinational corporations, by their very nature, do business in more than one country, they are subject to the laws of more than

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1. For purposes of this Note, a multistate corporation is defined as a corporation which does business in more than one state, but within the borders of the United States.

2. Multinational corporations are those corporations which are based in one country and do business in one or more foreign countries. D. Blake & R. Walters, *The Politics of Global Economic Relations* 80-81 (1976). These corporations are commonly characterized by complex internal structures or infrastructures. *Id.* at 84-88. One common type of corporate structure is the parent subsidiary configuration. A “parent corporation” is one which has a “controlling interest” of its subsidiaries through stock ownership. Culcal Stylco, Inc. v. Vornado, Inc., 26 Cal. App. 3d 879, 882, 103 Cal. Rptr. 419, 421 (1972). *See* Treas. Reg. § 1.482-1(a)(3) (1962) which defines “controlled” to include “any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of control which is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.” *See also* Treas. Reg. § 1.482-1(a)(4) (1962) which defines a “controlled taxpayer” to mean “any one of two or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests.”


5. *See* notes 60-68 and accompanying text *infra*.

6. *See* notes 70-74 and accompanying text *infra*.


8. *See* note 95 and accompanying text *infra*. 
one nation. In the area of taxation, this has posed certain problems, particularly for the United States, since these corporations are not only subject to federal taxation, but also to state taxation in the states where they do business.9

State taxation of multinational corporations has been attacked by corporations and has generated concern from foreign governments.10 Corporations contend that current state taxation methods, particularly those utilizing the unitary business principle and formula apportionment, distort the true allocation of income between the corporation and its various subdivisions by relying on indirect measures of income rather than income from more direct sources.11 California's corporate franchise tax scheme utilizes both the unitary business principle and formula apportionment.12


10. See notes 94 and 95 and accompanying text infra.

11. See Dexter, Taxation of Income from Intangibles of Multistate Multinational Corporations, 29 VAND. L. REV. 401, 404-05 (1976) (discussing the controversy between the states and the Committee on State Taxes of the Council of State Chambers of Commerce, an organization comprised of corporate businesses dealing with state allocation of intangible income in general and dividend income in particular).

12. Container Corp., 103 S. Ct. at 2940 (California has substantially adopted the Uniform Division of Income for Tax Purposes Act). See CAL. REV. & TAX. CODE §§ 25120-25139 (West 1979); compare with UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT §§ 1-22, 7A U.L.A. 93-108 (1978) (the two statutes are substantially analogous). The Uniform Division of Income for Tax Purposes Act (UDITPA) was promulgated by the Conference of Commissioners on Uniform State Laws. Dexter, supra note 11, at 404 n.11. The purpose of the Multistate Tax Compact is to standardize and maximize state taxation schemes while remaining within constitutional limitations. See generally Multistate Tax Compact, art. I, ST. & Loc. TAX. SERV. (P-H) (All States Unit) ¶ 6310 (Apr. 22, 1975), stating that "[t]he purposes of this compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; (2) Promote uniformity of compatibility in significant components of tax systems; (3) Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; (4) Avoid duplicative taxation.

At least one commentator has expressed the hope that UDITPA will prevent taxpayers from "utiliz[ing] jurisdictional barriers along with inconsistent attribution methods . . . to convert taxable income into 'nowhere income.'" Corrigan, supra note 3, at 429 (nowhere income is income that escapes all state taxation; various methods are used to create nowhere income. Id. at 429-30, 436). UDITPA has currently been enacted in twenty-three states. See ALA. CODE § 40-27-1 (1977); ALASKA STAT. § 43.19.010 (1983); ARK. STAT. ANN. §§ 84-2055 to -2073 (1980); CAL. REV. & TAX. CODE §§ 25120-25139 (West 1979); COLO. REV. STAT. § 24-60-1301 (1982); HAWAII REV. STAT. §§ 235-21 to -39 (1976); IDAHO CODE §§ 63-3027 to -3027A (1976); KAN. STAT. ANN. §§ 79-3271 to -3293 (1977); KY. REV. STAT. ANN. § 141.120 (Baldwin 1983); ME. REV. STAT. ANN. tit. 36, §§ 5210-5211 (Supp. 1982-83); MICH. COMP. LAWS ANN. § 205.581 (West Supp. 1983-84); MO. ANN. STAT. § 32.200 (Vernon 1969); MONT. CODE ANN. §§ 15-31-301 to -313 (1979); NEB. REV. STAT. § 77-2901 (1981); NEV. REV. STAT. § 376.010
Under the unitary business approach, parent corporations and their subsidiaries are viewed as one business for state tax purposes if there exists a sufficient, active relationship between the two. Once the existence of a unitary business has been determined, formula apportionment is applied. For example, California’s formula apportionment scheme determines what percentage of the business’ real property, sales and payroll is located within its boundaries. This percentage is then used to determine the amount of the unitary business’ income attributable to the state, and therefore subject to state taxation.

At least one foreign government has expressed the concern that state taxation methods which use the unitary business principle and formula apportionment prohibit the federal government from speaking in one voice with regard to foreign policy. The Supreme Court of the United States, in Container Corp. of America v. Franchise Tax Board, was presented with the opportunity to address these issues in determining the validity of a state tax on a multinational corporation.

The majority opinion in Container Corp. reflects the Court’s reluctance to further limit a state’s power to tax in the absence of


13. Container Corp., 103 S. Ct. at 2940-41 (horizontally and vertically integrated corporations may constitute a unitary business. Id. at 2941). See Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472, —, 183 P.2d 16, 21 (1947) (stating that as long as all elements of a unitary business are present, the unitary business principle can be applied to businesses whether there exists but one corporation with numerous branches or a parent corporation with subsidiaries). See also notes 101, 105-20 and accompanying text infra.

14. See CAL. REV. & TAX. CODE § 25101 (West 1979) (containing the California Apportionment formula). See also note 13 supra and notes 101, 105-20 and accompanying text infra (explaining what constitutes a unitary business for state taxation purposes).

15. CAL. REV. & TAX. CODE § 25101 (West 1979). See Container Corp., 103 S. Ct. at 2942 (stating that the “three-factor formula … has gained wide approval precisely because payroll, property and sales appear in combination to reflect a very large share of the activities by which value is generated.” Id. at 2949). See also notes 123 and 132 and accompanying text infra.

16. See Container Corp., 103 S. Ct. at 2942 (stating that once a set of activities is found to be a unitary business, the state must apportion the income within and without the state).


decisive legislative action. The analysis of this case will discuss three areas in which the appellant, Container Corp., alleged that worldwide unitary apportionment violated constitutional standards. First, the question of fair apportionment will be addressed. Second, the issue of double taxation will be examined. Finally, the effect of state taxation on the federal government's ability "to speak in one voice" with regard to foreign policy will be discussed.

FACTS AND HOLDING

Container Corp. of America is a manufacturer and distributor of paper packaging products. The corporation, which is incorporated in Delaware and is headquartered in Illinois, conducts business at both national and international levels. Because of business activity within California, the state assessed a corporate franchise tax on Container Corp. The corporation challenged the tax, claiming the tax was in derogation of the due process and commerce clause of the United States Constitution.

During the disputed tax years, Container Corp. controlled twenty foreign-based subsidiaries which California viewed as part of Container Corp.'s unitary business for state taxation purposes. The parent corporation did not control the daily management or the accountability of these foreign subsidiaries. Furthermore, Container Corp. did not buy raw materials or finished products from the subsidiaries, nor did it participate in joint marketing efforts with them.

In some activities, however, Container Corp. and its subsidiar-

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20. Container Corp., 103 S. Ct. at 2956-57; see also Mobil Oil Corp. v. Commissioner, 445 U.S. 425, 448-49 (1980) (the Court had earlier declined to impose the federal method of taxation on the states in the absence of decisive legislative action).
23. Id.
24. Container Corp., 103 S. Ct. at 2939 (California utilized a corporate franchise tax geared to income and employs the "unitary" business principle and formula apportionment in taxing corporations that do business within the state).
25. Container Corp., 103 S. Ct. at 2939 (Justice Brennan stating that "[t]his is another appeal claiming that the application of a State taxing scheme violates the Due Process and Commerce Clauses of the Federal Constitution").
26. Container Corp., 117 Cal. App. 3d at 990, 173 Cal. Rptr. at 123 (the years in question were 1963, 1964 and 1965). Container Corp.'s twenty subsidiaries were located in Western Europe and Latin America and all but one engaged in the paperboard packaging business. Id. at 991, 173 Cal. Rptr. at 123.
27. Id. at 991-92, 173 Cal. Rptr. at 123-24.
28. Id. at 992, 173 Cal. Rptr. at 124.
ies maintained a close relationship. Occasionally, the subsidiaries were assisted in the procurement of paperboard, raw materials and equipment or were actually sold these items by the parent corporation. Container Corp. sometimes lent money to its subsidiaries, and even more frequently guaranteed the subsidiaries’ loans. Although almost all the subsidiaries utilized their own accounting firms, nearly all audits were done by an accounting firm retained by the parent corporation. For the most part, the employees of the subsidiaries were not on the payroll of the parent corporation, but occasionally, an employee was transferred from the parent corporation to the subsidiary and would still receive compensation from the parent. In addition, Container Corp. and its subsidiaries integrated many of the major executive functions. The subsidiaries implemented the parent corporation’s policy of regional decentralization and continued to receive technical assistance from the parent. Finally, the parent corporation and the subsidiaries worked closely in their plans for corporate expansion, with the parent corporation reserving the right to review any proposed policy changes of the subsidiaries. All these facts were considered by the California Franchise Tax Board in finding that the domestic parent corporation and its foreign subsidiaries

29. Id. at 995-1000, 173 Cal. Rptr. at 126-29 (discussing the factors that showed unity between the parent corporation and its subsidiaries, and the factors which indicated independence).

30. Id. at 995-96, 173 Cal. Rptr. at 126 (concluding that although the subsidiaries could have bought paper from others at the price the parent corporation charged, the purchasing and brokerage ties were relevant).

31. Id. at 996, 173 Cal. Rptr. at 126. Container Corp. loaned its subsidiaries approximately $18,000,000 during the contested tax years, and guaranteed one-third of the subsidiaries’ other loans. See Container Corp., 103 S. Ct. at 2948, n.19 (emphasizing that there was a flow of capital resources from Container Corp. to its subsidiaries through loans and loan guarantees, and that there was no indication that any of these loans were conducted at “arm’s-length”).

32. Container Corp., 117 Cal. App. 3d at 992, 173 Cal. Rptr. at 124 (subsidiaries located in the Netherlands and Germany were not audited by Container Corp.'s accounting firm).

33. Id. at 996-97, 173 Cal. Rptr. at 126-27. Employees transferred to foreign subsidiaries from the parent corporation were allowed to retain benefits and were given options to buy the parent’s stock. During 1963-65, only thirty-eight of the parent corporation’s 13,400 employees were transferred to foreign subsidiaries. Id. at 991, 173 Cal. Rptr. at 123.

34. Id. at 998, 173 Cal. Rptr. at 127-28. See also Container Corp., 103 S. Ct. 1498 n.19. Although daily management was decentralized, the Court emphasized this was not enough to preclude a finding of a unitary business. This determination was due to the operational role played by Container Corp. in its business guidelines to subsidiaries, its involvement in business decisions of subsidiaries, and its sometimes uncompensated technical assistance to subsidiaries). Id.


36. Id. at 997-98, 173 Cal. Rptr. at 127.
were a unified business for franchise tax purposes.\footnote{Container Corp., 103 S. Ct. at 2944-45 (California conducted an audit of the corporation in 1969 and concluded that Container Corp. should have included its foreign subsidiaries as part of its unitary business).}

After being assessed a tax by the Franchise Tax Board, based on the presumption that Container Corp.'s foreign-based subsidiaries constituted a unitary business, the corporation filed suit.\footnote{Id. at 2945. Container Corp. paid, under protest, the additional amounts assessed after the 1969 audit and then filed suit in California Superior Court. See also note 37 supra.} The trial court and the California appellate court both held that the domestic corporation and its foreign-based subsidiaries constituted a unitary business for purposes of the California apportionment statute, and consequently upheld the California tax.\footnote{Container Corp., 117 Cal. App. 3d at 1007, 173 Cal. Rptr. at 133.} Container Corp. appealed to the United States Supreme Court.\footnote{Various procedural matters were determined before the case was heard. Container Corp. of Am. v. Franchise Tax Bd., 102 S. Ct. 630 (1982) (denying Container Corp.'s motion to hear the case in tandem with Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., ASARCO, Inc. v. Idaho Tax Comm'n, and F.W. Woolworth Co. v. Taxation & Revenue Dept'); Container Corp. of Am. v. Franchise Tax Bd., 102 S. Ct. 2034 (1982) (noting probable jurisdiction); Container Corp. of Am. v. Franchise Tax Bd., 102 S. Ct. 2230 (1982) (granting various interested non-parties leave to file amicus curiae briefs). Justice Stevens took no part in noting jurisdiction, or granting or denying the motions.}

On appeal, Container Corp. raised three issues.\footnote{Id. See notes 133-35 and accompanying text infra.} First, the corporation contended that its domestic and overseas operations did not constitute a unitary business for purposes of state taxation.\footnote{Id. See notes 183-85 and accompanying text infra.} Second, it argued that obvious differences among national economies rendered the standard method of apportionment so inaccurate as to violate the constitutional standard requiring "fair" apportionment.\footnote{Id. at 2939. Justice Stevens took no part in the decision. Id. at 2957. Justices Powell, Burger and O'Connor joined in the dissent. Id.} Finally, Container Corp. asserted that California had a constitutional obligation to employ an "arm's-length" analysis in evaluating the tax consequences of inter-corporate relationships.\footnote{Id. at 2939.} The United States Supreme Court affirmed the decision of the California appellate court.\footnote{Id. at 2957. Justice Brennan presented the majority opinion. Id. at 2939. Justice Stevens took no part in the decision. Id. at 2957. Justices Powell, Burger and O'Connor joined in the dissent. Id.} The Court held that the California court's finding that Container Corp. and its foreign subsidiaries constituted a unitary business was well within the "realm of permissible judgment."\footnote{Container Corp., 103 S. Ct. at 2948. The California appellate court applied the three unities approach. Container Corp., 117 Cal. App. 3d at 995-96, 173 Cal.}

\footnote{Container Corp., 103 S. Ct. at 2944-45 (California conducted an audit of the corporation in 1969 and concluded that Container Corp. should have included its foreign subsidiaries as part of its unitary business).}
nia met the requirement of fair apportionment, and that a state had no obligation to adopt the arm's-length approach utilized by the federal government.

**Background**

Congress possesses the power to regulate both federal and state taxation of interstate commerce. However, little federal legislation exists which limits a state's ability to tax interstate transactions. The sparsity of federal legislative action has resulted in the United States Supreme Court formulating its own judicial limitations on a state's taxing powers over entities such as multinational corporations, which do business in more than one jurisdiction. Some of these limitations have been shaped by the Court under the due process and commerce clauses of the United States Constitution.

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47. Container Corp., 103 S. Ct. at 2950.
48. See id. at 2956-57.
49. U.S. CONST. art. I, § 8, cl. 1 (stating that "[t]he Congress shall have Power to lay and collect Taxes, Duties, Imports and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imports and Excises shall be uniform throughout the United States. . ."). See also U.S. CONST. art. I, § 8, cl. 3 (stating that Congress shall have power "[t]o regulate the Commerce with foreign Nations, and among the several States, and with the Indian Tribes . .").
52. U.S. Const. amend. XIV, § 1 (stating that no state shall "deprive any person of life, liberty, or property, without due process of law . ."). See notes 55-58 and accompanying text infra.
53. See note 49 supra. See also notes 59-68 and accompanying text infra.
54. Generally, federal due process and commerce clause requirements prohibit
Constitutional Prerequisites To State Taxation

The due process clause imposes two requirements on a state's power to tax income derived from interstate commerce. First, there must exist a "minimal connection" or "nexus" between the state and the interstate activities to be taxed. If such a "nexus" exists, then there must be a rational relationship between the income attributed to the state and the interstate values of the enterprise. Stated another way, income from interstate commerce can only be apportioned to the state if there exists an adequate relationship between the state and the activity, and then only if the allocation is fair.

The commerce clause historically placed a more stringent limitation on state taxation of interstate commerce than did the due

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state taxation of value earned outside the state. See, e.g., Connecticut Gen. Life Ins. Co. v. Johnson, 303 U.S. 77, 80-81 (1938). However, states are allowed to tax income fairly attributable to activities internal to the state. See Hellerstein, supra note 9, at 138. The equal protection clause, U.S. CONST. amend. XIV, § 1, is also utilized by the Court to define the limits on the states' taxation powers. See, e.g., Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 337 (1977) (invalidating, under the equal protection clause, a New York statute which had the practical effect of taxing out-of-state transactions more heavily than in-state transactions); Wheeling Steel Corp. v. Glander, 337 U.S. 562, 572 (1949) (holding an ad valorem property tax on intangibles owned by non-residents and foreign corporations in violation of the equal protection clause due to the salient disparity in treatment given to non-resident taxpayers); Fox v. Standard Oil Co., 294 U.S. 87, 102-03 (1935) (sustaining an annual chain store tax which had been challenged on equal protection grounds). This note will not discuss any potential equal protection problems involved in state taxation of multinational corporations since the Court did not address these issues in Container Corp.


56. Exxon Corp. v. Department of Revenue, 447 U.S. at 219 (stating that a minimal connection or nexus "is established if the corporation avails itself of the 'substantial privilege of carrying on business' within the State," quoting Mobil Oil Corp. v. Commissioner, 445 U.S. at 437, quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445-45 (1940). Id. at 220).

57. See Wisconsin v. J.C. Penney Co., 311 U.S. at 444 (stating that the test is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The . . . controlling question is whether the state has given anything for which it can ask return.").

58. See ASARCO Inc. v. Idaho State Tax Comm'n, 102 S. Ct. at 3109 (stating that due process requirements are satisfied even though a state utilizing an apportionment formula is found to have taxed income, attributable to a different state through separate geographic accounting, if the business' "in intrastate and extrastate activities formed part of a single unitary business." [citation omitted]). See also Container Corp., 103 S. Ct. at 2940-41; Exxon Corp. v. Department of Revenue, 447 U.S. at 219-20; Mobil Oil Corp. v. Commissioner, 445 U.S. at 436-37; Wisconsin v. J.C. Penney Co., 311 U.S. at 444-45 (all discussing the two due process requirements).
process clause.59 The underlying philosophy, illustrated in early case law, reflected a belief that interstate activities should not be subject to the states' power of taxation.60 However, the more modern approach, first enunciated in Complete Auto Transit Inc. v. Brady,61 allows states to tax income from such interstate activities.62

In Complete Auto, the taxpayer challenged Mississippi's tax on the privilege of doing business within the state.63 The United States Supreme Court, in finding the tax constitutional, utilized a four-prong test.64 The Court stated the crucial elements in determining whether a state tax is constitutional were: 1) that the taxed activity have a sufficient nexus with the state;65 2) that the tax be fairly apportioned;66 3) that the tax not discriminate against interstate commerce;67 and 4) that the tax be fairly related to services

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59. See generally Spector Motor Serv. Inc. v. O'Connor, 340 U.S. 602, 610 (1951) (invoking the application of an Illinois tax on vehicles involved in interstate transportation which the Court held unconstitutional under the commerce clause); Freeman v. Hewit, 329 U.S. 249, 256-57 (1946) (where the Court held an Indiana tax on interstate brokerage fees violative of the commerce clause). Both cases implied that a tax imposed on the privilege of engaging in an activity in the state may not be imposed on an activity that is solely part of interstate commerce. The holdings in both cases were rejected by the Court in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 281, 289-99 (1977). See also Lockhart, A Revolution in State Taxation of Commerce? 65 MINN. L. REV. 1025, 1034-43 (1981) (examining the effects of Complete Auto).

60. Complete Auto, 430 U.S. at 278 (stating that the underlying philosophy behind Spector Motor and Freeman reflected a belief that "interstate commerce should enjoy a sort of 'free trade' immunity from state taxation.").


63. Id. at 274 (the taxpayer, a Michigan corporation, was engaged in transporting motor vehicles by motor carrier for General Motors Corp. Id. at 276).

64. Id. at 277-78.

65. Id. See also Container Corp., 103 S. Ct. at 2940; ASARCO Inc. v. Idaho State Tax Comm'n, 102 S. Ct. at 3109; Exxon Corp. v. Department of Revenue, 447 U.S. at 219-20; Mobil Oil Corp. v. Commissioner, 445 U.S. at 436-37; General Motors Corp. v. Washington, 377 U.S. 436, 448 (1964); Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954); Wisconsin v. J.C. Penney Co., 311 U.S. at 444-45 (all discussing the necessity for a state to show a minimum connection or nexus between the person, property or transaction it wishes to tax).


provided by the state. 68

Although the Complete Auto test is still viable when dealing with state taxation of interstate commerce, the Court has made a more extensive constitutional inquiry when examining state taxation of foreign commerce. 69 Due to the increased likelihood of multiple taxation and the potential negative effect on federal foreign policy, the Court, in Japan Line, Ltd. v. County of Los Angeles, 70 differentiated between foreign commerce and interstate commerce in the area of state taxation, utilizing the Complete Auto test. 71 The Court stated that a fifth and sixth prong are to be considered when a state is taxing foreign commerce. 72 The fifth prong of the test requires that when a tax is imposed, consideration be given to the risks of multiple taxation upon foreign commerce. 73 The sixth prong delves into whether a state’s taxation of foreign commerce would prevent the government from “speaking in one voice” when regulating commercial relations with foreign governments. 74

Methods of State Taxation

Various methods of taxation have been devised by states 75 in an attempt to satisfy both the due process and commerce clause requirements. Although there is a general prohibition against a state taxing value earned outside the state, value attributable to activities earned within the state is considered taxable. 76

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68. Complete Auto, 430 U.S. at 278. See notes 57 and 58 and accompanying text supra.

69. See notes 70-74 and accompanying text infra.

70. 441 U.S. 434 (1979) (involving a property tax on cargo containers owned by Japanese shipping companies which were taxed both in Japan and in California. Id. at 436-37).

71. Id. at 446-51.

72. Id. at 446.

73. Id. See also Container Corp., 103 S. Ct. at 2951, 2953-55; Exxon Corp. v. Department of Revenue, 447 U.S. at 228-29; Mobil Oil Corp. v. Commissioner, 445 U.S. at 443 (all examining the additional risks of multiple taxation when dealing with instrumentalities of interstate commerce).


76. See note 54 supra.
dealing with multistate and multinational corporations, it is difficult to ascertain what proportion of their income should be subject to taxation in the states in which they do business.\footnote{See generally Dexter, supra note 11, at 401-04 (discussing the fact that the same intangible income may be subject to taxation in as many as five different classes of states); Corrigan, supra note 3, at 425-36 (discussing corporate methods of avoiding state taxation by utilizing jurisdictional barriers and various corporate internal structures).} Three general methods have been suggested for deriving locally taxable incomes: the geographical or transactional method of accounting,\footnote{Container Corp., 103 S. Ct. at 2940. See also notes 80-84 and accompanying text infra.} the “arm's-length” approach,\footnote{Container Corp., 103 S. Ct. at 2950, 2955-57. See also notes 85-93 and accompanying text infra.} and unitary apportionment.\footnote{See Exxon Corp. v. Department of Revenue, 447 U.S. at 220-23; Mobil Oil Corp. v. Commissioner, 445 U.S. at 438; Butler Bros. v. McColgan, 315 U.S. at 507.}

The geographical or transactional method of accounting operates upon the notion that income earned in one state may not be taxed in another, if the income is ascertainable by separate geographical accounting.\footnote{See G. Altman \\& F. Keesling, ALLOCATION OF INCOME IN STATE TAXATION 89 (1946).} Basically, this approach accepts at face value the amount of income the corporation attributes to having been generated in the state.\footnote{See Mobil Oil Corp. v. Commissioner, 445 U.S. at 438 (stating that “the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.” Citing Butler Bros. v. McColgan, 315 U.S. at 508-09). See also J. Hellerstein, STATE AND LOCAL TAXATION, 400 (3d ed. 1969) (stating that there is “no logical or viable method for accurately separating out the profit attributable to one step in the economic process from other steps.”); G. Galtman \\& F. Keesling, supra note 82, at 97 (concluding that “the separate accounting method is wholly unsuited to the proper apportionment of the income of a unitary business”).} This income is then subject to state taxation. The approach has been criticized by both courts and commentators, since corporations, through numerous methods of accounting, are capable of concealing actual income generated by the business within a particular state.\footnote{See I.R.C. § 482 (1983) which states that:} Furthermore, the Court has stated that although separate geographical accounting may be useful for internal corporate functions, it ignores the factors of profitability arising from the operation of the business as a whole.\footnote{Mobil Oil Corp. v. Commissioner, 445 U.S. at 438.}

The “arm’s-length” approach is utilized by the federal government in its assessment of corporate tax.\footnote{See L.R.C. § 482 (1983) which states that:} It adopts the idea that
income is clearly reflected only when related entities treat each other in the same way they would treat unrelated entities. This method basically accepts allocations made by the corporation at face value, unless circumstances indicate that the transactions or bookkeeping were not done at arm's-length. If the service finds that a transaction was not conducted at arm's-length, it is allowed to allocate to each branch or business subsidiary, that portion of profits the branch or subsidiary would have earned if it had been dealing at arm's-length with other branches or subsidiaries.

Although the potential adoption of the arm's-length approach in assessing state revenues would provide uniform treatment of businesses, it has been criticized for various reasons. First, the arm's-length approach would require the states to assume a relationship which does not exist, since intra-corporate affiliates, i.e., branches and subsidiaries, do not carry on business at "arm's-length." Second, this method could prove to be too burdensome and difficult for the states to use, given the amount of revenue involved. Finally, an arm's-length adjustment normally occurs only when there has been a substantial deviation in transactional

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

87. See Container Corp., 103 S. Ct. at 2950 (where the Court states that: Under the arm's-length approach, every corporation, even if closely tied to other corporations, is treated for most—but decidedly not all—purposes as if it were an independent entity dealing at arm's length with its affiliated corporations, and subject to taxation only by the jurisdictions in which it operates and only for the income it realizes on its own books.
88. See Du Pont v. United States, 608 F.2d 445, 449 (Ct. Cl. 1979) (stating that § 482 allows "the Secretary of Treasury (or his delegate) discretion to allocate income between related corporations when necessary to 'prevent evasion of taxes or clearly to reflect the income' of any such corporations"). See, e.g., Erickson v. Commissioner, 598 F.2d 525, 528-29 (9th Cir. 1979) (the Commissioner was allowed to reallocate losses in accordance with a leaseback agreement and disallow the taxpayer's depreciation deduction).
90. See notes 90-93, 181 and accompanying text infra.
91. See Note, Multinational Corporations and Income Allocation Under Section 482 of the Internal Revenue Code, 89 HARV. L. REV. 1202, 1214-15 (1976) (the author argues that adopting regulations for the sole purpose of consistency can not be justified in the face of economic rationality).
accounting between related businesses. This could easily result in the use of more subtle methods of market manipulation which would not be subject to adjustment, and could potentially allow significant amounts of corporate income to escape taxation.

Despite some of the inherent problems of the arm's-length approach, there has been a movement on the part of corporations and foreign governments to force states to adopt this method. The potential multiple taxation of income from foreign-held subdivisions has resulted in multinational corporations and foreign countries applying growing pressure on the federal government to require the state to adopt the arm's-length approach. Furthermore, retaliatory tax treatment against American-owned businesses, operating on a multinational level, may result from continued use of the unitary apportionment method.

The unitary business principle and formula apportionment are integrally related concepts in many state taxation schemes.

92. See Comment, supra note 91, at 502 (stating that an "arm's-length adjustment is made only when an enterprise has departed substantially from market norms in its internal dealings"). [emphasis added].

93. Id. (concluding that despite problems of market manipulation and complexity in use, the need for uniformity in this area may outweigh the states' interests of maximizing their respective revenue bases).

94. Some of the largest corporations in the world contend that states should be forced to adopt the arm's-length approach. Motion for Leave to File Brief as Amici Curiae (Amicus Brief No. 1) at 2, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983). See Amicus Curiae Brief for the United States at 2a-9a, Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., No. 81-349 (U.S. Oct. 1981) (containing letters expressing British and Canadian dissatisfaction with formula apportionment and urging that states be required to adopt the arm's-length approach). The Solicitor General has also expressed the view that the state's adoption of the arm's-length approach is necessary for federal uniformity. Id. at 2. The Court has declined to force the states to adopt the arm's-length approach. See Container Corp., 103 S. Ct. at 2957 (concluding that the unitary formula apportionment method is not "preempted by federal labor law, or in any way inconsistent with federal policy"); Mobil Oil Corp., 445 U.S. at 448 (stating that "[a]bsent some explicit directive from Congress, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the states").

95. Amicus Curiae Brief for the United States at 2a-9a, Chicago Bridge & Iron Co. (containing excerpts of letters from the British and Canadian Embassies vocalizing their respective governments' opposition to unitary tax apportionment); See also Human, supra note 74, at 512-15 (examining the current controversy regarding state taxation and its effect on foreign relations). Additionally a bill has been introduced in the House of Representatives which would "clarify the extent to which a State, or political subdivision, may tax certain income from sources outside the United States." H.R. 2918, 98th Cong., 1st Sess., 129 CONG. REc. 2697 (1983).

96. See Amicus Curiae Brief for the United States at 3, Chicago Bridge & Iron Co.

97. See Container Corp., 103 S. Ct. at 2940-43 (discussing the unitary business concept and formula apportionment in relation to each other); see also Comment, State Taxation of Unitary Businesses, 8 FORDHAM URBAN L.J. 819, 849, 852-55 (1980) (generally discussing formula apportionment).
Before a state can apportion a business' income and assess a tax, it must first determine what constitutes the business. The unitary business concept is used to determine what comprises the business.

The development of the unitary business principle corresponds to the growth of both multistate and multinational corporations. As businesses began to develop more complex infrastructures with corporate subdivisions located in different states and countries, the states were faced with the dilemma of either recognizing various subdivisions as comprising one business, or treating each subdivision as a separate individual entity. Adoption of the unitary business principle allowed the states to recognize that corporate subsidiaries and branches, separated from the rest of the corporation's business only by distance and jurisdictional boundaries, derive a benefit from business being conducted within the state.

State law, in conjunction with general Supreme Court guidelines, regulates what constitutes a business within a state. Because state laws often vary, there is no clear-cut definition governing what constitutes a unitary business. Instead, there are a number of variations on what factors are needed in the relationship between the in-state business and the out-of-state business or businesses to support a finding of a unitary business.

98. Comment, supra note 97, at 820 (stating that "the unitary business concept is the first step in identifying the tax base," and that the second step is applying an apportionment formula). See Comment, supra note 91, at 502-03 (commenting that before an apportionment formula can be applied, it is first necessary to determine what constitutes the business).

99. See note 98 supra.

100. See generally Comment, supra note 97, at 819-20 (discussing a business' potential relationship with multiple states); Corrigan, supra note 3, at 423 (stating that technical advances have created major tax administration problems and opportunities for the states).


102. See notes 57 and 58 supra.

103. See Container Corp., 103 S. Ct. at 2939-43 (discussing the constitutional limitations placed on state law). See also Hellerstein, supra note 51, at 115 (stating that existing limitations on state taxation schemes have been largely shaped by the Supreme Court).

104. See notes 105-20 and accompanying text infra.

105. See Container Corp., 103 S. Ct. at 2947. The Court listed numerous factors relied on by the state court in its finding of a unitary business, including the "appellant's assistance to its subsidiaries in obtaining used and new equipment and in
Although there are numerous methods of defining a unitary business, only three methods will be discussed.

One method used in determining what constitutes a unitary business is a three-step analysis first enunciated by the California Supreme Court in *Butler Bros. v. McColgan*. In *Butler Bros.*, the court examined the relationship between in-state and out-of-state business interests and activities to determine whether unity of ownership, unity of operation, and unity of use existed. After finding that all three unities were present, the court held that

filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the 'considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion,' [citations omitted] the 'substantial' technical assistance provided by appellant to the subsidiaries, [citations omitted] and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries." *Id.* The Court also stated in *Container Corp.* that it "need not decide whether any one of these factors would be sufficient as a constitutional matter to prove the existence of a unitary business." *Id.* at 2948. *See also* *Butler Bros. v. McColgan*, 315 U.S. at 508 (holding that unity of ownership and management, and closely integrated branches made a business unitary for state taxation purposes); *Bass, Ratcliff & Gretton Ltd., v. State Tax Comm'n*, 266 U.S. at 282 (finding a business unitary since the process of manufacturing ale in England resulted in no profits for the taxpayer until it was sold in New York and other places); *W.R. Grace & Co. v. Commissioner*, 378 Mass. 577, —, 393 N.E.2d 330, 336 (1979) (holding that Miller Brewing Co. was part of the plaintiff-taxpayer's unitary business, since the plaintiff was the majority stockholder, its President sat on Miller's Board of Directors, it gave the financial world notice of its controlling interest, and it could have actually participated in management). The Court had established some limitations on the factors to be used in defining a unitary business. *See ASARCO*, 102 S. Ct. at 3114 (stating that corporate purpose alone does not define a unitary business because "[w]hen pressed to its logical limit, this conception of the 'unitary business' limitation becomes no limitation at all."); *See also* *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 102 S. Ct. 3128, 3134 (1982) (stating that its "decision in *ASARCO* makes clear... that the potential to operate a company as part of a unitary business is not dispositive... ").

106. *See*, Comment, *supra* note 97, at 832-49 (discussing more completely the various methods used by courts in finding a unitary business).

107. *17 Cal. 2d 664, —, 111 P.2d 334, 341 (1941).* The Supreme Court had also discussed unity of ownership, use and operation, but had never enunciated the test in a trifurcated analysis. *See Butler Bros.*, 315 U.S. 501, 507-09 (1940).

108. *Butler Bros.*, 17 Cal. 2d at —, 111 P.2d at 341; *see* *Chase Brass & Copper Co. v. Franchise Tax Bd.*, 10 Cal. App. 3d 496, 502, 95 Cal. Rptr. 805, 808 (1970) (stating that unity of ownership is typified by ownership of one corporation by another).

109. *Butler Bros.*, 17 Cal. 2d at —, 111 P.2d at 341; *see* *Chase Brass & Copper Co. v. Franchise Tax Bd.*, 10 Cal. App. 3d at 502, 95 Cal. Rptr. at 808 (attempting to draw a line of demarcation between unity of operation and unity of use). *See also Container Corp.*, 103 S. Ct. at 2948 n.19 (emphasizing the flow of capital resources from Container Corp. to its subsidiaries through loans and loan guarantees, and noting the management role played by Container Corp. in its subsidiaries' affairs as two pertinent factors pointing towards unity of operation).

110. *Butler Bros.*, 17 Cal. 2d at —, 111 P.2d at 341. *See* *Chase Brass & Copper Co. v. Franchise Tax Bd.*, 10 Cal. App. 3d at 504, 95 Cal. Rptr. at 809 (1970) (stating that "[u]nity of use relates to executive forces and operational systems." [citation omitted].
there existed a unitary business for state tax apportionment purposes.111 This three unity approach is still widely used to determine whether in-state and out-of-state business operations constitute a unitary business.112

Another approach which is sometimes used to determine whether a unitary business exists is the "dependent upon or contributory test."113 This method examines the in-state operation in order to determine if the in-state operation benefits or is benefited by the out-of-state businesses.114 If the in-state operations contribute to or benefit from the out-of-state operations, then there exists a unitary business.115 However, this approach has been criticized where the in-state operations contribute nothing to the out-of-state operations, because it potentially results in a state's taxing income from outside the state.116 Furthermore, this approach focuses only on corporate internal structures and fails to take into consideration the effect on earnings that in-state and out-of-state operations have upon each other.117

A third well-known method in determining whether a unitary business exists is the "bright line" approach.118 Under the bright line approach, if there is a substantial flow of goods between the in-state business and out-of-state business, there exists a unitary

111. Butler Bros., 17 Cal. 2d at —, 111 P.2d at 341.
112. See, e.g., Anaconda Co. v. Franchise Tax Bd., 126 Cal. App. 3d 351, 350-63, 178 Cal. Rptr. 740, 745-47 (1981) (applying the three unity test in determining whether the corporation's foreign-based subsidiaries were part of its unitary business); Container Corp., 117 Cal. App. 3d at 994-1000, 173 Cal. Rptr. at 125-29 (applying the three unity approach in determining that Container Corp. and its foreign-based subsidiaries constituted a unitary business); Xerox Corp. v. Comptroller of the Treasury, 290 Md. 126, —, 428 A.2d 1208, 1215-16 (1981) (applying the three unity approach in determining whether the corporation's interest and royalty income constituted part of its unitary business).
113. See Crawford Mfg. Co. v. State Comm'n of Revenue & Taxation, 180 Kan. 352, —, 305 P.2d 504, 510 (1956) (stating that the essential test is "whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state."); Edison California Stores Inc., v. McColgan, 30 Cal. 2d 472, —, 183 P.2d 16, 20 (1947) (using the "dependent upon" test in conjunction with the three unity approach of Butler Bros.).
114. See notes 115-17 infra.
116. Comment, supra note 97, at 836.
117. Id.
118. Container Corp., 103 S. Ct. at 2947; see Commonwealth v. Advance Wilson Indus., Inc., 436 Pa. 200, —, 317 A.2d 642, 644-45 (1974) (requiring that there be interrelated business activities between divisions before they constitute part of a unitary business); Commonwealth v. ACF Indus., Inc., 441 Pa. 129, —, 271 A.2d 273, 280-81 (1970) (also requiring that the state show a flow of goods between different divisions before the Court will find that a unitary business exists).
business for state taxation purposes. This method has been crit-
icized on the ground that it allows intangible value, resulting from
in-state business activities, to escape state taxation.

If a business is found to be unitary, formula apportionment
under an applicable state statute is applied. Since the state ap-
portionment statutes are creatures of the individual state, they
may take different factors into consideration. For example, some
states determine the percentage of the unitary business' property,
payroll and sales located within their boundaries. The state
then uses this percentage to determine how much of the unitary
business' income is taxable in their state. It should be noted, however, that fair ap-
portionment and other constitutional considerations must be satisfied
by the state's apportionment statute.

A finding that a taxpayer's in-state and out-of-state activities
constitute a unitary business is only the threshold determination.
A state's finding that in-state and out-of-state activities are unitary
does not always bring about adverse tax consequences.

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1. See Container Corp., 103 S. Ct. at 2947 n.17 (stating that the substantial flow
   of goods is not federally required).
2. See McLure, Operational Interdependence Is Not the Appropriate “Bright
   Line Test” of a Unitary Business—At Least Not Now, 18 Tax Notes 107, 108-09
   (1983) (discussing the reasons states should not be required to adopt the bright line
   approach).
3. See note 98 and accompanying text supra.
5. States using the Uniform Division of Income for Tax Purposes Act consider
   all three factors; see Unif. Div. Of Income For Tax Purposes Act § 9, 7A U.L.A. 100
   (1978); see also note 12 supra (for a list of the twenty-three states which have
   adopted the Model Act). Some states which have not adopted the Model Act also
   take these three factors into consideration. See, e.g., Mass. Gen. Laws Ann. ch. 63,
   § 38 (West 1983); see W.R. Grace & Co. v. Commissioner, 378 Mass. 577, —,
   393 N.E.2d 330, 331 (1979) (stating that Massachusetts derives a foreign corporation's state
   income tax by basically utilizing the corporation's net income under the federal Inter-
   nal Revenue Code and applying it to a “three-factor formula based on a ratio of the
   local corporate property, payroll, and sales to such factors everywhere”).
   (1978), which states: “All business income shall be apportioned to this state by
   multiplying the income by a fraction, the numerator of which is the property factor
   plus the payroll factor plus the sales factor, and the denominator of which is three.”
   This section has been substantially adopted in twenty-three states. See note 12
   supra.
   Co. v. Bair, 437 U.S. at 271-81 (stating that Iowa's single factor formula is not per se
   invalid under the due process or commerce clause).
8. See notes 56-74 and accompanying text supra.
9. This is especially true if property, sales or labor costs are higher in the out-
of-state business or if the out-of-state business has suffered losses. See, e.g., Hon-
   olulu Oil Corp. v. Franchise Tax Bd., 60 Cal. 2d 417, —, 34 Cal. Rptr. 552, 553, 386 P.2d
ever, in the event that adverse consequences do result, the corpor-
rate taxpayer may challenge the tax by demonstrating with "clear
and cogent evidence," that the tax would violate the constitutional
requirement of fair apportionment.\textsuperscript{128}

\section*{Analysis}

The analysis of \textit{Container Corp.} will be subdivided into two
general areas. First, a brief sketch of the majority's discussion of
fair use will be presented. Particular attention will be placed on
the Court's treatment of evidence based on separate geographical
accounting. Second, the problem of multiple taxation of income
derived from foreign subsidiaries and its potential disabling effect
on foreign policy, under the California apportionment method, will
be discussed. The majority's and the dissent's analyses of multiple
taxation, and the foreign policy implications of each under the \textit{Japan Line} test, will be contrasted. The conclusion arrived at is that
the majority's refusal to find the California apportionment method
unconstitutional is reflective of the Court's reluctance to limit the
states ability to tax in the absence of decisive Congressional
action.

\section*{Fair Apportionment}

The federal due process clause requires that income attributed
to a corporation for taxation purposes must be rationally related to
the intrastate values of the enterprise.\textsuperscript{129} In \textit{Complete Auto},\textsuperscript{130} the
Court enunciated a four-part test and held that the state tax must
be "fairly apportioned."\textsuperscript{131} In California and other states which use
the unitary business approach and formula apportionment, there
always exists a relationship between the income attributed to the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{128}\textit{Container Corp.}, 103 S. Ct. at 2939-40 (quoting Exxon Corp. v. Department of Rev-
\textit{enue, 447 U.S. at 221; Butler Bros. v. McCollan, 315 U.S. at 507; Norfolk & W. Ry. v.
\textit{North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936)).}
\item \textsuperscript{129} See note 54 and accompanying text \textit{supra}.
\item \textsuperscript{130} \textit{Complete Auto}, 103 S. Ct. at 2939-40 (quoting Exxon Corp. v. Department of Rev-
\textit{enue, 447 U.S. at 221; Butler Bros. v. McCollan, 315 U.S. at 507; Norfolk & W. Ry. v.
\textit{North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936)).}
\item \textsuperscript{131} \textit{Complete Auto}, 103 S. Ct. at 2939-40 (quoting Exxon Corp. v. Department of Rev-
\textit{enue, 447 U.S. at 221; Butler Bros. v. McCollan, 315 U.S. at 507; Norfolk & W. Ry. v.
\textit{North Carolina ex rel. Maxwell, 297 U.S. 682, 688 (1936)).}
\end{itemize}
\end{footnotesize}
state for taxation purposes and the intrastate value of the business. The question remains whether this apportionment is necessarily fair.

In Container Corp. the appellant asserted that the California tax had failed to meet the constitutional requirement of fair apportionment. The corporation based its challenge on two related contentions. First, the corporation asserted that California's reliance on indirect measures of income, i.e., payroll, sales and property, distorts the true allocation of income between the corporation and its foreign subsidiaries, since the subsidiaries were significantly more profitable than the corporation. Second, the appellant asserted that since production costs in foreign countries are significantly lower than in the United States, the California tax "unfairly inflates the amount of income apportioned to the United States operations" where production costs are higher.

The Court rejected Container Corp.'s first contention which asserted that California's reliance on indirect measures of income distorted the true allocation of income. Container Corp. predicated this contention primarily on two types of evidence: the breakdown of the net income derived from sales and invested capital earned by Container Corp. as compared to its foreign subsidiaries, and the testimony of an expert witness. The net income evidence indicated that the corporation's foreign subsidiaries often averaged a higher percentage of net income from sales and invested capital than did the domestic business. This evidence was substantiated by further testimony from an expert witness who stated that the greater profitability of foreign subsidiaries undermined the basic premise of apportionment. The Court declined to consider this evidence, stating that "the profit figures

132. This results because of the use of the three factor formula which compares or relates in-state business activities with out-of-state business activities. See CAL. REV. & TAX. CODE § 25128 (West Supp. 1979); see also Container Corp., 103 S. Ct. at 2949 (stating that the three factor of payroll, property and sales are widely used and are acceptable because they reflect a large share of business activities which generate value).
133. Container Corp., 103 S. Ct. at 2939.
134. Id. at 2948.
135. Id. at 2949; citing Brief for Appellant at 12, Container Corp.
136. Container Corp., 103 S. Ct. at 2948-49. The Court stated that it had rejected a very similar argument in Mobil. Id. Container Corp. had maintained that Mobil could be distinguished from its case "because the Court assumed [in Mobil] that the payor subsidiaries were unitary with Mobil...[and] Mobil did not introduce evidence of distortion in the apportionment formula." Appellant's Brief at 10, Container Corp. of Am. v. Franchise Tax Bd., 103 S. Ct. 2933 (1983).
137. See Appellant's Brief at 12-14, Container Corp.
138. Id. at 18.
139. Id. at 14.
relied on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justified resort to formula apportionment in the first place.\textsuperscript{140}

Container Corp.'s second contention was that the substantial disparity in production costs between the corporation and its foreign subsidiaries unfairly inflated the income apportioned to the United States.\textsuperscript{141} The corporation submitted statistical evidence which displayed a marked difference of up to fourteen percent\textsuperscript{142} between wages paid in foreign countries and those paid in the United States; American workers were paid significantly higher wages.\textsuperscript{143} The corporation asserted that since California's apportionment formula utilized wages as a factor, the formula unfairly inflated the amount of income attributed to the United States, where wages are higher.\textsuperscript{144} The Court rejected this contention, stating that a fourteen percent distribution was not unfair.\textsuperscript{145} The Court acknowledged that there was a difference in wages between some of the countries in which the subsidiaries were based and the United States, but nevertheless rejected both of the contentions asserted by Container Corp.\textsuperscript{146} In responding in a general manner to Container Corp.'s allegations that the apportionment formula was unfair, the Court examined the underlying rationale behind the California apportionment formula and the various methods a state may use in taxing businesses. In so doing, the Court concluded that the three factor formula used by California is widely used because it reflects "a very large share of the activities by which value is generated."\textsuperscript{147} Finally, the Court looked at the methodology employed by Container Corp. and that employed by California. The Court, in rejecting the appellant's apportionment method, found the differences in value of taxable income attributable to California to be within "the margin of error inherent in any method of attributing income among the components of a unitary business."\textsuperscript{148}

The Court's summary dismissal of evidence based on separate geographical accounting introduced in \textit{Container Corp.} to demon-

\begin{itemize}
\item \textsuperscript{140} \textit{Container Corp.}, 103 S. Ct. at 2948.
\item \textsuperscript{141} \textit{Id.} at 2949.
\item \textsuperscript{142} \textit{Container Corp.}, 103 S. Ct. at 2950.
\item \textsuperscript{143} \textit{Id.}; see Appellant's Brief at 17, \textit{Container Corp.}
\item \textsuperscript{144} \textit{Container Corp.}, 103 S. Ct. at 2949; see also Appellant's Brief at 17, \textit{Container Corp.} (showing a comparison of wages in various countries).
\item \textsuperscript{145} \textit{Container Corp.}, 103 S. Ct. at 2950.
\item \textsuperscript{146} \textit{Id.} at 2948-49.
\item \textsuperscript{147} \textit{Id.} at 2949.
\item \textsuperscript{148} \textit{Id.} at 2950.
\end{itemize}
strate the unfairness of a state tax,\textsuperscript{149} reflects a trend. An examination of the Court's treatment of separate geographical accounting\textsuperscript{150} in preceding cases illustrates this trend. Until \textit{Container Corp.}, the Court had never dismissed, so quickly, evidence based on separate geographical accounting introduced to show the unfairness of a state's taxation method.\textsuperscript{151}

In \textit{Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell},\textsuperscript{152} a taxpayer successfully demonstrated that a North Carolina tax was unfair through the use of evidence based on separate geographical accounting.\textsuperscript{153} Later, in \textit{Bulter Bros. v. McColgan}\textsuperscript{154} the Court allowed a taxpayer to introduce separate accounting evidence but discounted such evidence inasmuch as it did not "impeach the validity or propriety of the formula" applied by the state.\textsuperscript{155} In \textit{Moorman Manufacturing Co. v. Bair},\textsuperscript{156} an interstate corporation challenged the Iowa tax formula\textsuperscript{157} utilized to apportion the business' income for state tax purposes.\textsuperscript{158} Although the corporate taxpayer did not utilize separate geographical accounting data, the \textit{Moorman} Court appeared to indicate that a taxpayer could use a separate accounting analysis to prove that a state apportionment method was unfair.\textsuperscript{159}

In \textit{Exxon Corp. v. Dept of Revenue},\textsuperscript{160} however, when a taxpayer attempted to rely on the \textit{Moorman} dicta to prove that Wisconsin had not fairly apportioned its tax, the Court limited its earlier statement.\textsuperscript{161} The Court held that, although separate geographical accounting may be helpful, it is no sense conclusive as to

\begin{itemize}
  \item\textsuperscript{149} \textit{Id.} at 2948-49.
  \item\textsuperscript{150} See notes 83 and 84 and accompanying text \textit{supra} (providing an overview of what constitutes separate geographic accounting).
  \item\textsuperscript{151} \textit{See generally} notes 151-59 and accompanying text \textit{infra}. Although the Court had rejected evidence based on separate geographical accounting in \textit{Mobil}, it has been introduced to attack the state's tax base rather than the fairness of Vermont's apportionment formula. \textit{Mobil Oil Corp. v. Commissioner}, 445 U.S. at 436-38.
  \item\textsuperscript{152} 283 U.S. 123 (1931).
  \item\textsuperscript{153} \textit{Hans Rees' Sons}, 283 U.S. at 126-27 (the Court examined the value and income attributed by the taxpayer to various branches of the taxpayer's business enterprises).
  \item\textsuperscript{154} 315 U.S. 501 (1942).
  \item\textsuperscript{155} \textit{Id.} at 508.
  \item\textsuperscript{156} 437 U.S. 267 (1978).
  \item\textsuperscript{157} \textit{See} note 125 \textit{supra}.
  \item\textsuperscript{158} \textit{Moorman}, 437 U.S. at 271-72.
  \item\textsuperscript{159} \textit{Id.} at 272, 275 n.9 (stating that "the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations." \textit{Id.} at 272).
  \item\textsuperscript{160} 447 U.S. 207 (1980).
  \item\textsuperscript{161} \textit{Exxon Corp. v. Department of Revenue}, 447 U.S. at 221-23.
\end{itemize}
whether a state tax is unfair.\textsuperscript{162} Thus, the Court has consistently limited the weight, although not the admissability, of separate geographical analysis data.

It currently appears that the Court will not place much emphasis on evidence derived from separate accounting when determining the fairness of a state's apportionment formula.\textsuperscript{163} This type of evidence, however, probably should be considered more heavily by the Court in cases which involve multinational, rather than multi-state, corporations. As the statistical evidence in \textit{Container Corp.} indicates, variations in wages and other production factors in foreign countries may result in distortions in state apportionment formulas.\textsuperscript{164} Since evidence based on separate geographical accounting appears to be supported by independent statistical evidence, such evidence may well be indicative of real variations in the costs of production from country to country, and consequently should be considered by the Court.

Although Container Corp. managed to show a fourteen percent distortion in the application of the California apportionment formula, its independent statistical evidence dealt solely with payroll variances between California and the foreign countries in which its subsidiaries were located.\textsuperscript{165} Other multinational corporations may be able to show even greater distortions under similar apportionment formulas. Since the potential for even greater deviations does exist, the Court will be faced with similar challenges. This leaves open one important question—the amount of distortion a corporation must show to render a state apportionment formula unfair.\textsuperscript{166}

\textit{The Application of the Japan Line Test}

Container Corp. raised two additional constitutional challenges to California's franchise tax, both based on alleged violations of the foreign commerce clause. First, the corporation alleged that the state tax imposed a constitutionally prohibited double tax on its income from foreign subsidiaries.\textsuperscript{167} Second, Container Corp. claimed that California and other states which use

\begin{itemize}
\item \textsuperscript{162} Id. at 223.
\item \textsuperscript{163} See \textit{Container Corp.}, 103 S. Ct. at 2948-49.
\item \textsuperscript{164} See id. at 2949, see also Appellant's Brief at 12-18, \textit{Container Corp.}
\item \textsuperscript{165} \textit{Container Corp.}, 103 S. Ct. at 2949-50.
\item \textsuperscript{166} The Court in \textit{Container Corp.} interpreted the \textit{Hans Rees' Sons} Court to hold that a two-hundred fifty percent distortion violated the constitutional requirement of fair apportionment. \textit{Container Corp.}, 103 S. Ct. at 2949-50.
\item \textsuperscript{167} See Appellant's Brief at 21, \textit{Container Corp.}; see also \textit{Container Corp.}, 103 S. Ct. at 2951-55.
\end{itemize}
similar apportionment methods interfered with the federal government's ability to speak in one voice with regard to foreign policy.\textsuperscript{168}

Container Corp. asserted that California's apportionment method resulted in double taxation of income earned in other countries by its foreign subsidiaries.\textsuperscript{169} The Court conceded that this was indeed the case.\textsuperscript{170} The issue of double taxation was also addressed in \textit{Japan Line, Ltd. v. County of Los Angeles}.\textsuperscript{171} However, the majority in \textit{Container Corp.} distinguished the double taxation that occurred in that case from the constitutionally repugnant double taxation in \textit{Japan Line}.\textsuperscript{172}

In \textit{Japan Line}, a California tax on cargo containers resulted in multiple taxation, which the Court found unconstitutional.\textsuperscript{173} The Court distinguished between instrumentalities of interstate commerce and instrumentalities of foreign commerce for purposes of determining the validity of state apportionment formulas.\textsuperscript{174} Noting that instrumentalities of foreign commerce are exposed to additional risks of multiple taxation, the Court stated that the commerce clause forbade such a double taxation burden.\textsuperscript{175} In \textit{Container Corp.}, the majority seemed to clarify its earlier holding. Instead of finding double taxation unconstitutional by its mere existence, the majority invoked an intermediate "close scrutiny" standard, and considered the "context in which the double taxation [took] place and the alternatives reasonably available to the taxing State."\textsuperscript{176}

\begin{thebibliography}{9}
\item \textsuperscript{168} See Appellant's Brief at 27, \textit{Container Corp.}; see also \textit{Container Corp.}, 103 S. Ct. at 2955-57.
\item \textsuperscript{169} See note 167 supra.
\item \textsuperscript{170} \textit{Container Corp.}, 103 S. Ct. at 2951. The Court stated that: the tax imposed here, like the tax imposed in \textit{Japan Line}, has resulted in actual double taxation, in the sense that some of the income taxed without apportionment by foreign nations as attributable to appellant's foreign subsidiaries was also taxed by California as attributable to the State's share of the total income of the unitary business of which those subsidiaries are a part.
\item \textit{Id.}
\item \textsuperscript{171} 441 U.S. 434, 446-47 (1979); see also note 70 supra.
\item \textsuperscript{172} \textit{Container Corp.}, 103 S. Ct. at 2952 (distinguishing \textit{Container Corp.} from \textit{Japan Line} in three ways: first, the tax involved in \textit{Container Corp.} was on income, not property; second, the majority asserted that the double tax in \textit{Container Corp.} was not an inevitable result of the state taxing scheme; third, \textit{Container Corp.} was a domestic, rather than foreign corporation).
\item \textsuperscript{173} \textit{Japan Line}, 441 U.S. at 453-54.
\item \textsuperscript{174} \textit{Id.} at 445-46 (stating that when dealing with instrumentalities of foreign commerce "a more extensive constitutional inquiry is required." \textit{Id.} at 446).
\item \textsuperscript{175} \textit{Id.} at 447-48.
\item \textsuperscript{176} \textit{Container Corp.}, 103 S. Ct. at 2953. \textit{Contra Container Corp.}, 103 S. Ct. at 2957 (the dissent stated that "the Court fails to apply 'close scrutiny' in a manner that meets the requirements of that exacting standard of review.").
\end{thebibliography}
The majority in *Container Corp.* restated and reanalyzed the potential tax alternatives available to California.\(^{177}\) These alternatives included prohibiting the states from taxing *Container Corp.*'s income, or requiring the states to use arm's-length approach.\(^{178}\) The Court unequivocally dismissed the first alternative which prohibited taxation of the corporation's income.\(^{179}\) However, the Court went through a somewhat detailed analysis of the arm's-length approach.\(^{180}\) The majority concluded that use of such a method would not guarantee an end to double taxation, since there is no uniform version of the arm's-length approach in the international community.\(^{181}\) Consequently, in the absence of reasonable alternatives, the finding of double taxation does not necessarily make the tax unconstitutional.\(^{182}\)

The dissent in *Container Corp.* rejected the majority's analysis, claiming that the majority failed to recognize the fundamental differences between the actual double taxation which results from California's use of its apportionment formula, and the risk of double taxation under the arm's-length approach.\(^{183}\) The dissent stated that under California's present franchise tax, double taxation was inevitable.\(^{184}\) The dissenters pointed out, however, that although no uniform system of arm's-length taxation currently exists in application, these differences could be resolved by international negotiation.\(^{185}\) Consequently, whereas the California apportionment formula inevitably results in double taxation, the arm's-length approach would only potentially result in double taxation.

\(^{177}\) *Id.* at 2953-55.

\(^{178}\) *Container Corp.*, 103 S. Ct. at 2953.

\(^{179}\) *Id.* The Court stated that the obvious unfairness of such an outcome needed no further elaboration. It should be noted that no one had suggested this alternative. This leaves open the question of whether more reasonable alternatives, other than no taxation or forcing the states to adopt the arm's-length approach, would be considered by the Court.

\(^{180}\) *Id.*

\(^{181}\) *Id.* at 2955.

\(^{182}\) *Id.*

\(^{183}\) *Id.* at 2959.

\(^{184}\) *Id.* at 2958-59. The dissent concluded that:

On its face, the present double taxation violates the Foreign Commerce Clause. I would not reject, as the Court does, the solution to this constitutional violation simply because an international system based on the principle of uniformity would not necessarily be uniform in all the details of its operation.

*Id.* at 2959.

\(^{185}\) *Id.* at 2958-59 (the dissent stated that although differences may currently exist in applications of the arm's-length approach, they are not inherent in the system and that "as international practice becomes more refined, such differences are more likely to be resolved and double taxation eliminated." *Id.* at 2959).
Container Corp. also contended that the California apportionment formula, as applied to itself and other multinational corporations, prohibited the federal government from speaking in one voice with regard to foreign policy. The majority stated that there were two ways to violate the one voice standard. First, the one voice standard is violated if a state's action "implicates foreign policy issues which must be left to the Federal Government." Second, the standard is not met when a state's actions are contrary to a "clear federal directive."

The majority examined three factors to determine whether the California apportionment formula violated the one voice standard by implicating foreign policy issues which must be left to the federal government. First, the majority examined the state tax to determine whether it created "automatic 'asymmetry.'" The majority stated that the California apportionment formula in Container Corp., unlike that in Japan Line, did not create automatic asymmetry in international operations. Second, the majority looked at the nationality of the corporation. Upon examination of Container Corp., the majority found that it was a domestic corporation, owned by national interests. Finally, the majority looked at the California apportionment formula and the California tax rate, commenting that Container Corp. was

186. Appellant's Brief at 27, Container Corp.
188. Id.
189. Id. at 2955-56. These three factors were examined to determine if "the tax imposed by California might justifiably lead to significant foreign retaliation." Id. at 2955.
190. Id. at 2955. The Court provided an example of what constitutes automatic asymmetry in Japan Line Ltd. v. County of Los Angeles, 441 U.S. 443 (1979). In finding automatic "asymmetry" in Japan Line, the Court had noted that Japan did not tax American-owned containers but that the state of California taxed Japanese-owned containers thus creating "an asymmetry in international maritime taxation operating to Japan's disadvantage." Japan Line, 441 U.S. at 453.
191. Container Corp., 103 S. Ct. at 2955 (stating that the California taxing scheme in Container Corp. did not inevitably result in double taxation, thus distinguishing it from Japan Line. Id. at 2952).
192. Id. at 2955-56.
193. Id.
194. See id. at 2956 n.32. The majority stated that:
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.
195. Id. at 2956. See also notes 12-16 and 123 and accompanying text supra (describing how the California apportionment formula works).
"without a doubt amenable to be taxed in California in one way or another, and that the amount of tax it [the corporation] pays is much more the function of California's tax rate than of its allocation method." 196

Since the California state tax did not violate the one voice standard by implicating foreign policy issues that must be left to the federal government, the majority looked to see if there had been interference with specific instructions of congressional intent. 197 Noting first that no federal statute regulated this area, the majority examined various treaties the federal government had entered into with foreign nations regarding taxation of international commerce. 198 None of these treaties specifically prohibited states from using the apportionment method to determine the tax of a multinational corporation. 199 After again commenting that Congress had never enacted legislation prohibiting this method of state taxation, the majority concluded that the tax was constitutional. 200

The dissent in Container Corp., however, concluded that California's tax plan violated the one voice standard "because it seriously 'implicates foreign policy issues which must be left to the Federal Government.'" 201 The dissent first suggested that foreign governments have legitimate grounds to complain about the multiple taxation which occurs under the state apportionment formula, because this tax has the potential impact of discouraging American investment in foreign countries. 202 Second, the dissent noted that this tax not only affects domestic corporations, but also foreign corporations which conduct business in the United States. To support its conclusion, the dissent pointed to a bill in Congress and to a Solicitor General's Brief, 204 filed in another case, which expressed the government's desire to prohibit this type of state tax

196. Container Corp., 103 S. Ct. at 2956.
197. Id.
198. Id.
199. See id.
200. Id. at 2957. The Court also noted that the executive branch had not filed an amicus brief in opposition to the California tax. Id. at 2956. The majority, after mentioning a brief filed by the Solicitor General in Chicago Bridge & Iron Co., stated that they had no reason to believe that that amicus brief still represented the government's views. Id. at 2956 n.33. But cf. Amicus Curiae Brief for the United States at 7-8 n.3, Chicago Bridge & Iron Co. (seeming to indicate that the amicus brief filed by the Solicitor General in Chicago Bridge & Iron Co. should also be considered in Container Corp.).
201. Container Corp. at 2999 (enunciating a principle set forth in Japan Line).
202. Id.
203. Id. at 2959-60. H.R. 2918, 98th Cong., 1st Sess., 129 CONG. REC. 2697 (1983); See note 95 supra.
204. Id. at 2961 n.8.
on multinational corporations.\textsuperscript{205}

The dissent's proposed resolution of the problems of double taxation and state interference with the one voice standard, would force the states to adopt an "arm's-length" approach.\textsuperscript{206} At first glance, the dissent's proposed solution seems more compelling than the majority's position. Such a resolution would, in effect, eliminate the potential distortions in state apportionment formulas,\textsuperscript{207} lessen the probability of double or multiple taxation of foreign-earned income,\textsuperscript{208} and appease foreign governments.\textsuperscript{209} Furthermore, it would allow the federal government to speak in one voice with regard to foreign policy.\textsuperscript{210} Not only are multinational corporations unhappy with the resulting multiple taxation of foreign-earned income, but foreign governments have expressed dissatisfaction with the state taxation methods currently in use.\textsuperscript{211} However, the multiplicity of problems the states would encounter if forced to adopt the arm's-length method makes the majority's approach more practical.\textsuperscript{212}

\textbf{CONCLUSION}

In the wake of the Supreme Court's decision in 	extit{Container Corp. of America v. Franchise Tax Board}, it appears that corporations challenging the fairness of state apportionment formulas can no longer rely on evidence based on separate geographical accounting. Instead, the Court will look to evidence based on independent statistical data, and even then any distortions must be gross. The Court's deemphasis of evidence based on separate geo-

\textsuperscript{205} Amicus Curiae Brief for the United States at 2-3, Chicago Bridge & Iron Co. See note 199 supra.

\textsuperscript{206} See Container Corp., 103 S. Ct. at 2959, see also notes 85-96 and accompanying text supra (explaining the arm's-length approach).

\textsuperscript{207} The distortions would be eliminated since the unitary business-apportionment formula would no longer be used.

\textsuperscript{208} Container Corp., 103 S. Ct. at 2958-59.

\textsuperscript{209} See Amicus Curiae Brief for the United States at 2a-9a, Chicago Bridge & Iron Co. (letters from various governments have indicated their dissatisfaction with current state taxation schemes and their desire that states adopt the arm's-length approach).

\textsuperscript{210} See Container Corp., 103 S. Ct. at 2961.

\textsuperscript{211} See notes 209 supra.

\textsuperscript{212} These problems include: the assumption of an arm's-length relationship which in fact does not exist; the difficulty and complexity of use with such a system in light of the revenue involved; and the potential for subtle methods of market manipulation resulting in the states' loss of revenue; see notes 90-93 and accompanying text supra. See also Comment, supra note 91, at 509 (the author concludes that it would be unwise to force the states to adopt the arm's-length approach); Human, supra note 74, at 533 (the author concludes that forcing the states to adopt the arm's-length approach would result in "nowhere income").
graphical accounting is unfortunate, since when dealing with multinational corporations, such evidence is supported, rather than undermined, by independent statistical evidence.

Congressional inaction appears to be one of the best explanations of the majority's reluctance in Container Corp. to find the California apportionment method unconstitutional as applied to multinational corporations. In light of the problems of implementation and application, the majority's refusal to force the states to adopt the arm's-length approach is practical. Furthermore, such a dramatic change in state taxation schemes would seem to be more within the domain of the legislature rather than the judiciary.

It must be noted that the majority limited its holding to the constitutionality of state apportionment methods as applied to domestic multinational corporations which are owned by national interests. This leaves open the question of how the Court will deal with cases involving multinational corporations, rather than domestic corporations, which are owned by foreign rather than national interests. Such challenges already appear to be on the horizon.213

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