Victory for a World Parish: Analysis and Criticism of Barclays Bank v. Franchise Tax Board of California

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Introduction

On June 20, 1994, the Supreme Court declared an end to the long-standing dispute between foreign multinational corporations and the state of California. California won.\textsuperscript{1} Since the early 1970s, California has taxed multinational corporations\textsuperscript{2} using a tax scheme known as the worldwide combined reporting (WWCR) method.\textsuperscript{3} This method of taxation has "provoked sharp criticism from all [the United States] major trading partners."\textsuperscript{4} Barclays challenged the constitutionality of the unitary method because California and a handful of other states were the only taxing jurisdictions

\footnote{1}{Barclays Bank v. Franchise Tax Bd. of Cal., 114 S. Ct. 2268 (1994). The scope of this Note is limited to the Barclays portion of the case. In the Supreme Court, Barclays was combined with Colgate-Palmolive Co. v. Franchise Tax Bd. of Cal., No. 92-1839. Barclays involved the constitutionality of California's corporate tax scheme as applied to a foreign corporation with either a foreign parent or foreign subsidiaries and to a domestic corporation with a foreign parent. This question was specifically left open in Container Corp. of Am. v. Franchise Tax Bd. of Cal., 463 U.S. 159, 189 n.26 (1983). The Colgate case involved the same factual situation challenged in Container Corp.—a domestic parent with foreign subsidiaries. Therefore, this Note will not include an analysis of Colgate.}

\footnote{2}{The term multinational is used in this Note to denote any corporation with operations in more than one country. The concept of corporate operations extends to corporate subsidiaries and affiliated corporations. Thus, multinational refers to the family of related affiliated and subsidiary corporations of a parent corporation.}

\footnote{3}{The dispute in Barclays revolves around the application of worldwide combined reporting to a subgroup of multinationals: "domestic corporations with foreign parents . . . [and] . . . foreign corporations with either foreign parents or foreign subsidiaries." Barclays, 114 S. Ct. at 2271 (quoting Container Corp., 463 U.S. at 189 n.26). The terms "domestic" and "foreign" refer to the country of incorporation or residence.}


\footnote{29}{CORNL INT'L L.J. 607 (1996)}
in the world to apply this controversial system to multinationals.\(^5\)

Although Barclays is a U.S. Supreme Court decision, it only affects foreign companies.\(^6\) Even without regard to the recent litigation, California's tax scheme is of international significance for two reasons. First, the California tax is considered a "source of instability in the international tax environment"\(^7\) because it threatens international tax standards. Second, many multinational corporations have a presence in California since California's economy is "larger than most nations of the world."\(^8\) Although numerous foreign countries have vigorously opposed California's scheme through economic, political, and judicial action,\(^9\) the protest has been fruitless.

California should not have won in Barclays. The Supreme Court did not adequately address the international concerns implicated in Barclays. California's tax scheme often results in double taxation by reaching profits earned by foreign multinationals in foreign countries, profits which are already taxed by foreign jurisdictions.\(^10\) Both the companies and their governments find this practice offensive.\(^11\) Thus, California's tax practice creates substantial waves in foreign policy and international economics. The Supreme Court in Barclays sanctioned California's foray into international relations. The Court ignored the crucial distinction between foreign ownership of a multinational, as in Barclays,\(^12\) and domestic ownership of a multinational, as in Container Corp.\(^13\)

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\(^5\) See Brief for Barclays Bank, Petitioner at 6, Barclays (No. 92-1384). The separate accounting method is "universally used" by other nations of the world. Id. at 5-6. See infra note 216. As of 1984, twelve states applied some version of WWCRI REGAN, supra note 3, § 1.

\(^6\) Barclays, 114 S. Ct. at 2271.


\(^9\) Countries involved as amici in the Barclays litigation included the United Kingdom, Brief for the Government of the United Kingdom as Amicus Curiae, Barclays (No. 92-1384), the United States, Brief for the United States as Amicus Curiae, Barclays (No. 92-1384), Australia, Austria, Canada, Finland, Japan, Norway, Sweden, Switzerland, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain, Brief of the Members States of the European Communities and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland as Amici Curiae, Barclays (No. 92-1384).

\(^10\) Common practice dictates that the country of corporate residence has the power to tax all corporate profits. Thus, if a company is located in several jurisdictions, the jurisdiction of residence has the right to tax all corporate income. The other countries in which the company operates will have the right to tax only the income generated within their jurisdiction. OGLEY, supra note 7, at 31. California's tax is offensive because it often results in California taxing more than the world-accepted amount of California source income.


\(^12\) 114 S. Ct. 2268.

\(^13\) 463 U.S. 164.
This Note criticizes the Barclays decision. Part I explores the history of the tax controversy and explains California's taxing scheme, including recent legislative developments. Part II analyzes Barclays' arguments to the Supreme Court and discusses the international reaction to the decision. Part III criticizes the Supreme Court's decision and argues that the unique international nature of California's tax and the global nature of commerce demand a different result.

I. WWCR Tax History

A. Background to the WWCR Controversy

The historical roots of WWCR extend back to the 1870s. The precursors to WWCR first arose in the area of property taxation of railroads. Taxing jurisdictions needed a scheme to divide the value of a taxpaying entity among the jurisdictions in which the taxpayer operated. Their solution was the percentage apportionment method. For example, Illinois adopted a state railroad tax in 1872 that "attributed the tax to each county, city or town by reference to the length of track within the locality, compared with the total length of track." Later, when states began to institute state corporate income taxes, they extended apportionment from property taxes to state income taxes. For corporations earning income in multiple taxing jurisdictions, apportionment was suited to determining how much income should be taxed by each jurisdiction. The apportionment method for income tax assigned a percentage of the corporate income to that state based upon the ratio of the corporation's in-state activities to the corporation's entire activities.

The development of the WWCR method also involved a separate concept known as "combined business." While apportionment determines

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15. Ogley, supra note 7, at 170.
16. Id.
17. Miller, supra note 14, at 132.
18. Ogley, supra note 7, at 170.
20. Regan, supra note 3, § 1.
21. See Donald J.S. Brean, INTERNATIONAL ISSUES IN TAXATION: THE CANADIAN PERSPECTIVE 121 (1984). A state that uses the percentage apportionment method determines the amount of income to be apportioned to that state. The amount to be apportioned is a percentage of the corporation's total income. The applicable percentage is determined by formula. The formula consists of some combination of percentage apportionment factors. The typical apportionment factors are the ratio of in-state sales to total sales, in-state payroll to total payroll, and in-state aggregate property value to total aggregate property value. Id.
22. The combined business concept must be distinguished from the consolidated return. The consolidated return is a part of the U.S. federal income tax law which allows certain related corporations to be treated as a single taxpayer for purposes of filing one return. The combined business concept is used simply to determine the tax base of each
what percentage of the tax base the state is eligible to tax, the combined business concept determines the total tax base. The combined business concept looks beyond traditional corporate boundaries and groups together the incomes of corporations related by the factual existence of unity of operation, management, and ownership. As a result, the aggregation of the incomes of many related corporations determines the income tax base of a single member of the group. Thus, when combined reporting is joined with apportionment formulas, a percentage of the combined group's total income is consequently assigned as the taxable income of each member of the combined group operating in the taxing state.

Combined reporting originated in California during the 1930s. The paradigm situation consisted of a motion picture company in California which produced movies in California but transferred the finished films to a related out-of-state corporation for distribution. Prior to combined reporting, this practice allowed a corporation to avoid subjecting its distribution income to California income tax. The production costs were located in California, but the chief source of revenue, movie distribution, was moved outside California. California responded with the combined report, which enabled it to cross traditional corporate boundaries and add out-of-state distribution income to the in-state income to create a combined tax base. California then applied apportionment to the combined unitary tax base to determine the amount of the combined income attributable to California.

With the growth of international trade, "it required only a small step for . . . [California] to extend this basis of taxation to apply to the worldwide profits of multinational companies." During the 1960s, California began to apply combined reporting to groups of related corporations with worldwide operations to create worldwide corporate groups. Then, in the early 1970s, California instituted WWCR as its rule and allowed the separate accounting method only as a rare exception. The Barclays litiga-
tion, involving the 1977 tax year, arose in this era.  

B. History of Barclays

1. Prior WWCR Litigation

Barclays is the most recent in a long line of Supreme Court cases litigating aspects of the WWCR method of taxation. Barclays descends directly from the Supreme Court case Container Corp. of America v. Franchise Tax Board. Container Corp. litigated Due Process and Commerce Clause issues raised by California's WWCR scheme as applied to a domestic multinational corporation.

The plaintiff in Container Corp., Container Corporation of America (Container), was a domestic manufacturer of paper products headquartered in Illinois and incorporated in Delaware. Container was an affiliate of Mobil Oil Corporation and had twenty foreign subsidiaries in Latin America also engaged in the manufacture of paper products. Thus, Container was a U.S. domestic corporation with foreign subsidiaries.
Container's California state tax return included its own income, but did not include the income of any of its affiliates.\textsuperscript{40} California audited Container and concluded that, because Container and its twenty foreign subsidiaries were a unitary business, Container's tax liability was greater than it had reported.\textsuperscript{41}

Container's challenge to the assessment was unsuccessful in the lower state courts\textsuperscript{42} and it appealed to the U.S. Supreme Court.\textsuperscript{43} Three issues were challenged in the Supreme Court: first, whether Container and its subsidiaries comprised a unitary business;\textsuperscript{44} second, whether application of WWCR to a domestic multinational violated the constitutional requirement of fair apportionment;\textsuperscript{45} and third, whether California was required by the Foreign Commerce Clause of the U.S. Constitution to use separate accounting.\textsuperscript{46}

The Supreme Court ruled against Container on all three issues, finding that Container and its foreign subsidiaries comprised a unitary business.\textsuperscript{47} The Supreme Court held that, as applied to a domestic multinational, WWCR results in fair apportionment.\textsuperscript{48} The fair apportionment standard arises out of both the Due Process Clause and the Commerce Clause of the U.S. Constitution.\textsuperscript{49} According to the Court, a tax would not meet the standard of fair apportionment if first, "the income attributed to the state is in fact 'out of all appropriate proportions to the business transacted ... in that state,'"\textsuperscript{50} and, second, that the apportionment "has 'led to a grossly distorted result.'"\textsuperscript{51} Container argued that, because its foreign subsidiaries were far more profitable than its California operations, the WWCR method assigned a disproportionate share of its

\textsuperscript{40}. \textit{Id.} at 174
\textsuperscript{41}. \textit{Id.} at 175. Container's parent, Mobil Oil, was evidently not included in Container's unitary group since Mobil Oil is not "engaged in the same line of business" as Container. \textit{Id.} at 178. Mobil is an oil company while Container is a producer of paper products.
\textsuperscript{43}. \textit{Id.}, \textit{prob. juris. noted}, 456 U.S. 960 (1982).
\textsuperscript{44}. \textit{Container Corp.}, 463 U.S. at 163.
\textsuperscript{45}. \textit{Id.}
\textsuperscript{46}. \textit{Id.} The Foreign Commerce Clause is the same constitutional clause as the Commerce Clause. \textit{U.S. Const. art. I, § 8}. Taxation of foreign commerce, however, creates additional concerns and requires a more stringent analysis. The Foreign Commerce Clause states that "[t]he Congress shall have power . . . to regulate commerce with foreign Nations." \textit{Id.} \textit{See infra} notes 57-64 and accompanying text.
\textsuperscript{47}. \textit{Container Corp.}, 463 U.S. at 180. This Note will not pursue the unitary business issue. Barclays conceded that it fit into California's definition of a unitary business. \textit{Barclays}, 114 S. Ct. at 2276. Rather, Barclays challenged the way California taxed what it defined as a unitary business.
\textsuperscript{48}. \textit{Container Corp.}, 463 U.S. at 185.
\textsuperscript{49}. \textit{U.S. Const. amend. XIV, § 1}; \textit{U.S. Const. art. I, § 8}. The Court does not elaborate on how the fair apportionment standard arises out of these clauses. \textit{Container Corp.}, 463 U.S. at 170.
\textsuperscript{50}. \textit{Container Corp.}, 463 U.S. at 170.
\textsuperscript{51}. \textit{Id.}
income to California, resulting in a fourteen percent increase in its California tax liability. The Supreme Court held that these consequences did not violate the fair apportionment standard. The Court reasoned that the theoretical underpinnings of WWCR reject the notion of a geographical profit, but instead support the notion that "profitability arise[s] from the operation of the business as a whole." Although WWCR did assign greater income to California, the Court found it to be fair because it accounted for income arising from "economies of scale." The additional fourteen percent tax liability arising under WWCR was deemed not to be a grossly disproportionate result. The Court noted that fourteen percent was a "far cry" from the 250% difference in a case which failed the gross disproportion test.

The Court then addressed the third issue—whether the Foreign Commerce Clause required California to use separate accounting. Because the unitary group in Container Corp. included twenty foreign subsidiaries, the international effects of California's tax required scrutiny under the Foreign Commerce Clause. Japan Line Ltd. v. County of L.A. established a two-pronged test for applying the Foreign Commerce Clause to a state tax scheme. A tax violates this clause if the state tax either "creates a substantial risk of international multiple taxation," or "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" The first prong addresses the concern that enforcing the fair apportionment requirement in foreign commerce is more difficult because there is no court "capable of ensuring that

52. Id. at 182. This is because the California tax system allocated profit from a foreign jurisdiction to California.
53. Id. at 184.
54. Id. at 181 (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980)).
55. Id.
58. Japan Line Ltd. v. County of L.A., 441 U.S. 434, 451 (1979). Japan Line involved a property tax by Los Angeles County on international shipping containers that passed through the port of Los Angeles. The shipping containers were foreign-owned, and the foreign states levied their own property tax. The county tax was fairly apportioned and nondiscriminatory. The Supreme Court, however, found the tax unconstitutional under the Foreign Commerce Clause. The tax produced double taxation since the containers were taxed by both Los Angeles County and the foreign nation. At 452. The tax also frustrated a federal policy, evidenced in a treaty, of a uniform treatment of taxes on containers.
59. Id. at 451.
60. Id. (internal citation omitted). The policy underlying the one voice test is whether "the taxation of foreign commerce may necessitate a uniform national rule." Id. at 449. Hence, the term one voice arises from the question of whether the United States needs to project a single policy to the world rather than each state declaring its own policy willy-nilly. The basic operation of the one voice test of the Foreign Commerce Clause is to invalidate conflicting state policies in areas where federal uniformity is essential. Issues of international trade which implicate foreign affairs are matters in which federal uniformity is necessary. Container Corp., 463 U.S. at 194.
the aggregation of taxes is computed on no more than one full value."61 Because "foreign commerce is pre-eminently a matter of national [rather than state] concern,"62 the second prong focuses on foreign policy. State taxes on international companies risk foreign policy problems such as "international disputes"63 and "foreign . . . retali[ation]."64

The Supreme Court found no Foreign Commerce Clause violation in Container Corp. It distinguished Japan Line on several grounds: first, Container Corp. was an income tax case while Japan Line involved a property tax; second, in Container Corp., the Court found that double taxation was inevitable under any alternative California income tax scheme while the double tax in Japan Line could have been avoided if the taxing authority had abandoned its unjustified tax; finally, the tax in Container Corp. fell on a domestic corporation rather than on a foreign corporation as in Japan Line.65 Because there was no enhanced risk of multiple taxation, the first prong was not violated. The Court reasoned that there was no way to avoid double taxation of income since separate accounting66 "would not by any means guarantee an end to double taxation."67 The other available method to avoid double taxation would have been for California not to tax any of Container's income.68 In response to this option, the Supreme Court stated that "its obvious unfairness requires no elaboration."69 Finding no reasonable alternative, the Court found no violation of the first prong of the Foreign Commerce Clause.70

The Supreme Court also found no violation of the second prong. A state tax must implicate foreign affairs rather than merely having a "foreign resonance" to violate the second prong.71 Such foreign policy implication of a state tax would include "the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole."72 Foreign retaliation was unlikely in Container Corp. because the tax in Container Corp. was imposed on a domestic corporation, rather than on a foreign corporation as in Japan Line.73 Thus, the second prong was not violated.

62. Id. at 448.
63. Id. at 450.
64. Id.
66. See infra note 216 and accompanying text.
68. Id. at 187-88.
69. Id. at 190.
70. "[It would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation in favor of another allocation method that also sometimes results in double taxation."
71. Id. at 194.
72. Id.
73. Id. at 195.
2. Barclays Lower Court History

The *Container Corp.* Court upheld the California tax as applied to a domestic multinational but stated that there was "no need to address . . . the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." 74 Barclays challenged this issue. The two plaintiffs in *Barclays* were Barclays Bank International, a United Kingdom company, and Barclays Bank of California, a company incorporated in California but wholly owned by Barclays Bank International. 75 Barclays Bank International was a wholly-owned subsidiary of Barclays Bank Limited, a United Kingdom corporation, and the ultimate parent corporation. 76

*Barclays* reached the Supreme Court by way of California's state court system. 77 The actual dispute between the two Barclays affiliates and the California Franchise Tax Board began when Barclays Bank International and Barclays Bank of California filed their respective 1977 tax returns. Barclays Bank of California's return included only its domestic income; it did not include itself as part of any unitary group. 78 Barclays Bank International's return included its income and the income of a group consisting of itself and its subsidiaries but excluding its parent corporation and its other affiliates. 79 The California Franchise Tax Board audited both returns and determined that both Barclays Bank International and Barclays Bank of California were part of a worldwide unitary group, the Barclays Group, consisting of 220 corporations. 80 Using its WWCR methodology, California assessed Barclays Bank International and Barclays Bank of California an additional $4,076 and $254,699 in liability respectively. 81 Administrative proceedings subsequently reduced the additional liability to $1,678 and $152,420. 82 Barclays Bank International and Barclays Bank of California paid these assessments and filed suit for a refund in California Superior Court. 83

Barclays based its trial court claim on the Commerce and Due Process Clauses of the U.S. Constitution. 84 Barclays argued that foreign corpora-

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74. Id. at 189 n.26.
75. Petitioner's Brief at 2, *Barclays* (No. 92-1384).
76. Id. Barclays Bank Limited, the ultimate parent during the tax year in issue, 1977, later changed to Barclays Bank PLC. This is the entity that pursued the litigation in the Supreme Court as the successor in interest. Barclays Bank PLC is now a wholly-owned subsidiary of Barclays PLC. Id. at 5.
77. *Barclays*, 114 S. Ct. at 2272.
78. Id. at 2274.
79. Id.
80. Petitioner's Brief at 4, 8, *Barclays* (No. 92-1384).
81. Id. at 8.
82. Id.
84. Petitioner's Brief at 4, *Barclays* (No. 92-1384); Coffill, supra note 83, at 6; U.S. CONST. amend. XIV, § 1; U.S. CONST. art. I, § 8, cl. 3.
tions faced a discriminatory burden in violation of the Commerce Clause and Due Process Clause. The burden consisted of the additional compliance costs of converting all records to U.S. accounting standards—a cost not borne by domestic corporations.\textsuperscript{85} Barclays also argued that the California tax scheme violated the foreign policy prong of the Japan Line Foreign Commerce Clause test since there was an adverse impact on foreign affairs.\textsuperscript{86} Barclays prevailed at trial and in the California Court of Appeals.\textsuperscript{87} California appealed the case to the California Supreme Court. The California Supreme Court reversed the lower courts on the Foreign Commerce Clause issue\textsuperscript{88} and remanded the case to the Court of Appeals for further hearing on the Due Process issue and other Commerce Clause issues.\textsuperscript{89} On this second trip to the California Court of Appeals, Barclays lost on its remaining claims.\textsuperscript{90} Barclays' further appeals in the California system were denied and the case proceeded to the U.S. Supreme Court on a writ of certiorari.\textsuperscript{91}

C. Past International Objections to WWCR

Foreign government objection to the WWCR system has not been confined to the briefs filed in Barclays' support, but extends back at least fifteen years in the form of diplomatic notes.\textsuperscript{92} Foreign governments are unable to negotiate directly with California, a sub-national unit, and have directed their diplomatic complaints to the U.S. government in hopes that the United States would either preempt California through federal law or pressure California into dropping WWCR.\textsuperscript{93} In 1980, the government of the United Kingdom and the government of Italy, in its representative capacity as president of the European Community, expressed opposition to California's WWCR method with diplomatic notes sent to the U.S. government.\textsuperscript{94} Italy explained that the European Community members were "concerned about . . . the unitary basis of taxation as applied in California" and urged the United States to adopt legislation ending WWCR.\textsuperscript{95} In its Diplomatic Note of March 25, 1980, the United Kingdom stated that "Her Majesty's

\textsuperscript{85} See infra notes 134-39 and accompanying text.
\textsuperscript{86} Petitioner's Brief at 13, Barclays (No. 92-1384). Barclays noted that Canada, Denmark, France, Italy, Japan, the Netherlands, the United Kingdom, and West Germany protested California's tax. Id. at 6.
\textsuperscript{88} The California Supreme Court reversed the lower courts by holding that the California tax system did not violate the Foreign Commerce Clause. Barclays Bank v. Franchise Tax Bd. of Cal., 2 Cal. 4th 708 (1992). See supra notes 57-64 and accompanying text.
\textsuperscript{89} Barclays Bank, 2 Cal. 4th 708.
\textsuperscript{92} See supra note 9.
\textsuperscript{93} Petitioner's Brief at 7, Barclays (No. 92-1384). See Erica Stary, Current Tax Intelligence, 1984 Brtr. Tax Rev. 385, 536.
\textsuperscript{95} Diplomatic Note, Italy-U.S., Mar. 19, 1980.
Government is convinced that the unitary basis of taxation with combined reporting, particularly as applied in the international field, is entirely unsatisfactory.96 In 1982, in anticipation of the Supreme Court's hearing of Container Corp., Canada sent the State Department notice of its objections to the unitary tax.97 Canada stated that WCR "results in inequitable taxation and imposes excessive administrative burdens on international companies doing business in those [unitary method] states."98 Canada requested that the U.S. government include Canada's view in any U.S. government participation in the Container Corp. litigation. These notices prior to the decision in Container Corp. placed the United States on notice, years before the Barclays litigation, of significant international objection to California's WCR method.

The Supreme Court's decision to uphold WCR in Container Corp. prompted another round of international complaints directed against WCR.99 Greece, as president of the European Community, expressed the European Community's continued dissatisfaction with WCR via a diplomatic correspondence on August 1, 1983.100 This Diplomatic Note urged congressional legislation "to ensure that States do not use [the unitary] method of taxation at least for the subsidiaries of foreign corporations."101 In a Diplomatic Note of August 11, 1983, Japan also vigorously protested the WCR system.102 Japan bluntly stated that WCR is a "barrier to the expansion and development of Japan-U.S. economic relations"103 and insisted upon "abolition of the Unitary Tax System."104 Canadian Prime Minister Pierre Trudeau sent U.S. President Ronald Reagan a personal letter indicating Canadian displeasure with the Container

97. Diplomatic Note, Canada-U.S., No. 283, June 14, 1982. Canada, like the United States, is a federal system with both the national government and sub-national units that assess corporate income taxes. J. Harvey Perry, Taxation in Canada 133 (1984). A comparison of the U.S. and Canadian tax systems reveals that the Canadian provinces allocate income of foreign countries in accord with international tax conventions. Id. Canadian provinces have the option of administering their own tax or authorizing the federal government to collect the provincial tax. Under the federal collection option, the provincial tax is simply a percentage of the federal tax liability. Id. at 120. Since the Canadian federal government applies a separate accounting analysis to determine how much of a foreign owned corporation's income is amenable to Canadian tax, each province using the federal option is limited to taxing only Canadian Income. See id. at 74. The provinces which administer their own corporate taxes are constrained by a system of federal rules which are in compliance with international tax standards. Id. at 133. The Canadian example demonstrates that it is possible for a country with numerous taxing political subdivisions to live harmoniously within the international tax community.
99. Regan, supra note 3, § 1 ("In the wake of the Container decision, ... major trading partners of the United States renewed their objections to the worldwide unitary tax method.").
101. Id.
103. Id.
104. Id.
Corp. decision and California's continued use of WWCR. These formal notes and personal letters indicate the extent of the international community's hostility to WWCR.

These post-Container Corp. diplomatic objections prompted the Reagan administration to establish the Worldwide Unitary Taxation Working Group, chaired by Treasury Secretary Donald Regan, to study alternatives to the unitary system. The Working Group heard the testimony of interested parties including foreign governments. The United Kingdom, Canada, Japan, Australia, Switzerland, the Federal Republic of Germany, and Belgium all either testified before the Working Group or submitted diplomatic notes indicating their governments' objections to WWCR.

D. Recent Political Developments

Prior to the Supreme Court's decision to hear Barclays, California backed down for the tax years beginning January 1, 1994, and beyond. On October 6, 1993, California Governor Pete Wilson signed California Senate Bill 671. This bill allows multinational corporations to freely elect the "water's edge" method. This method, which is less controversial than WWCR, limits the corporate income California can tax to income earned by the unitary group in the United States. This new California legislation effectively ended California's use of WWCR.

106. REGAN, supra note 3, § 1.
107. Id.
108. See id. The United Kingdom vigorously objected to WWCR since its companies have the largest direct investment in the United States and are thus most affected by the unitary system. See Statement of the United Kingdom before the U.S. Treasury Worldwide Unitary Taxation Working Group, at 69 (1984). See Paper Submitted by the Government of Canada to the U.S. Treasury Worldwide Unitary Taxation Working Group, at 80 (1984). "The Canadian government considers that the use of unitary tax schemes is inconsistent with . . . international investment policy goals." Id. at 87. See Diplomatic Note, Switzerland-U.S., No. 461.20, Nov. 15, 1983; Diplomatic Note, Germany-U.S., Nov. 28, 1983 (delivered to the U.S. Treasury Worldwide Unitary Taxation Working Group). "A failure to . . . eliminate the international incidence of unitary taxation might lead the international community to conclude that the United States . . . is no longer contributing to the international tax order towards which . . . nations have worked for so many years." Id. at 116. See Diplomatic Note, Belgium-U.S., Jan. 25, 1984 (delivered to the U.S. Treasury Worldwide Unitary Taxation Working Group).
110. In response to the recommendations of the U.S. Treasury Worldwide Unitary Taxation Working Group, REGAN, supra note 3, annex D, (recommending a water's edge election), California had enacted a water's edge election in 1986. This 1986 election, however, required the taxpayer to pay a substantial fee and could be unilaterally disregarded by the Franchise Tax Board. CAL. REV. & TAX. CODE §§ 25115(a), 25111(c) (West 1992). Simply, the election was onerous. See Coffill, supra note 83, at 7. Foreign governments interpreted California's retention of the power to disregard the water's edge election as "a continuing refusal [by California] to accept the validity of separate accounting." Unitary Tax: The Next Stage, 1986 BRIT. TAX REV. 253.
111. Coffill, supra note 83, at 7.
The "water's edge" method limits the reach of state corporate income taxes to income earned within the U.S. boundary. The traditional water's edge rule provides that "the states cannot look beyond the water's edge, that is beyond the nation's boundaries, in calculating in-state corporate income." Any state that applies the water's edge method taxes, at maximum, the corporation's U.S. income. The traditional water's edge method, however, treats related corporations as independent for tax purposes. The traditional water's edge method, then, applies separate accounting to accurately value transactions between related corporations.

The California water's edge election is not the traditional water's edge method, but an "elective variation." California's water's edge method establishes a smaller unitary group, one limited to specified "affiliated entities" with defined relationships to the United States. California Revenue and Taxation Code section 25110 defines the related entities to be included in the water's edge group. The California method does not truly adopt separate accounting since it does not treat related corporations as independent for tax purposes.

113. Id.
114. See supra note 32.
115. Brief for United Kingdom as Amicus Curiae at 18, Barclays (No. 92-1384).
117. The California water's edge group consists of seven types of related corporations. The first is affiliated banks and corporations that are includable in a federal consolidated return filed by the California taxpayer but excluding those making an election under 26 U.S.C. § 936; CAL. REV. & TAX. CODE § 25110(a)(1) (West 1992). Second, Domestic International Sales Corporations (DISC) and Foreign Sales Corporations (FSC) are included in the group. CAL. REV. & TAX. CODE § 25110(a)(2). DISCs and FSCs are special corporations established primarily for export of goods and are given favorable tax treatment. BLACK'S LAW DICTIONARY 484 (6th ed. 1990); Bruce and Lieberman, 264-4th T.M., Foreign Sales Corporations A-4. Third, the group includes corporations, but not banks, whose own apportionment factors, ratio of U.S. sales, payroll, and property to worldwide corporate sales, payroll and property, averages greater than 20% in the United States. CAL. REV. & TAX. CODE § 25110(a)(3). These include some foreign incorporated members of the group which do substantial business, as evidenced by the 20% apportionment average, in the United States. Coffill, supra note 116, at 2. Fourth, affiliated U.S. incorporated banks and corporations which have more than 50% of their stock controlled directly or indirectly by the taxpayer and are not eligible to be included in a federal consolidated return are included. CAL. REV. & TAX. CODE § 25110(a)(4). Fifth, foreign incorporated banks and corporations which are not included in any other category which, under the Internal Revenue Code of the United States, have income attributable to the United States, are included to the extent of the U.S. income. CAL. REV. & TAX. CODE § 25110(a)(5). Sixth, affiliated export trade corporations as defined in Internal Revenue Code § 970-72 are included. CAL. REV. & TAX. CODE § 25110(a)(6). Last, a portion of controlled foreign corporations as defined by Internal Revenue Code § 957 are included. CAL. REV. & TAX. CODE § 25110(a)(7). Income of affiliated controlled foreign corporations is only included to the extent of a technical ratio of a certain class of federal income to earnings. See Coffill, supra note 116, at 2.
The California water's edge method still uses a combined group, consisting of related corporations with U.S. contacts, as well as apportionment factors using U.S. rather than worldwide totals. The tax base apportioned under the water's edge system is the total income of the U.S.-related corporations rather than the total income of the worldwide group. The apportionment ratios are determined using, for example, the ratio of the taxpaying company's California sales to the total sales of all related U.S. group corporations. This method effectively results in California's taxing member corporations of foreign multinationals only "on the basis of its U.S. operations."

California's new legislation has been widely interpreted as a retreat in the face of international pressure. The most notable example of the international pressure came from the British Government. In 1985, the United Kingdom increased the international pressure on California by passing legislation in retaliation against California's tax scheme. This legislation would withdraw certain United Kingdom tax credits from U.S. parent multinationals with operations in California and the United Kingdom. The retaliatory measure was not immediately operable but rather was held in reserve. In May 1993, the United Kingdom announced that if California did not propose a satisfactory solution to the WWCR disagreement by the end of 1993, it would place its retaliatory measure into effect. In August 1993, Michael Grylls, a member of the United Kingdom House of Commons, sent a letter to Alfred Alquist, a member of the California Senate, emphasizing that Britain's "resolve on retaliation, in the absence of a satisfactory solution, remain[ed] undiminished and should not be underestimated." As political pressure from Britain increased, the Finance Committee in the German Bundestag passed a resolution threatening retaliation if California did not abandon WWCR "within a rea-

118. California combines certain entities. True separate accounting treats all companies as independent.
120. Id.
121. Id.
122. Id. at 1.
124. Finance Act, 1985, § 54 (Eng.). Reenacted, United Kingdom Income and Corporation Taxes Act, 1988, §§ 812 – 815 (Eng.). This retaliatory measure was enacted but not activated. The statute withdrew tax from U.S. owned corporations who did business both in the United Kingdom and California (or some other unitary method state). Petitioner's Brief at 25, Barclays (No. 92-1384).
126. Petitioner's Brief at 25, Barclays (No. 92-1384).
128. Letter from Sir Michael Grylls, Member United Kingdom House of Commons, to Alfred E. Alquist, supra note 11.
In 1993, the European Community also threatened to retaliate against U.S. industry in response to the WWCR issue. European Community Tax Commissioner Christiane Scrivener declared that continued use of WWCR "could lead to retaliatory measures against American Companies because [the European Community] would have no other choice."

After California's water's edge election was passed in October, the United Kingdom took credit for forcing the change. California, however, may have had other motivations for making the change. Rather than conceding defeat by making the legislative change, California may have been involved in a calculated attempt to preserve its past victory—Barclays' defeat in the California court system—by persuading the Supreme Court not to hear the case because the water's edge legislation resolved the issue. If the Supreme Court chose not to hear the case, California could keep the billions in contested taxes. In addition, WWCR would be sanctioned as legal should California choose to enact it again. The Clinton Administration urged this course of action in support of California. In response to the Supreme Court's request for the U.S. view on granting certiorari, the United States submitted a brief in support of California's argument that the "[l]egislation adopted by California . . . leads us to conclude that further review of the decision below is not warranted." Therefore, California's water's edge election may not have been merely a bowing to international pressure to solve the crisis, but rather a strategic move by California to preserve its state court victory.

II. Analysis of Barclays

This Section analyzes the Barclays case from two perspectives. Section A analyzes the reasoning and conclusions of the Supreme Court. Section B considers the international significance of the case as evidenced by the international reaction to the decision.

A. Analysis of Barclays—Supreme Court

1. Barclays' Arguments

Barclays challenged the California tax scheme on Commerce Clause, Due Process, and Foreign Commerce Clause grounds. Barclays presented two primary claims in the Supreme Court. First, Barclays asserted that WWCR
caused foreign-based multinationals to incur significant compliance costs that were not incurred by domestic corporations. ¹³⁴ Barclays argued that this inequality violated the Commerce Clause because the compliance burden discriminated against interstate commerce in violation of Complete Auto Transit v. Brady.¹³⁶ According to Complete Auto Transit, a state tax violates the Commerce Clause if “the tax either (1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; or (4) is not fairly related to the services provided by the State.”¹³⁷ Barclays asserted that while a foreign multinational must convert its accounting records to U.S. currency and U.S. accounting conventions, a domestic multinational has its records in U.S. currency and is subject to U.S. accounting guidelines. Barclays argued that the significant accounting burden imposed on foreign-based multinationals placed the foreign companies in a less competitive position, and hence discriminated unconstitutionally.¹³⁹

Barclays’ second major claim implicated the Due Process Clause.¹⁴⁰ California tax regulations included a provision for the taxpayer to submit returns based on reasonable approximations to avoid the costly conversion of the foreign multinational’s records to U.S. standards.¹⁴¹ Barclays argued that this regulation did not “contain sufficiently explicit standards, not only to permit a person of ordinary intelligence to understand what conduct is prohibited, but also to prevent arbitrary, harsh and discriminatory enforcement by government officials.”¹⁴² Barclays, citing Grayned v. City of Rockford,¹⁴³ Kolender v. Lawson,¹⁴⁴ and Papachristou v. City of Jacksonville,¹⁴⁵ alleged that the Due Process violation stemmed from a vagueness problem with the regulation since it required only a reasonable approximation without further specification of the standard.¹⁴⁶ Barclays argued that the undefined reasonableness standard granted the California Franchise Tax Board standardless discretion in violation of Due Process.¹⁴⁷

Barclays also argued that California’s tax violated the two-pronged Foreign Commerce Clause test enunciated in Japan Line.¹⁴⁸ According to

¹³⁴. Barclays, 114 S. Ct. at 2277.
¹³⁵. Id.; U.S. CONST. art. I, § 8, cl. 3.
¹³⁷. Barclays, 114 S. Ct. at 2276 (citing Complete Auto Transit, 430 U.S. at 279).
¹³⁸. Petitioner’s Brief at 26, Barclays (No. 92-1384).
¹³⁹. Id.
¹⁴². Petitioner’s Brief at 48, Barclays (No. 92-1384).
¹⁴⁶. Petitioner’s Brief at 29, Barclays (No. 92-1384).
¹⁴⁷. Id. at 30.
¹⁴⁸. In the area of foreign commerce, two additional tests apply to the validity of a state tax. Japan Line, 441 U.S. at 451. These two prongs are: (1) the enhanced risk of multiple taxation; (2) the state tax impairs federal uniformity in an area where federal
Barclays, since California's method of taxation implicated foreign policy, it violated the *Japan Line* "one voice" test. Allen Wallis, Under Secretary of State for Economic Affairs during the Reagan Administration, stated that "few issues have provoked so broad and intense a reaction from foreign nations." The California method engenders this response because it is at cross purposes with the separate accounting taxation method used internationally by the United States' major trading partners. WWCR unravels "sixty years of cooperative effort among nations to establish the arm's length method as the exclusive international standard." Further, the realized risk of retaliation by foreign nations, most notably the United Kingdom, coupled with the vigorous complaints of numerous other states, illustrates the impact of the California tax on foreign affairs.

The "enhanced risk of multiple taxation" prong of the *Japan Line* test is violated, according to Barclays, by the more aggravated risk of multiple taxation that a foreign-owned multinational faces in California. A foreign-owned multinational typically has more foreign operations than does a domestic corporation such as Container, and thus a greater portion of the foreign multinational's income is subject to a double tax. The degree and the risk of double taxation are greater. Over ninety-eight percent of the Barclays worldwide combined group's income was earned in countries other than the United States. Since Barclays is subject to foreign income tax on that ninety-eight percent, California risks applying a double tax to a huge proportion of Barclays' income. Therefore, California's tax certainly subjects foreign multinationals to a more "enhanced risk of multiple taxation."

2. Supreme Court's Response

The Supreme Court rejected each of Barclays' arguments. The Court first applied the four-pronged *Complete Auto Transit* test to determine whether

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uniformity is essential (the "one voice" test). *Id.* See supra notes 58-64 and accompanying text.

149. *See supra* note 148.
150. Wallis, *supra* note 4. Wallis stated that the "United States Government has received diplomatic notes from fourteen member countries of the Organization for Economic Cooperation and Development (OECD), either directly or through the European community, as well as communications from the OECD itself, all protesting against the application of the unitary tax method to their companies. . . . The Prime Ministers of three of [the United States] largest trading partners have written to the President to express their concern and have raised the issue in personal meetings with him." *Id.*
152. *Id.*
153. *See id.* at 25. *See supra* part I.D.
155. *Id.*
156. Petitioner's Brief at 27, *Barclays* (No. 92-1384).
157. *Id.*
158. *Id.*
159. *Japan Line*, 441 U.S. at 446 (emphasis added).
the California tax violated the Commerce Clause. The Court stated, without further elaboration, that three prongs were “easily met.” Barclays argued that the California tax violated the fourth prong, discrimination against interstate commerce, by imposing a discriminatory compliance burden. Rejecting this claim for lack of a “factual predicate,” the Court explained that Barclays failed to show that the approximations generally discriminate against multinational corporations through over-taxation. Further, the Court cited the California regulation allowing “reasonable approximations” and explained that this provision permitted Barclays to avoid the allegedly discriminatory compliance costs of converting foreign accounting records to U.S. standards.

The Due Process claim was summarily dismissed. The Court’s opinion noted both that reasonableness is a common legal standard and that the California courts had construed the regulation to “curtail the discretion of California tax officials.” Thus, the California Franchise Tax Board does not have standardless discretion, but is limited by the common standard of reasonableness.

The Supreme Court extensively analyzed the Foreign Commerce Clause arguments. First, the Court dismissed the risk of double taxation claim. The Court acknowledged that double taxation had occurred in Barclays, but pointed out that double taxation had also occurred in Container Corp. The Court explained that the tax in Container Corp. was upheld because a switch to separate accounting would not have certainly ended the double taxation and the Court would not order a switch from one method of double taxation to another. Further, in Barclays, the Court found no evidence that separate accounting would be more likely to lessen the risk of double taxation for a foreign multinational than it would for a domestic multinational as in Container Corp.

The Court dismissed the “one voice” argument in a two-step finding. First, the Court found no clear federal policy on state taxation of foreign multinationals. Therefore, California’s unitary tax was not in direct conflict with a stated federal policy. In step two, the Court avoided an

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160. Barclays, 114 S. Ct. at 2276; Complete Auto Transit, 430 U.S. at 274. See supra notes 136-37 and accompanying text.
161. Barclays, 114 S. Ct. at 2276. The three Commerce Clause tests which the tax did not violate were: “(1) [the tax] applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; . . . (4) is not fairly related to the services provided by the state.” Id. The easy finding that these tests were met may be explained by the fact that Barclays did not challenge the tax on any of these grounds. Rather, Barclays attacked only on discrimination grounds. Id. at 2277.
162. Id.
163. Id. at 2278.
164. See supra notes 140-47 and accompanying text.
165. Barclays, 114 S. Ct. at 2278. See supra notes 140-47 and accompanying text.
166. Barclays, 114 S. Ct. at 2278.
167. Id. at 2281.
168. Id. at 2280.
169. Id.
170. Id.
171. Id. at 2281-82.
The application of the *Japan Line* one voice test by finding that Congress had approved California’s WWCR by negative implication.\(^{172}\) The Court declared that “Congress may . . . passively indicate that certain state practices do not ‘impair federal uniformity in an area where federal uniformity is essential.’”\(^{173}\) Therefore, Congress can passively approve violations of the one voice test. The negative implication arose from two sources. First, the Court noted that Congress was “aware that foreign governments were displeased with States’ worldwide combined reporting requirements” and failed to enact any bill against it.\(^{174}\) Second, the Court found that “[t]he history of Senate action on a United States/United Kingdom tax treaty . . . reinforces our conclusion.”\(^{175}\) Since 1975, the United Kingdom and the United States had been in the process of finalizing a treaty to prevent double taxation of companies by the two nations.\(^{176}\) Article 9(4) of the proposed treaty “restricted the power of the States of the United States to apply the ‘unitary method’ of taxation to British enterprises.”\(^{177}\) The United States Senate “refused to ratify the treaty until this particular clause was removed.”\(^{178}\) These two factors sufficiently implied negative congressional intent to prevent the Court from applying the one voice test.

B. International Reaction to Barclays

1. Foreign Government Reaction

The British government reacted negatively to the *Barclays* decision.\(^{179}\) Following the release of the *Barclays* decision, the British Chancellor of the Exchequer, Hon. Kenneth Clarke, issued a statement which demonstrated the United Kingdom’s disappointment with the decision but also hinted at defeat and resignation.\(^{180}\) Mr. Clarke stated, “I am naturally disappointed by the Supreme Court’s decision on the Barclays case. The Government has always strongly opposed the imposition of world-wide unitary tax on UK owned companies and supported Barclays throughout this litigation.”\(^{181}\) The statement reiterated the United Kingdom’s continued dislike for WWCR but reluctantly accepted California’s 1993 water’s edge legisla-

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172. *Id.* at 2284.
173. *Id.* at 2282 (emphasis in original) (quoting *Japan Line*, 441 U.S. at 448).
174. *Id.* at 2283.
175. *Id.* at 2284.
177. DIAMOND & DIAMOND, supra note 176, at 479.
178. OGLEY, supra note 7, at 170.
180. *Id.*
181. *Id.*
tion as an adequate resolution to the WWCR dispute.\textsuperscript{182}

There is lingering international concern that other states, and maybe a future recalcitrant California legislature, will be emboldened by California's victory in \textit{Barclays}.\textsuperscript{183} Mr. Clarke expressed the concern of the United Kingdom, stating that the United Kingdom would "retain its retaliatory powers against the possibility that States might damage UK owned companies at some time in the future."\textsuperscript{184} The U.S. government believes that WWCR will not spread because of California's experience.\textsuperscript{185} An immediate return to WWCR by California or adoption by other states in the near future seems unlikely. The Supreme Court's decision, however, does leave the door open for a cash-strapped state to adopt a unitary system to fill the state's coffers at the expense of foreign multinationals after the international furor dissipates. The continuing concern of the international community is therefore warranted.

2. New OECD Guidelines Condemning WWCR

The Organisation For Economic Co-operation and Development (OECD) issued a discussion draft on July 8, 1994, which condemned the use of WWCR.\textsuperscript{186} The OECD issued the report only weeks after the \textit{Barclays} decision of June 20, 1994. The report noted that WWCR "has not been applied as between countries although it has been attempted by some local taxing jurisdictions."\textsuperscript{187} This statement clearly refers to California and the handful of other states that use WWCR.\textsuperscript{188} The report further stated that WWCR is "not a realistic alternative to the arm's length principle"\textsuperscript{189} and concluded that "global formulaic apportionment should be rejected."\textsuperscript{190}

The OECD's condemnation of WWCR is most likely a response to threats to the separate accounting standard.\textsuperscript{191} These include California's

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\textsuperscript{182} Id. Mr. Clarke states that the California water's edge legislation is a "major step forward and it should ensure that in future no UK owned company is exposed to damage there from the imposition of world-wide unitary tax." \textit{Id.}


\textsuperscript{184} British Official Expresses Disappointment in Barclays Decision, \textit{supra} note 179.

\textsuperscript{185} More U.S. States May Try Unitary Tax After Barclays Verdict, \textit{supra} note 183.

\textsuperscript{186} The OECD is an international policy-making organization consisting of government delegations from twenty-five leading industrialized countries. Guy De Jonquieres, \textit{OECD Guidelines Seek To Avert Double Tax}, Fin. Times, July 9, 1994, at 4. OECD member countries are: Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, Japan, Finland, Australia, New Zealand, and Mexico. The European Community also participates in OECD work. OECD \textit{Comm. of Fiscal Affairs, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration} 1994 Discussion Draft 68 (1994).

\textsuperscript{187} OECD \textit{Comm. of Fiscal Affairs, supra} note 186, at 65.

\textsuperscript{188} See \textit{supra} note 5 and accompanying text.

\textsuperscript{189} OECD \textit{Comm. of Fiscal Affairs, supra} note 186, at 66.

\textsuperscript{190} \textit{Id.} at 68.

\textsuperscript{191} Leslie B. Samuels, Remarks at the Seventh Annual International Tax Institute sponsored by the Internal Revenue Service and the George Washington University (Dec. 16, 1994) \textit{available in} 9 Tax Notes Int'l 1951 (1994).
The use of WWCR, recent Congressional proposals suggesting revising the Internal Revenue Code to add an alternate minimum corporate income tax using WWCR principles, and a Congressional proposal to revise the transfer pricing regulations for Internal Revenue Code § 482. The new proposals would have implemented transfer pricing principles embodying the WWCR principles. Fortunately, the U.S. Treasury Department never acted on the proposals and has since embraced the new OECD report, which rejects the WWCR methodology. It takes little imagination to suspect that the Treasury Department's retreat from the WWCR methodology was influenced by California's experience.

III. Criticism of Barclays—The International Problem

The Barclays case was wrongly decided. The holding fails to adequately account for important international issues and their effects on constitutional analysis. Barclays should have won on Foreign Commerce Clause grounds because WWCR creates an aggravated risk of multiple taxation and implicates foreign policy issues. The Supreme Court's Foreign Commerce Clause analysis is at fault. The Court relied more on Container Corp., a case involving tax on a domestic multinational, than on Japan Line, which involved a tax on a foreign multinational and thus was more relevant. Japan Line recognized the special sensitivity necessary in an international setting. Further, by using its "negative implication" jurisprudence, the Court ignored the relevant portion of the one voice test as defined in Container Corp. Proper treatment of international concerns as established in Container Corp. and Japan Line, must lead to the conclusion that the Supreme Court's decision is wrong on both prongs of the Foreign Commerce Clause test.

A. The Supreme Court Was Wrong on the Double Taxation Prong

The double taxation prong of the Foreign Commerce Clause, as stated in Japan Line and restated in Container Corp., examines whether the state tax creates an enhanced risk of multiple taxation. The principles applicable to taxation of foreign corporations outlined in Japan Line dictate that Cali-

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195. Ogley, supra note 7, at 171.
197. Container Corp., 463 U.S. at 159.
199. See supra notes 172-78 and accompanying text.
200. See supra notes 58-64 and accompanying text.
201. Barclays, 114 S. Ct. at 2282-83.
202. Japan Line, 441 U.S. at 446. See also Container Corp., 463 U.S. at 185.
Cornell's WWCR system, as applied to foreign multinationals, is unconstitutional under this prong.

1. The Cause of Double Taxation Under WWCR

The California system creates double taxation because WWCR is inconsistent with the separate accounting standard used by almost all nations of the world. While the separate accounting method separately taxes taxable income derived from book income, California's WWCR assigns a percentage of the income of the entire unitary group to California. Therefore, whenever the taxable income amount derived under WWCR exceeds the separate accounting amount, California taxes foreign-sourced income subject to tax by that foreign jurisdiction. As between states taxing domestic corporations, the Court has approved apportionment of income by percentage formulas because it can enforce fair apportionment between the states so that multiple taxation is avoided. This feature of American jurisprudence that prevents domestic double taxation cannot operate in the international realm, in which case one of the taxing jurisdictions is a foreign sovereign on which the Supreme Court cannot enforce fair apportionment. Thus, international consensus is the only way to avoid international double taxation.

2. Separate Accounting Minimizes Risk of Double Taxation

The Supreme Court objected to imposing the separate accounting method on California because it reasoned that separate accounting might also result in double taxation. Double taxation could occur because the definition of separate accounting may vary from nation to nation. However, although some double taxation may result under the separate accounting method, international custom minimizes this risk because the international community constantly engages in dialogue to minimize the differences in separate accounting methodologies. For example, the recent OECD report, which condemns WWCR, also implements new model rules on transfer pricing. Transfer pricing is a significant area of difference among separate accounting jurisdictions, and the OECD's new rules attempt to fully achieve "the objectives of . . . avoiding double taxation." The international consensus on the separate accounting principle is that it has an "overwhelming advantage in relation to . . . formulary apportionment." Simply put, double taxation will be minimized when all jurisdictions, including California, apply separate accounting. WWCR's theoretical underpinnings are fundamentally at odds with separate

204. See supra note 32.
206. See Samuels, supra note 191, at 1952.
207. Barclays, 114 S. Ct. at 2280.
208. Samuels, supra note 191, at 1951.
209. See OECD Comm. of Fiscal Affairs, supra note 186.
210. Id.
211. Samuels, supra note 191, at 1952.
accounting principles and thus California is guilty of consciously engaging in double taxation.

3. Japan Line Compels California’s Use of Separate Accounting

Japan Line contains a key principle: “California’s tax . . . must be evaluated in the realistic framework of the custom of nations.” Because no single court can prevent double taxation in the international sphere, it can be avoided only by following the custom of nations. In Japan Line, international custom allowed Japan, the domicile of the owners of the property, to tax the full value of the property. Thus, any tax by Los Angeles, the taxing authority in Japan Line, resulted in double taxation, which is prohibited under the Commerce Clause. With this statement, the Supreme Court recognized the existence of international custom and that, as the taxing party in violation of international custom, Los Angeles was thus guilty of charging the double tax. In Barclays, separate accounting is the international custom, allowing each jurisdiction to tax the value earned within its borders. Thus, under California’s WWCR scheme, each time a company’s taxable income exceeds the company’s separate accounting amount, the company is subject to double taxation by California in the amount of the excess.

The accepted international framework of corporate income tax on multinationals is the separate accounting method. In Barclays, as in Japan Line, the double tax results from California’s ignoring international custom, and so California is the jurisdiction guilty of imposing the double tax. Therefore, the California tax in Barclays should have been found unconstitutional under the Foreign Commerce Clause as it was in Japan Line. Not only does the separate accounting method have the greatest tendency to reduce double taxation, but the separate accounting

212. Japan Line, 441 U.S. at 454.
213. See supra part III.A.1.
215. Id.
216. The separate accounting method is universally accepted as the international standard. The “separate accounting or arm’s length principle . . . is the method adopted almost universally.” Stary, supra note 93, at 536. Separate accounting is “normal” and “the accepted principle of international taxation practice.” Erica Stary, Current Tax Intelligence, 1983 Brr. Tax Rev. c1, c122. The “arm’s length standard has been . . . universally accepted.” Jonathan Schwarz, Survey of World Taxation, Fin. Times, May 20, 1994, at II.
217. See supra notes 209-11 and accompanying text.
218. This analysis appears to implicate the double taxation analysis in Container Corp. Thus, it is distinctly possible that Container Corp. is wrongly decided also. If the difference of foreign or domestic domicile of the parent multinational makes a constitutional difference in the double taxation analysis, this Note suggests that it is because the analysis is under the Foreign Commerce Clause which is less concerned with domestically controlled entities. Nevertheless, this Note is only concerned with the Barclays opinion and will offer nothing more than speculation on Container Corp. The major error, then, of the Court’s analysis is to follow Container Corp. rather than to apply the principles of Japan Line.
219. See supra part III.A.2.
method is also the custom of nations. As such, Japan Line dictates that California's WWCR system is unconstitutional under the double taxation prong of the Foreign Commerce Clause and therefore must be replaced by the separate accounting method.

Admittedly, double taxation is not inevitable under the WWCR approach; factual circumstances do exist in which California's system does not result in double tax. Any time the California method does not result in double tax, however, it is either because California is taxing an income amount equal to that under the separate accounting method or because California is taxing a lesser income amount. California is the loser in the latter case because the jurisdiction is not fully exercising its right to tax source income. Therefore, it is not constitutionally relevant that WWCR does not always result in double taxation.

B. The Supreme Court's Application of the One Voice Test Is Flawed

The Supreme Court failed to apply the one voice test as outlined in Container Corp. and Japan Line. The Barclays Court did not apply this test because it found that Congress implicitly had approved the WWCR method by its failure to pass a bill against state use of WWCR and had failed to approve a treaty that prevented the states from using WWCR. Implying congressional intent from congressional inaction is a dangerous form of jurisprudence. Congress had as much opportunity to explicitly approve of WWCR as it did to explicitly disapprove of it. Faced with ambiguous congressional intent, the Court should have applied the one voice test.

The Supreme Court found that the Senate's treatment of the United States-United Kingdom Convention for the Avoidance of Double Taxation demonstrates that "Congress implicitly has permitted the States to use the worldwide combined reporting method." This event, however, was misinterpreted by the Court. At worst, Senate action on the treaty shows ambivalence. At best, it can be interpreted as explicit disapproval of California's WWCR method. The original draft of the treaty contained Article 9(4), which restricted the federal government and political subdivisions, including California, from applying WWCR to United Kingdom multinationals. When the treaty was presented to the Senate for ratification, Senator Frank Church proposed an amendment in the Foreign Relations Committee which would have modified Article 9(4) to remove the prohibition on a state's use of WWCR. This amendment was defeated in committee by a vote of five in favor and ten against. Senator Church's

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221. See supra notes 58-64 and accompanying text.
222. Barclays, 114 S. Ct. at 2283-84.
224. Barclays, 114 S. Ct. at 2284 (emphasis added).
225. Convention for the Avoidance of Double Taxation, art. 9(4), supra note 176.
226. Staff of Joint Comm. on Taxation, supra note 176, at 1.
227. Id.
amendment was then brought to the Senate floor and was again defeated.228 A ratification vote was then taken on the unmodified treaty, including the prohibition on state WWCR.229 A majority of Senators approved the treaty.230 The vote was forty-nine in favor and thirty-two against.231 Although a majority of senators approved the treaty, it was five votes short of the Constitutionally-mandated two-thirds majority necessary to ratify a treaty.232 Thus, despite the failure to ratify the unmodified treaty, a majority of senators approved of restricting state use of WWCR.

Subsequently, however, the Treasury Department announced that it would tolerate a treaty which did not restrict state use of WWCR.233 A third protocol was negotiated with the United Kingdom modifying Art. 9(4) to conform to the Church amendment, thus removing the restriction on state use of WWCR taxation.234 The Senate ratified this final version of the treaty ninety-eight in favor, none against.235 In doing so, Congress placed the Court in a difficult situation. Did Congress implicitly approve state use of WWCR? A majority of senators voted for a treaty which explicitly restricted state WWCR taxation while a two-thirds majority ratified a later version of the same treaty which was silent on the state issue. It seems a leap for the Court to have found implicit congressional approval of state WWCR taxation from explicit prohibition and silence. The most that can be inferred is that the Senate sent ambiguous signals on the issue. The majority's approval of the prohibition logically precludes a finding of approval. The Supreme Court was incorrect and should have applied the one voice test.

Had the Court reached the one voice test, as this Note argues it should have, the Court should have declared WWCR unconstitutional under the Foreign Commerce Clause. Container Corp. defines the one voice test relevant to the California tax: "a state tax at variance with federal policy will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive."236 WWCR violates the foreign policy branch of the test. The Court suggests in Container Corp. that a state tax interferes with foreign policy if it might justifiably lead to foreign retaliation.237 That retaliation has occurred—the United Kingdom has enacted retaliatory legislation.238

228. Id.
229. Id.
230. Id.
231. Id.
232. U.S. CONST. art. II, § 2. See Brief for United States as Amicus Curiae at 7, Barclays (No. 92-1384). The apparent anomaly of 49 votes for and 32 against being merely five votes short of a two-thirds majority in a 100-member body is resolved by U.S. Const. art. II, § 2 which requires approval of only two thirds of the members present to ratify a treaty.
233. STAFF OF JOINT COMM. ON TAXATION, supra note 176, at 1.
236. Container Corp., 463 U.S. at 194 (emphasis added).
237. Id.
238. See supra notes 123-30 and accompanying text.
Container Corp. lists three circumstances which would justify foreign retaliation: first, if the tax creates an "automatic 'asymmetry,'"\textsuperscript{239} second, if the tax is imposed on a foreign entity;\textsuperscript{240} and third, if foreign nations have a "legitimate interest in reducing the tax burden of domestic corporations."\textsuperscript{241} All three factors are implicated in Barclays. First, WWCR does create an asymmetry. WWCR "disturbs the symmetry of international tax-ation relationships"\textsuperscript{242} and is fundamentally inconsistent with the universally accepted separate accounting method. The separate accounting standard is universally accepted.\textsuperscript{243} Separate accounting is embodied in both the OECD Model Tax Convention On Income and On Capital\textsuperscript{244} and the United Nations Model Double Taxation Convention between Developed and Developing Countries.\textsuperscript{245} Therefore, it is beyond question that the unitary method creates an asymmetry when compared with the international standard.

Second, the legal incidence\textsuperscript{246} of the tax in Barclays, at least that tax on the foreign incorporated company, fell on a foreign corporation. There were two litigants in Barclays: Barclays Bank International, a foreign corporation, and Barclays Bank of California, a California corporation. Both were owned by a foreign corporation.\textsuperscript{247} In a narrow sense, the California tax on Barclays Bank of California does not fall on a foreign corporation since it is a California corporation.\textsuperscript{248} In the broader, multinational structure, which California is so quick to group with the domestic corporation, the incidence of the tax falls on the ultimate parent, a foreign corporation. There can be no doubt that the WWCR tax on Barclays Bank International falls, in both the narrow and broad senses, on a foreign corporation.

The third factor, a foreign nation's interest in relieving the tax burden on its corporations, also weighs in Barclays' favor. In Container Corp. the Supreme Court suggests that corporations, even foreign ones, are subject to tax in California and that excessive taxation is simply a function of the tax rate.\textsuperscript{249} However, the amount of tax paid by a foreign multinational in California is not merely a function of the tax rate, but is a result of the aberrant tax system imposed by California.

\textsuperscript{239} Container Corp., 463 U.S. at 195 (quoting Japan Line, 441 U.S. at 453).
\textsuperscript{240} Id.
\textsuperscript{241} Id.
\textsuperscript{242} Stary, supra note 216, at c122.
\textsuperscript{243} See supra note 216.
\textsuperscript{244} OECD Committee On Fiscal Affairs, Model Tax Convention On Income and On Capital, art. 9 (1992).
\textsuperscript{245} United Nations Model Double Taxation Convention between Developed and Developing Countries, art. 9(1) (1980). The commentary to the United Nations Model Convention assumes that countries apply separate accounting. Commentaries on the Articles of the United Nations Model Double Taxation Convention between Developed and Developing Countries, art. 9(A).
\textsuperscript{246} This refers to which legal entity is obligated to pay the tax.
\textsuperscript{247} See supra notes 75-76 and accompanying text.
\textsuperscript{248} See supra notes 75-76 and accompanying text.
\textsuperscript{249} Container Corp., 463 U.S. at 195.
These factors can be used to distinguish Container Corp., which upheld WWCR, from the proper result in Barclays. In Container Corp., the tax ultimately fell on a domestic parent corporation. Thus, the foreign country hosting the subsidiaries has little to complain about. In Barclays, however, the legal incidence falls directly on a foreign company when there is a foreign corporation in California. The legal incidence falls indirectly on a foreign company in the case of a domestic company with a foreign parent. A foreign sovereign rightfully is concerned about the effects of another sovereign’s taxes on its corporations.

The Supreme Court stated that “Congress may more passively indicate that certain state practices do not ‘impair federal uniformity in an area where federal uniformity is essential.’” Applying this standard to the Foreign Commerce Clause undermines the very reason for an extended Commerce Clause analysis when foreign commerce is in question, because “sensitive matters of foreign relations . . . are concerned.” This passive congressional approval standard must be compared with the “unmistakable clarity” of Congress that is necessary to save state legislation which falls short under the four Commerce Clause tests of Complete Auto Transit. Apparently, Congress must take explicit action before it approves any state practice which would otherwise violate the Commerce Clause. In the area of foreign commerce, the one voice test of the Foreign Commerce Clause, which applies only to foreign commerce, evidently can be overridden by the smallest of congressional action—silent ambiguity. The Foreign Commerce Clause has the additional two tests which make up the “more extensive Constitutional inquiry” when foreign commerce is in question. A more rigorous test is required because “sensitive matters of foreign relations and national sovereignty are concerned” in foreign commerce. The Court’s insistence that the one voice test may be met by a lesser congressional action than is necessary for the Complete Auto Transit tests cannot be reconciled with the logic supporting the existence of the additional Foreign Commerce Clause tests. The Court appears to provide special protection for foreign commerce, justified by foreign policy concerns, yet it fatally weakens the one voice test by allowing Congress to override the test with silence and ambiguity. If matters of foreign commerce are as delicate as the Court asserts, there is no justification for the lower standard given the one voice test. The concerns of foreign commerce should command a constitutional standard far above that applied to domestic commerce.

250. Barclays, 114 S. Ct. at 2282-83 (quoting Japan Line, 441 U.S. at 448; emphasis in original; internal citation omitted).
252. Barclays, 114 S. Ct. at 2283.
253. Complete Auto Transit, 430 U.S. at 274. See supra notes 136-37 and accompanying text.
254. Japan Line, 441 U.S. at 446.
255. Id. at 456.
Conclusion

The crisis over California's WWCR method is over for now. The Barclays decision was wrongly decided. Whether this decision will embolden other jurisdictions to employ WWCR remains to be seen. Given the international-relations firestorm created by California, it seems unlikely. WWCR, however, affords jurisdictions with high property, sales, and payroll values, relative to the other jurisdictions in which the unitary group operates, the opportunity to tax a greater share of the unitary group's income than does the separate accounting method. This feature may cause states desperate for revenue to impose WWCR taxation in order to obtain more revenues from a source commonly viewed as not paying its fair share. However, states must realize that the United States operates in a global economy. Overtaxing foreign companies can have dire effects on the U.S. economy if the foreign jurisdiction retaliates. Congress should decide whether to disregard international custom and explicitly approve WWCR or to legislate against it. This issue has too many foreign and economic policy considerations to be forgotten until the next WWCR crisis emerges. If this issue comes before the Court again and, as is likely, Congress has not spoken, the Court should explicitly reject WWCR taxation and recognize the international custom involved in taxation of multinational corporations.

256. See Schwarz, supra note 216, at II.