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State Taxation of Multinational Corporations and the Apportionment of Worldwide Income: *Container Corporation of America v. Franchise Tax Board*, 103 S.Ct. 2933 (1983)

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Note

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Container Corporation of America v. Franchise Tax Board, 103 S.Ct. 2933 (1983).

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I. INTRODUCTION

In the taxation of corporations, California employs an income tax method[1] which utilizes the "unitary-business" doctrine[2] and three-factor formula apportionment.[3] Rather than determining lo-

1. CAL. REV. & TAX. CODE §§ 25101 - 25140 (West 1979). This approach is modeled after the Uniform Division of Income for Tax Purposes Act (UDITPA) method.
2. The various aspects involved in the definition of a unitary-business are examined more fully in Section IIA of this Article. The basic concept of a unitary-business relates to two or more business entities (in this case parent and subsidiary corporations) which are closely affiliated and which through their organizational or operational structure transfer value (through such means as economies of scale) between the entities. The unitary-business concept ignores the separateness of the entities in form and, instead, focuses on practical business realities and treats the separate entities as one business for the purpose of state income tax analysis.
3. The formula apportionment method of attributing the income of a corpora-

cally taxable income based on traditional separate accounting methods,[4] which most states consider inherently suspect due to the possibilities of "manipulation and imprecision," and which often ignore or fail to adequately capture "the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise,"[5] California rejects the figures derived from these more formal separate accounting methods. Instead, California determines the existence of a "unitary-business" which operates across state or national boundaries. Once the scope of the unitary-business has been defined, California apportions the worldwide income of that unitary-business to the state on the basis of a three-factor formula. This method of state corporate income taxation has gained wide acceptance.[6]

Container Corporation of America (hereinafter referred to as Container Corporation) is a manufacturer of custom-ordered pa-

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tion to the taxing state involves an analysis of certain factors which go into the production of income, the total amount of those factors present in the unitary-business, and the extent to which those factors are present in the taxing state. California and UDITPA utilize three factors: property, payroll, and sales. The basic calculations involved in the three-factor formula apportionment method can be mathematically illustrated as follows:

$$\underbrace{\frac{\text{In-State Property of All Unitary Corporations Operating in State}}{\text{Everywhere Property of Unitary G oup}} + \frac{\text{In-State Payroll of All Unitary Corporations Operating in State}}{\text{Everywhere Payroll of Unitary Group}} + \frac{\text{In-State Sales}\dagger\text{ of All Unitary Corporations Operating in State}}{\text{Everywhere Sales of Unitary Group}}}_{\text{AVERAGED BY DIVIDING THESE FACTORS BY 3}} \times \text{Combined Total Net Income Earned Everywhere By Unitary Group} = \text{Income Earned Within Taxing State}$$

† All intercorporate transactions are eliminated in this forumula.

WhiteNack, *State Tax Litigation after the* Container *Decision: The Potential Tax Break for Foreign Multinationals*, 21 TAX NOTES 771 (1983).

4. Corporate entities using separate accounting methods treat each entity, or component of an entity, as separate for the purpose of attributing income to a state or other jurisdiction. This analysis has traditionally been done on a geographical basis, attributing to the state the income realized on the books of the entity or component located in the state and ignoring interjurisdictional transfers of value between entities or components.
5. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2940 (1983). For example, a study by the Citizen/Labor Energy Coalition, based on a survey of sixteen states, concluded that multinational oil companies may underreport income by as much as 50 percent. *Unitary Tax*, DAILY TAX REPORT (BNA) No. 233, at G-5 (Dec. 2, 1983).
6. Twenty-four states currently use the unitary-business/formula apportionment method of income attribution. Of these, twelve states have adopted the approach of apportioning the enterprise's worldwide income. *Unitary Tax*, DAILY TAX REPORT (BNA) No. 185, at G-6 (Sept. 22, 1983) [hereinafter cited as *Unitary Tax*].

perboard packaging whose United States operations are vertically integrated.[7] During the years at issue[8] Container Corporation controlled twenty foreign subsidiaries,[9] owning between 66.7 percent and 100 percent of each subsidiary.[10] All but two of these subsidiaries were engaged in the same business as Container Corporation.[11] Sales from Container Corporation to its subsidiaries involved approximately one percent of the subsidiaries' total purchases.[12] Although the subsidiaries were largely autonomous with regard to personnel and day-to-day management,[13] Container Corporation established "general standards of professionalism, profitability and ethical practices"[14] for its subsidiaries, and major policy decisions of the subsidiaries were subject to review by Container Corporation. Container Corporation provided advice and consultation on a variety of subjects and occasionally assisted in the procurement of equipment by the subsidiaries.[15] In addition, Container Corporation directly held or guaranteed approximately one-half of the subsidiaries' long-term debt.[16]

On the basis of these relationships between Container Corporation and its subsidiaries, the California Superior Court held that parent and subsidiaries constituted a unitary-business.[17] As a unitary-business, Container Corporation was subject to the apportionment of its worldwide income in order to determine the amount of income attributable to California. The inclusion of the foreign sub-

7. A vertically integrated business involves a series of enterprises which, in effect, comprise one enterprise through common linkage in a production chain involving a single product.

> For example, without exception each of the large steel firms of our economy—United States Steel, Bethlehem Steel, Republic Steel, and the others—are vertical combinations of plants; each firm owns ore and coal mines, limestone quarries, coke ovens, blast furnaces, rolling mills, forge shops, foundaries, and, in some cases, fabricating shops.

C. McConnell, Economics 134 (7th ed. 1978).

8. *See infra* note 18.

9. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2943 (1983). These subsidiaries were located in Columbia, Mexico, Venezuela, Panama, Austria, Germany, Holland, and Italy. WhiteNack, *supra* note 3, at 773.

10. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2943 (1983).

11. *Id.*

12. *Id.*

13. *Id.* Container Corporation occasionally filled personnel positions that subsidiaries could not, with Container Corporation personnel.

14. *Id.*

15. *Id.* at 2944.

16. *Id.*

17. The California Superior Court decision was affirmed by the California Court of Appeal in Container Corp. of America v. Franchise Tax Bd., 117 Cal. App. 3d 988, 173 Cal. Rptr. 121 (1981), and the California Supreme Court declined discretionary review.

sidiaries as part of Container Corporation's unitary-business increased the amount of total income subject to apportionment, while decreasing the percentage of total income attributable to California. The net effect of the inclusion of the foreign subsidiaries was to increase Container Corporation's tax liablity in California for each of the years involved.[18]

On appeal to the United States Supreme Court,[19] Container Corporation contested the application of California's taxation method on three grounds. First, Container Corporation disputed the finding of a unitary-business consisting of itself and its foreign subsidiaries. Second, Container Corporation claimed that, even if a unitary-business did exist, differences in international economic conditions caused a distortion of income when the apportionment method was applied, which warranted rejection of the worldwide income apportionment. Third, Container Corporation claimed that states' use of the unitary-business concept across national boundaries and the apportionment of worldwide income violated the foreign commerce clause because the method resulted in double taxation and violated federal uniformity in the international sphere.

18. Container Corporation's calculations of its unitary-business tax liability, excluding foreign subsidiaries, are summarized in Table 1. California's calculations are summarized in Table 2.

TABLE 1

CONTAINER CORPORATION CALCULATIONS

	1963	*1964*	*1965*
Total income of unitary business	$26,870,427.00	$28,774,320.48	$32,280,842.90
Percentage attributed to Calif.	11.041%	10.6422%	9.8336%
Amount attributed to Calif.	2,966,763.85	3,062,220.73	3,174,368.97
Tax (5.5%)	163,172.01	168,422.14	174,590.29

Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2945 (1983) (citing Joint Appendix to Briefs, Exhibit A-7).

TABLE 2

CALIFORNIA CALCULATIONS

	1963	*1964*	*1965*
Total income of unitary business	$37,348,183.00	$44,245,879.00	$46,884,968.00
Percentage attributed to Calif.	8.6886%	8.3135%	7.6528%
Amount attributed to Calif.	3,245,034.23	3,673,381.15	3,588,012.68
Tax (5.5%)	178,476.88	202,310.95	197,340.70

Id.

19. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, *reh'g denied*, 104 S.Ct. 265 (1983).

This Article will examine the Supreme Court's holding on each of the three contested issues. First will be an examination of the fundamental principles of the unitary-business determination, including a discussion of the constitutional restraints placed upon states using the unitary-business method and the discretion allowed by the Supreme Court in unitary-business determinations made by state courts. Second will be an examination of the distortion of income produced when the unitary-business/formula apportionment method is applied despite differences in international economic conditions and the amount of income distortion the Court appears willing to accept. Finally will be an examination of the foreign commerce clause considerations of double taxation and federal uniformity in the international sphere. The analysis of the double taxation issue will include a discussion of the level of scrutiny applied by the Court in cases of international double taxation. The federal uniformity analysis will include an examination of the Court's tests for determining state violation of federal uniformity, and will apply those tests to the facts presented by the *Container* case.

II. UNITARY-BUSINESS AND INCOME DISTORTION

A. The Unitary-Business Determination

The first step in the process of apportionment of income is determining the existence of a unitary-business.[20] Determination of a unitary-business, for the purpose of apportionment of income, is subject to constitutional analysis under the due process and commerce clauses.[21] The test used by the Court in this analysis involves an inquiry into 1) whether there exists a "minimal connection" or "nexus" between the interstate or international activities and the taxing state,[22] and 2) whether there exists "a rational relationship between the income attributed to the State and the intrastate values of the enterprise."[23] In *ASARCO, Inc. v.*

20. In the field of state corporate income taxation, the Court has consistently held that "the linchpin of apportionability . . . is the unitary-business principle." Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 439 (1980). *See also* F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982) (citing the "linchpin" language of *Mobil Oil*); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).
21. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2940 (1983).
22. *Id.* at 2940. The same language was used by the Court in Exxon Corp. v. Department of Revenue, 447 U.S. 207, 219 (1980) and Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 437 (1980).
23. Exxon Corp. v. Department of Revenue, 447 U.S. 207, 219-20 (1980) (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 437 (1980)). By "intrastate values," the Court is referring to aspects of the enterprise, particularly those that go into the production of income, which are located in the taxing

Idaho State Tax Commisson,[24] the Court further refined the test, requiring that some bond of ownership or control uniting the unitary-business be found.[25]

Functionally, these principles require the taxing state to demonstrate a sharing or exchange of value[26] between entities sought to be treated as a unitary-business. The Court has permitted a finding of a unitary-business in cases involving vertically integrated businesses with components in different states[27] or nations,[28] and enterprises of a similar nature operating separately but involving common managerial or operational resources.[29] Particularly in this latter category of separately operating but linked enterprises, organizational and operational characteristics are examined to determine if economies of scale or transfers of value exist. From 1980 to 1982, the Court further refined this concept through its application in a number of cases.[30]

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state. These aspects include more than just physical assets, such as plants and equipment. Such items as technical expertise of personnel located in the taxing state and sales occurring in the taxing state also constitute valuable aspects of an enterprise located in the taxing state.

24. 458 U.S. 307 (1982).
25. *Id.* at 322-23.
26. A sharing or exchange of value, also referred to as a transfer of value, exists when two or more distinct entities are able to take advantage of one another by virtue of their close affiliation. Examples of this include economies of scale and situations in which entities are able to share valuable information. *See generally* McClure, *Operational Interdependence is Not the Appropriate "Bright Line Test" of a Unitary-Business—At Least Not Now*, 18 TAX NOTES 107 (1983). Due to close affiliations of entities (e.g., the parent-subsidiary relationship), such transfers of value often do not appear on the books of the value-giving entity as producing income.
27. *See, e.g.,* Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920).
28. *See e.g.*, Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924).
29. *See, e.g.*, Butler Bros. v. McColgan, 315 U.S. 501 (1942). Linkage through common managerial or operational resources particularly involves situations where entities are sharing managerial expertise or assistance in various aspects of operation such as personnel, equipment, or supplies. *See supra* note 26.
30. In *Mobil Oil*, 445 U.S. 425 (1980), the Court found that foreign source dividend income from Mobil's integrated petroleum enterprise was earned in a course of activities related to the sale of petroleum in Vermont, and was therefore includable as part of the income of the unitary-business. In Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980), Exxon Corporation operated three separate functional departments—exploration and production, refining, and marketing—of which only the marketing department operated in Wisconsin. Nonetheless, the Court held that, due to the interrelationship between the various departments as part of a vertically integrated business, the marketing department was part of a unitary-business consisting of all three departments and subject to apportionment of its total income in Wisconsin.

    In ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982), the Court found that no unitary-business existed, despite the fact that the parent-cor-

Container Corporation argued on appeal that the test as developed by the Court over the past fifty years was too nebulous, permitting the state courts too much discretion in the determination of a unitary-business. As an alternative, Container Corporation proposed that the Court adopt a "bright line" test,[31] whereby a unitary-business would be established only if the taxing state could show a substantial flow of goods between affiliated entities.[32] Container Corporation argued that such a bright line test would be more objective, providing a more reasonable basis for the unitary-business determination.[33] Support for the use of the "flow of goods" test was found in the language of the *ASARCO* opinion[34] and in previous cases[35] in which the Court found a unitary-business based on "a continuous flow and interchange of common products."[36]

The Court, in brief reference to the issue, declined to adopt the "flow of goods" test as the sole criterion for determination of a unitary-business.[37] While a state may, if it chooses, adopt the "flow of goods" test as an exclusive test for determining the existence of a unitary-business,[38] the Court maintained that it is constitutionally permissible for the state to analyze whether a flow of *value*, as opposed to a flow of goods, is demonstrable.[39] The "flow of goods"

poration owned approximately 51 percent of its subsidiaries' stock, on the basis of the parent's management agreement with other shareholders to not assert control over the subsidiaries and evidence that the parent had refrained from exercising its potential to control the subsidiaries. Similarly, in F. W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354 (1982), a parent's potential to control its subsidiaries was not proof of a unitary-business; based on a lack of subsidiary-parent integration or management centralization, the Court declined to find a unitary-business relationship.

31. Brief for Appellant on the Merits at 47, Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933 (1983).
32. *Id.*
33. An in-depth analysis of the various arguments in support of and in opposition to the "flow of goods" test is beyond the scope of this Article. Arguments in support of the test include its objective limitations on state court determinations and the use of cost spreading by corporations through accounting procedures. Arguments in opposition to the test include primarily those in favor of apportionment generally: the existence of value transfers that arise without any flow of goods and the distrust of separate accounting procedures. For an excellent treatment of the opposing views compare Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 NAT'L TAX. J. 487, 501-502 (1968), with McClure, *supra* note 26.
34. 458 U.S. 307, 330 n.24 (1982).
35. Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980).
36. ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 330 n.24 (1982).
37. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2947 (1983).
38. *Id.* at 2947 n.17.
39. *Id.* at 2947.

test is one of many possible analyses that a state may use in its unitary-business determination. The Court's refusal to accept the "flow of goods" test as the sole test reaffirms the functional inquiry into "contributions to income resulting from functional integration, centralization of management, and economies of scale."[40]

Having failed in its attempt to limit the unitary-business test to "flow of goods," Container Corporation was forced into an analysis of its corporate activities under the broader "flow of value" test and the ownership or control inquiry. Under this analysis, the taxpayer has the burden of showing by "clear and cogent evidence" that extraterritorial values are being taxed.[41] "This burden is never met merely by showing a fair difference of opinion which as an original matter might be decided differently."[42] Rather than review "findings of fact supported by substantial evidence,"[43] the "Court will, if reasonably possible, defer to the judgment of state courts in deciding whether a particular set of activities constitutes a 'unitary-business.' "[44] The Court's preference for deferring to judgments of the state courts creates a "realm of permissible judgment,"[45] in which the state courts will not be reversed.[46]

Container Corporation argued that the California trial court's determination was made "under a different legal standard,"[47] claiming that the court had improperly relied on Container Corporation's *potential* to control various operations of its subsidiaries rather than any *actual* control exercised.[48] Container Corporation claimed that, though it had potential review of its subsidiaries' decisions, no actual control or review had occurred, and therefore no unitary-business relationship existed.[49] Both Container Corporation and the California Franchise Tax Board agreed, however, that "major policy decisions of the subsidiaries were subject to review"

40. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980). *See also* F.W. Woolworth Co. v. Taxation and Revenue Dep't, 458 U.S. 354, 364 (1982).
41. Exxon Corp. v. Department of Revenue, 447 U.S. 207, 221 (1980).
42. Norton Co. v. Department of Revenue, 340 U.S. 534, 537-38 (1951).
43. *Id.* at 538.
44. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2945 (1983).
45. *See* Norton Co. v. Department of Revenue, 340 U.S. 534, 538 (1951); Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2946 (1983).
46. *See infra* note 57.
47. Brief for Appellant on the Merits at 43. *See also supra* note 30.
48. In addition to the "control" issue, Container Corporation claimed that there was no support for a unitary-business finding. Container Corporation alleged that an insignificant flow of goods between itself and its subsidiaries existed, and that its foreign operations staff was extremely limited. Brief for Appellant on the Merits at 42. However, the Supreme Court's decision appears to rely solely on the control of subsidiaries factor as being sufficient to support the finding of a unitary-business.
49. *Id.* at 44.

by Container Corporation.[50] The state court had found that high-level officials of Container Corporation gave the subsidiaries directions regarding compliance with standards of professionalism, profitability, and ethical practices.[51] Other factors pointed to by the state court in its finding of actual control included Container Corporation's role in providing and guaranteeing loans to its subsidiaries,[52] considerable interplay in the area of corporate expansion,[53] and Container Corporation's acts of providing its subsidiaries with substantial technical assistance.[54] These factors, taken together, convinced the Supreme Court that the state court had reached a conclusion within the realm of permissible judgment.[55]

The *Container* decision appears to grant the state courts broad discretion in the determination of a unitary-business, circumscribed only by the boundaries of the judicially created realm of permissible judgment. Criticism has been leveled at this broad discretion and its ramifications.[56] These criticisms include the imprecise and nebulous nature of the test, the virtual impossibility of obtaining a reversal of an initial state court unitary-business determination,[57] and the preclusion of appeals by any but gargantuan businesses.[58] The alternative bright line test, however, has its own disadvantages—most importantly, the problem of arbitrary classification.[59]

The advantages and disadvantages of the certainty of the bright line approach must be weighed. Here, the Court has refused use of bright line tests, having rejected both the "flow of goods" test and

50. Container Corp. of America v. Franchise Tax Bd., 117 Cal. App. 3d 988, 998, 173 Cal. Rptr. 121, 127 (1981).

51. *Id.* at 998, 173 Cal. Rptr. at 127-28.

52. *Id.* at 997, 173 Cal. Rptr. at 127.

53. "Although there was no continued effort by appellant Container Corporation of America to solicit business for its foreign subsidiaries, on at least one occasion appellant assisted in the negotiation of a contract for a foreign subsidiary." *Id.*

54. *Id.* at 998-99, 173 Cal. Rptr. at 128.

55. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2948 (1983).

56. *See e.g.*, WhiteNack, *supra* note 3.

57. In both the *ASARCO* and *Woolworth* cases, the Supreme Court's reversal of the unitary-business determination relied, to a great extent, on the *"factual findings made by the* [lower] *state courts"* that no unitary-business existed. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2946 n.15 (1983) (emphasis in original).

58. WhiteNack, *supra* note 3, at 776.

59. McClure, *supra* note 26. A bright line test could result in either over-inclusion or under-inclusion of enterprises as a unitary-business, depending upon which test is adopted. For example, the bright line "corporate purpose" test, discussed *infra* note 60, would clearly be over-inclusive.

the "corporate purpose" test.[60] As a matter of policy and permissible state taxation, the Court has left the limitation of unitary-business determinations to legislative action, constrained only by broad constitutional limitations.[61] Considering the various ways in which affiliated business entities may share or transfer value,[62] the Court's reaffirmation of the "flow of value" test appears to recognize the practical realities of corporate taxation. Any limitation of state corporate income taxation more restrictive than the "flow of value" test involves numerous political and tax policy decisions at the state and national levels. These policy decisions are much better suited to legislative determination than to Supreme Court determination.

B. Distortion of Income through Apportionment

Once the existence of a unitary-business has been established by the taxing state, that state generally has the authority to apportion the income of that unitary-business to the state rather than accept the income figure attributed to the state through separate accounting methods.[63] In challenging the figure derived through apportionment, the taxpayer has the burden of proving that "there is no rational relationship between the income attributed to the state and the intrastate values of the enterprise."[64] Such a challenge of an apportionment formula is evaluated under the due process and commerce clauses, to determine if the apportionment formula is fair.[65]

In this analysis, the Court employs two components of fairness: internal consistency and external consistency of the apportionment formula. Internal consistency of the formula involves whether, if applied by every taxing jurisdiction, the formula would result in taxation of an income greater than the income of the unitary-business.[66] External consistency involves whether the appor-

60. In *ASARCO*, the Idaho State Commission had proposed the use of a test which would deem a series of affiliated corporations unitary if the parent had acquired, managed, or disposed of subsidiaries for purposes "relating or contributing to the [parent] taxpayer's business." ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 326 (1982). The Court in *ASARCO* claimed that such a test would destroy the unitary-business concept by making *all* investments and operations part of a unitary-business as a result of the corporate purpose to earn money or provide a return on the investment of capital. *Id.*
61. *See supra* note 21-25 and accompanying text.
62. *See* McClure, *supra* note 26.
63. The authority to apportion income rather than accept separate accounting figures is grounded in a long line of cases beginning with Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924).
64. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436 (1980).
65. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2942 (1983).
66. The *Container* Court apparently concluded that the three-factor apportion-

tionment formula actually produces a reasonable picture of the generation of income. Under the external consistency component, the taxpayer corporation does not meet its burden of proof by merely showing that the apportionment formula *may* result in the taxation of income that did not have its source in the taxing state.[67] The taxpayer, to invalidate use of an apportionment formula, must present "clear and cogent evidence"[68] that the income apportioned to the state is "out of all appropriate proportion to the business transacted . . . in that State,"[69] or has "led to a grossly distorted result."[70]

The apportionment formula used by California is the three-factor formula.[71] The three-factor formula was approved by the Supreme Court in *Butler Bros. v. McColgan*,[72] and the Court has recognized the formula as a "benchmark against which other apportionment formulas are judged,"[73] in cases involving income apportionment of unitary-businesses with interstate operations.[74]

Despite the fairness attributed to the three-factor formula by the Court in the taxation of interstate enterprises, Container Corporation argued that, for international enterprises, the three-factor formula produces a distortion of income warranting its rejection.[75] Container Corporation claimed that it operated entirely within the United States, and that each of its subsidiaries operated entirely within a foreign nation.[76] Container Corporation's distortion arguments centered on the practical differences between economic

ment formula satisfies the internal consistency test. In fact, almost any formula would satisfy the internal consistency test, as long as it uniformly applied to all corporations. An example of a formula that may fail the internal consistency test is a formula that draws a distinction between domiciliary and non-domiciliary corporations, through such means as utilizing different formula ratios based on the domicile of the corporation. For example, if states A and B each taxed all of the income of domiciliary corporations and apportioned income of non-domiciliary corporations, any corporation domiciled in one state and operating in both states would be taxed on more than 100 percent of its income.

67. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2942 (1983) (citing Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272 (1978)).
68. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2942 (1983).
69. Hans Rees' Sons, Inc. v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931).
70. Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 326 (1968).
71. *See supra* note 3.
72. 315 U.S. 501 (1942).
73. Container Corp. of America v. Franchise Tax. Bd., 103 S.Ct. 2933, 2943 (1983).
74. Cases involving income apportionment of unitary-businesses with interstate operations include: Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978); General Motors Corp. v. Washington, 337 U.S. 436 (1964); Hans Rees' Sons, Inc. v. North Carolina *ex rel* Maxwell, 283 U.S. 123 (1931).
75. Brief for Appellant on the Merits at 11.
76. *Id.*

conditions in the United States and foreign nations. According to Container Corporation, California's apportionment scheme necessarily ignored differences in economic conditions, particularly differences in payroll costs and profitability, which resulted in a distortion in the apportionment of income by shifting the income from low cost/high profitability jurisdictions to high cost/low profitability jurisdictions.[77] To support these claims of income shifting, Container Corporation presented evidence of differing wage rates[78] between the United States and various foreign nations.

77. *Id.* at 12.

78. Container Corporation pointed to statistics showing that wage rates in less developed countries are significantly lower than the wage rate in the United States.

TABLE 3

HOURLY EARNINGS RATES TRANSLATED INTO UNITED STATES DOLLARS FOR WAGE EARNERS IN MANUFACTURING INDUSTRIES†

		Year		
Country	Sex	1963	1964	1965
United States	MF*	2.46	2.53	2.61
Australia	M	2.05	2.11	2.21
	F	1.43	1.49	1.54
Austria	MF	.55	.60	.65
Belgium	M	.74	.83	.90
	F	.45	.51	.56
Canada	MF	1.80	1.88	1.97
Ceylon	MF	.15	.15	.16
Chile	MF	.24	.30	.32
Colombia	MF	.30	.30	.23
Denmark	MF	1.17	1.27	1.43
El Salvador	MF	.28	.28	.29
Finland	MF	.81	.92	1.00
France	MF	.54	.58	.61
Germany	MF	.87	.94	1.03
Ghana	MF	.70	.76	.35
Greece	MF	.28	.31	.34
Guatemala	MF	.36	.36	.37
Ireland	MF	1.40	1.55	1.65
Israel	MF	.58	.64	.73
Italy	MF	.54	.59	.62
Japan	MF	.43	.48	.52
Korea	MF	.14	.09	.10
Mexico	MF	.48	.53	.56
New Zealand	MF	2.33	2.44	2.59
Norway	M	1.11	1.18	1.28
	F	.77	.83	.92

Similar evidence was presented regarding profitability.[79] Container Corporation contended that this greater profitability of foreign subsidiaries caused the basic premise of combined apportionment (that a given amount of any income factor produces the

TABLE 3 (continued)

HOURLY EARNINGS RATES TRANSLATED INTO UNITED STATES DOLLARS FOR WAGE EARNERS IN MANUFACTURING INDUSTRIES†

Country	Sex	Year 1963	1964	1965
Peru	MF	.32	.35	.35
Philippines	MF	.23	.23	.22
Puerto Rico	MF	1.13	1.18	1.24
Sweden	MF	1.41	1.54	1.69
Switzerland	M	.98	1.06	1.14
United Kingdom	M	2.48	2.67	2.93

† UNITED NATIONS, MONTHLY BULLETIN OF STATISTICS, Table 57 at 32 (Jan. 1968).

* M refers to wages of males, F refers to wages of females, and MF to a single composite figure. Figures normally include bonuses, cost of living allowances, taxes, social insurance contributions payable by the employed person and, in some cases, payments in kind. They normally exclude social insurance contributions payable by the employers, family allowances and other social security benefits.

79. Container Corporation argued that wage rate differences were not off-set by lower productivity (see Table 4), and that the amount of each of the three factors (payroll, sales, and property) required to produce one dollar of net income was lower in foreign nations (see Table 5).

TABLE 4

PERCENTAGE OF U.S. AVERAGE HOURLY COMPENSATION, ADJUSTED FOR ESTIMATED DIFFERENCES IN PRODUCTIVITY†

Country	1969	1970
Japan	40	40
West Germany	61	72
United Kingdom	65	68
Belgium	60	61
Canada	79	82
France	58	54
Italy	62	67
Netherlands	74	71
Sweden	72	74

† UNITED STATES TARIFF COMM'N, T.C. PUB. 473, COMPETITIVENESS OF U.S. INDUSTRIES 30 (1972).

same amount of income regardless of the locale of the factor)[80] to break down when applied to foreign operations.[81] As additonal evidence of the validity of this contention, Container Corporation pointed to the higher "hurdle rate" (minimum return on investment) that U.S. companies require for investing in foreign operations.[82] The apportionment of worldwide rather than domestic income allegedly resulted in a distortion of income attributed to California of approximately fourteen percent.[83]

The Court rejected Container Corporation's claims as failing to impeach the basic rationale behind use of the three-factor formula by states. The Court reasoned that Container Corporation's arguments and evidence were "based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment."[84] Because inherent flaws in separate accounting methods make them suspect of reducing the

TABLE 5

AMOUNT REQUIRED TO PRODUCE $1.00 OF NET INCOME FOR THE YEARS 1963-65†

Country	Payroll	Sales	Property
United States	$3.34	$10.65	$4.83
Colombia	0.27	5.17	4.74
Mexico	1.53	10.69	6.29
Venezuela	0.81	4.73	3.40
Germany	3.95	17.62	9.73
Netherlands	0.96	7.98	1.59

† Brief for Appellants on the Merits at 18. These figures were derived by dividing the net income produced in each country by the respective sales, payroll, and property factors for that country.

80. *See* Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2950 n.20 (1983).
81. Brief for Appellant on the Merits at 14 (referring to testimony of expert witness Prof. John C. McDonald of Stanford University). Because each dollar of a factor located in a foreign country produces a greater income, the assumption that locale makes no difference in income production has the effect of shifting income to the domestic locale with lower income production.
82. *Id.* The Court appears to have dismissed the issue as a slight imperfection, referring to the variety of factors which influence foreign investments. *See* Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2950 n.20 (1983).
83. Brief for Appellant on the Merits at 16; Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2950 (1983). This distortion figure is based on the difference between California's apportionment figure and Container Corporation's separate accounting figure. *See supra* note 18.
84. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2948 (1983). The "basic theoretical weaknesses" of separate accounting methods include imprecision, the possibilities of manipulation by corporations in order to reduce taxes, and an inadequate ability to capture many types of transfers of value.

income attributed to a state, a difference between separate accounting methods and formula apportionment in the amount of income attributed to a state does not necessarily indicate a distortion of income by the formula apportionment method.[85] The very rationale behind the use of formula apportionment by states is that it will result in the attribution of a greater amount of income to the state than separate accounting methods. The justification, from the state's standpoint, is that the larger attribution of income to the state is actually the result of additional income, produced by factors of income production located in the taxing state, which does not appear "on the books" of the corporation through separate accounting methods.

While the Court recognized that the three-factor formula is imperfect,[86] it also recognized that separate accounting is imperfect.[87] The Court concluded that Container Corporation had failed to present any evidence which would indicate that the margin of error is greater for apportionment than for separate accounting.[88] In *Hans Rees' Sons, Inc., v. North Carolina* ex rel. *Maxwell*,[89] the Court had held that the single-factor formula used by North Carolina[90] resulted in an attribution of income to the state out of any reasonable proportion to the enterprise's activities in the state. The difference between the amount of income attributed to North Carolina under separate accounting and that attributed under apportionment was 250 percent. In *Container*, only a 14 percent difference was demonstrated. The Court found this 14 percent difference fell "within the substantial margin of error inherent in any method" of income attribution.[91]

85. For example, if separate accounting methods indicate that one dollar is attributable to the state as income, and formula apportionment indicates that two dollars are attributable as income, the formula apportionment method has not necessarily distorted the income picture; it may be that the amount attributed through separate accounting is a distortion, and the apportionment figure may be the correct amount.
86. "First, the one-third-each weight given to the three factors is essentially arbitrary. Second, payroll, property, and sales still do not exhaust the entire set of factors arguably relevant to the production of income. Finally, the relationship between each of the factors and income is by no means exact." Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2949-50 n.20 (1983).
87. *See supra* note 85 and accompanying text.
88. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2949-50 (1983). If the respective margins of error in the two methods of attribution are equal (or approximately equal), then the Court would have no reason to prefer one method over the other and should leave the decision to the states.
89. 283 U.S. 123 (1931).
90. The single factor utilized by North Carolina in its apportionment formula had been the ownership of tangible property. *Id.* at 125.
91. 103 S.Ct. 2933, 2950 (1983).

The important question left open by the *Container* decision is: How substantial is the margin of error the Court considers inherent in income attribution? Aside from the reference to the "substantial margin of error" which the Court appears to consider to be an acceptable amount of distortion, the Court failed to provide an indication of how much distortion is too much, other than the 250 percent difference noted in *Hans Rees' Sons* and the reference to impermissibly gross distortion.[92] Taken together, *Hans Rees' Sons* and *Container* suggest a broad range of allowable distortion, which in future litigation may compel the courts to attempt to specify outside limits on the amount of alleged distortion (based on the difference between separate accounting and apportionment figures) that will be considered constitutionally permissible. The Court's reluctance to draw a line indicating what percentage differential is too great appears to be grounded in the difficulty of appraising the distortion inherent in the two income attribution methods and the Court's apparent preference for granting the states wide latitude in the application of the unitary-business/formula apportionment method.[93]

III. FOREIGN COMMERCE CONSIDERATIONS

Had Container Corporation's unitary-business been entirely domestic, the Court's analysis of the California apportionment method would have concluded with the unitary-business and income distortion issues.[94] However, the international character of the taxation in *Container* presented additional constitutional considerations under the foreign commerce clause. While California and a number of other states[95] have adopted the worldwide income apportionment approach for taxation of multinational unitary-businesses, the federal government and the foreign jurisdictions in which Container Corporation's subsidiaries operate utilize a form

92. *See id.* at 2948-49.

93. If the Court were to establish a limit as to the percentage of permissible distortion, an additional problem might result. Corporations would have an incentive to manipulate their separate accounting procedures to create a differential over the limit specified by the Court. By leaving impermissible distortion an "open" question, the Court has provided itself and state courts the opportunity to carefully review the record of each case when deciding the distortion issue.

94. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2950 (1983).

95. At this writing, twelve states have adopted the worldwide income approach to apportionment: Alaska, California, Colorado, Florida, Idaho, Indiana, Massachusetts, Montana, New Hampshire, North Dakota, Oregon and Utah. *Unitary Tax*, *supra* note 6, at G-6. Florida adopted the worldwide approach immediately after the Court announced the *Container* decision. *Court's Blueprint used by Florida in Unitary Tax Law*, DAILY TAX REPORT (BNA) No. 136, at G-5 (July 14, 1983).

of separate accounting analysis commonly known as the "arm's-length" approach.[96] This difference in approach to the taxation of multinationals produces considerations involving double taxation and federal uniformity in the international context.

A. Double Taxation

Under the internationally accepted arm's-length approach to corporate income attribution,[97] foreign nations have the right to tax all of the income attributed to those nations by separate accounting methods. Container Corporation claimed that use of formula apportionment by states results in the attribution of some of that foreign-taxed income to the United States, resulting in the income being taxed twice.[98] The Court had recognized in *Japan Line Ltd. v. County of Los Angeles*,[99] that "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned."[100] Container Corporation argued such actual double taxation existed in its case, and therefore, the Court should strike down the use of apportionment in the international context.

In its foreign commerce analysis of double taxation, the Court applied a level of scrutiny in which it considered the context in

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96. 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.

Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2950 (1983).

97. Brief for Appellant on the Merits at 30.

98. Container Corporation claimed that approximately four million dollars of additional income attributed to the United States during the years at issue was also taxed in the foreign nation to which it was attributed through separate accounting. Brief for Appellant on the Merits at 21.

99. 441 U.S. 434 (1979) (striking down property tax on cargo shipping containers owned, based, and registered abroad because containers were used exclusively in international commerce and because containers were subjected to full taxation by the nation in which they were based).

100. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 456 (1979) (footnote omitted). Matters of foreign tax or trade retaliation by foreign nations against the United States arise from the threat of double taxation. In addition, there is no international forum in which to adjust formulas and their application to avoid double taxation problems. Container Corporation argued: "Where [domestic] apportionment formulas conflict, the Court can determine whether any one formula is to blame and invalidate the unfair formula. In foreign commerce, however, no tribunal exists to ensure that income earned in foreign commerce is taxed in the aggregate only once." Brief for Appellant on the Merits at 24.

which the double taxation occurs[101] and the alternatives reasonably available to the taxing state.[102] While relying heavily on the double taxation analysis of *Japan Line*, the Court refused to require the states to use the internationally accepted arm's-length approach.

The context of the taxation in *Container* involved closely linked entities operating in essentially the same business.[103] While the arm's-length approach urged by Container Corporation generally accepts the enterprise's separate accounting figures, the approach also recognizes the possibility of transfers of value between closely affiliated entities, in much the same vein as formula apportionment.[104] From this perspective, the worldwide income apportionment approach is not so far out of step with the approach generally

101. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2953 (1983). The "context" includes the type of business and entities involved and the international setting in which the taxation takes place.

102. *Id.*

103. *Id.* at 2943.

104. In rejecting Container Corporation's analysis in support of the arm's-length method, and recognizing the similarities between formula apportionment and the arm's-length method, the Court pointed to a provision of United States tax law:

> 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 such organizations, trades, or businesses.

I.R.C. § 482 (1976). The Treasury Regulations implementing this section provide in part:

> The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer, is other than it would have been had the taxpayer in the conduct of his affairs been an uncontrolled taxpayer dealing at arm's-length with another uncontrolled taxpayer.

Treas. Reg. § 1.482-1(c) (1968). This regulation relies primarily on the clear-reflection-of-income portion of I.R.C. § 482. In Ruddick Corp. v. United States, 643 F.2d 747 (Ct. Cl. 1981), the Court of Claims held that "the presence of a business purpose or the absence of any plan to lessen taxes does not, in and of itself, exclude the operation of the [§ 482] provision." *Id.* at 750. As indicated previously, the Court has imposed a constitutional requirement on the unitary-business determination that a bond of ownership or control be found. *See supra* note 25 and accompanying text. Thus, § 482, as interpreted by both the Treasury Department and the courts, appears to operate in a manner akin to formula apportionment, i.e., attempts to more closely capture the true generation of income despite separate accounting figures and formal divisions of entities.

used in the international context.[105]

The setting in which the double taxation occurs directly affects the alternatives available to the taxing state in any attempt to avoid double taxation. The double taxation in *Japan Line* had been almost entirely avoidable by adherence to the international rule of not taxing cargo containers "owned, based, and registered abroad . . . that are used exclusively in international commerce."[106] The *Container* Court found no similar rule to avoid double taxation.[107] Even the arm's-length approach, with its provisions for dealing with controlled entities,[108] and with its differing rules among nations in its use,[109] poses a risk of double taxation which the Court considered to be roughly equivalent to the threat posed by the formula apportionment method.[110] In addition, the double taxation posed by the formula apportionment method is not inevitable; the method may result in no double taxation or even an under-taxation in which less than the total income of the unitary-business is subjected to taxation.[111] Finally, the Court dismissed the alternative of requiring states to adopt a method of taxation which would not result in *any* international double taxation. If such an alternative were adopted and carried to its logical extreme, the Court found that it would require states to defer "to a variety of . . . reallocation decisions made by individual foreign countries in individual cases."[112] The Court, finding this requirement to be too extreme, stated that "although double taxation is a constitutionally disfavored[113] state of affairs, particularly in the international context, *Japan Line* does not require forbearance so extreme or so one-sided."[114]

The bottom line of the Court's opinion appears to rest on the

105. The *Container* Court found other nations to have similar provisions for evaluating the income attribution of controlled entities. 103 S.Ct. 2933, 2953 (1983).
106. 441 U.S. 434, 444 (1979).
107. The Court mentioned the alternative of not taxing a multinational corporation's income at all. 103 S.Ct. 2933, 2953 (1983). Such an alternative, however, is plainly unfair, and was discussed by the Court only to highlight the absence of a feasible alternative.
108. *See supra* note 104.
109. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2954 (1983).
110. *Id.*
111. For example, in Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102, 417 N.E.2d 1343 (1981), *appeal dismissed sub nom.* Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 457 U.S. 1103 (1983), the court ruled that Caterpillar Tractor was entitled to a tax refund as a result of the application of the unitary-business doctrine and formula apportionment.
112. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2955 (1983).
113. Constitutional disfavor is not to be equated with constitutional prohibition. *Id.* at 2953. While double taxation is to be avoided whenever possible, the Court has not absolutely prohibited the existence of all double taxation.
114. *Id.* at 2955.

nature of the threat of double taxation. While California's tax in *Container* resulted in *actual* double taxation, as long as double taxation under the apportionment method is not inevitable and double taxation under the arm's-length method remains a possibility, the Court found no compulsion to strike down the apportionment system. This result is not surprising, considering the Court's acceptance of the states' suspicions of separate accounting methods of income attribution.[115] Given what it concluded to be two taxing systems that posed similar threats of double taxation, and the lack of a feasible alternative, the Court appears to have accepted what it considers to be a tolerable level of double taxation, even in the international context. The Court's acceptance of some double taxation as tolerable appears to be justified. While no international judicial forum exists to avoid the problems of double taxation,[116] multinational corporations are not without recourse to Congress to seek their desired result. Given this legislative alternative, the Court's refusal to require the states to adjust their taxation to the vagaries of other nations' methods appears sound. A crucial question which remains is: What are the limits of this tolerable double taxation? The answer to this question is probably linked to the income distortion issue,[117] because both the distortion and the international double taxation issues involve, in essence, income being taxed twice as a result of the method of income attribution. However, the tolerable limits on international double taxation may be more strict than the limits on income distortion (particularly income distortion in the domestic context), due to the sensitivity the Court evidences toward international matters.[118]

B. Federal Uniformity[119]

Because of the possible international repercussions[120] presented by the California tax, an additional inquiry under the foreign commerce clause is whether the apportionment method "impair[s] federal uniformity in an area where federal uniformity

115. *See supra* notes 5 & 84 and accompanying text.
116. *See supra* note 100.
117. *See supra* Section II(B) of text.
118. *See* Japan Line Ltd. v. County of Los Angeles, 441 U.S. 434, 456 (1979). For discussion of underlying reasons for this sensitivity, see *supra* note 100.
119. At the outset, it should be noted that the federal uniformity involved in this case is not the federal tax uniformity of Art. I, § 8, cl. 1 of the Constitution. Article I, § 8, cl. 1 refers to uniformity of federal taxes as applied to the states. The federal uniformity involved in *Container* refers to the United States speaking with one-voice in matters of foreign policy and international trade.
120. *See infra* notes 134-138 and accompanying text.

is essential."[121] This inquiry does not invalidate a state tax when the tax "has foreign resonances, but does not implicate foreign affairs,"[122] unless Congress has explicitly directed the states to conform to a single approach.[123] The determination of whether a state tax violates federal uniformity involves a two-step analysis, whereby the tax will be invalidated if it either:

1) is in violation of a clear federal directive; or
2) "implicates foreign policy issues which must be left to the Federal Government."[124]

While Congress has not enacted federal statutes to pre-empt state legislation in this area,[125] the question of whether a clear federal directive pre-empts state apportionment of worldwide income through the unitary-business concept involves more than a search for specific federal legislation prohibiting such a state taxation method.[126] Tax treaties to which the United States is a party may also pre-empt state use of a taxation method. However, the Court found no directive in the tax treaties of the United States. Despite the fact that various tax treaties require the Federal Government to use the arm's-length approach in taxing multinationals, that requirement is generally waived in the case of taxation of a nation's own domestic corporations.[127] Since Container Corporation is a domestic corporation, the federal tax treaties provided no clear directive on the approach to be taken by the states.[128] Finally, the Court noted that none of the United States tax treaties control the taxing activities of "sub-national governmental units such as [s]tates,"[129] noting also that the Senate had declined to consent to such a treaty provision extending restrictions against apportionment to the states.[130]

121. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 424, 448 (1979).
122. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2955 (1983).
123. *Id.*
124. *Id.*
125. *Id.* at 2956.
126. Congress has considered, but has failed to enact, legislation to regulate this area of state income taxation. *Id.* During the litigation of *Container*, a bill was introduced in Congress to prohibit apportionment of worldwide income. H.R. 2918, 98th Cong., 1st Sess. (1983). A companion bill was later introduced to the Senate. S. 1225, 98th Cong., 1st Sess. (1983). *Tax Cases Decided in Supreme Court's Latest Term Are Deemed Most Significant in More Than a Decade*, DAILY TAX REPORT (BNA) No. 162, at K-1 (Aug. 19, 1983).
127. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2956 (1983).
128. *Id.*
129. *Id.*
130. *Id. See also* 124 CONG. REC. 18400, 19076 (1978). Given the Court's hesitance to intrude into "essentially legislative" areas, Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2943 (1983), the Court's reluctance to enter here is not surprising. *See* Moorman Mfg. Co. v. Bair, 437 U.S. 267, 278-80 (1978).

Without a clear federal directive prohibiting state use of apportionment in the international context, the question left is whether foreign policy matters properly left to the federal government are involved. Container Corporation argued that the "asymmetry"[131] in international taxation created by the apportionment method's conflict with the international norm of the arm's-length method would result in foreign trade retaliation. In support of this claim, Container Corporation pointed to an *amicus curiae* brief filed by the Solicitor General in a related case,[132] which urged restriction of state apportionment due to the threat of foreign trade retaliation. The threat of retaliation was allegedly due to the income distortion and double taxation problems that the tax presents,[133] and the potential inhibition of foreign investments by U.S. firms.[134]

In considering this matter, the Court claimed little competence in evaluating the possible offensiveness of this tax policy to foreign nations, or in balancing the risk of retaliation against United States' sovereign rights in tax policy.[135] Nevertheless, the Court attempted to create a general framework in which to view the issue. The Court quickly dismissed the claim that the tax created an automatic asymmetry in international taxation.[136] Second, the Court noted that the tax in *Container*, unlike that in *Japan Line*, was levied against a domestic corporation rather than a foreign corporation.[137] However, the repercussions of this dichotomy between domestic and foreign corporations was not discussed by the Court.[138] Third, the Court claimed that, despite the interests of

131. Brief for Appellant on the Merits at 33. *See also* Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 450-53 (1979).
132. The Solicitor General filed an *amicus curiae* brief in Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., 457 U.S. 1103 (1983). However, no *amicus curiae* brief was filed by the Solicitor General in *Container*.
133. *See supra* Sections II(B) & III(A) of text.
134. A cause of the potential inhibition of foreign investment is that U.S. firms would demand a greater return on foreign investments to compensate for the increased tax liabilities. This higher hurdle rate would mean that fewer foreign investment options would meet the criteria for investment by American firms. *See infra* note 138 and accompanying text.
135. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2955 (1983).
136. The Court failed to provide any hint as to when it would find automatic asymmetry. The question, though, appears to be roughly equivalent to the question of inevitable double taxation. As long as the tax does not inevitably result in double taxation, asymmetry does not automatically result.
137. The Court explicitly left open the question of whether it would change its analysis in a situation involving a domestic corporation owned by foreign interests. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2956 n.32 (1983).
138. The dissent in *Container* argued that this domestic-foreign dichotomy was unwarranted and could have serious repercussions concerning foreign investment by United States firms. *Id.* at 2959-60 (Powell, J., dissenting). For an excellent discussion of the possible effects of this dichotomy see WhiteNack,

foreign nations, Container Corporation was "amenable to be taxed in California one way or another."[139] The Court reasoned that the amount of taxes paid by Container Corporation was as much a function of the tax rate applied by California as it was a function of the apportionment method.[140] Finally, the Court was confronted with the Solicitor General's *amicus curiae* brief filed in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*[141] in which the Solicitor General had opposed states' use of the unitary-business concept and formula apportionment of worldwide income. The Court declined to speculate as to why the Solictor General had not filed *amicus curiae* brief in *Container*,[142] but concluded that the executive branch's political position may have changed on the issue.[143] This possible shift of the political sands, together with the other factors considered, convinced the Court that the tax did not implicate foreign policy issues properly left to the Federal Government.[144]

Given the political repercussions of the tax,[145] the Court's decision to permit the states to tax within broad constitutional limita-

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supra note 3, at 779-82. The governments of Canada, Japan, the Netherlands, and the United Kingdom have protested to the United States regarding the investment effects of worldwide income apportionment. *Administration Seeks Unitary Method Compromise*, 20 TAX NOTES 1026 (1983); *Tax Policy*, DAILY TAX REPORT (BNA) (Sept. 13, 1983); *Unitary Tax*, *supra* note 6, at G-4; *Unitary Taxes*, DAILY TAX REPORT (BNA) No. 182, at G-6 (Sept. 19, 1983).

139. Container Corp. of America v. Franchise Tax Bd., 103 S.Ct. 2933, 2956 (1983).

140. The dissent objected strenously to this rationale, claiming:

> Although [the argument that California could impose the same tax burden under the arm's-length method simply by raising the general tax rate] may be true in theory, the argument ignores the political restraints that make such a course infeasible. If [Container's] tax rate were increased, the State would be forced to raise the rate for all corporations.

Id. at 2960 (Powell, J., dissenting). The dissent's position appears to be correct here. But, the factor-of-the-tax-rate rationale was not the only justification used by the Court in rejecting Container Corporation's claims of foreign trade retaliation and inhibition of foreign investment; the Court's other rationale (no automatic asymmetry and the foreign-domestic corporation distinction) sufficiently justify rejection of those claims.

141. *See supra* note 132.

142. Container Corp. of America v. Franchise Tax Bd., 2933, 2956 n.33 (1983).

143. *Id.* However, the dissent claimed that the Court's conclusion clearly ignored the position of the executive branch:

> I recognize that the Government may change its position from time to time, but I see no reason to ignore its view in one case currently pending before the Court when considering another case that raises exactly the same issue. The Solicitor General has not withdrawn his memorandum, nor has he supplemented with anything taking a contrary position.

Id. at 2960 (Powell, J., dissenting).

144. *Id.* at 2957.

145. In addition to the international and corporate concerns, the concept of the

tions appears sound. Opposition to the tax by various nations[146] and corporate interests[147] has been met by strong state support for the tax.[148] Congress appears to be divided on the issue.[149] In response to this divisiveness, President Reagan ordered the Justice Department not to file an *amicus curiae* brief in support of a rehearing in *Container*.[150] And in an attempt to develop recommendations and possibly a compromise,[151] President Reagan called for the formation of an international task force, to be composed of representatives from the states, the Federal Government, multinational firms, and major trading partners of the United States.[152] The conclusion to be drawn from this deluge of political concern and activity is that the Court was correct in its opinion that the resolution of this matter was beyond its competency and should not be decided in a judicial forum. Had the Court chosen to bind itself, on the basis of a Solicitor General's opinion in a prior case,[153] to the conclusion that the tax method infringed on federal uniformity, the Court would have struck down the tax on *constitu-*

New Federalism, designed to shift responsibility and power to the states, comes into play on this issue. *See infra* note 148.

146. *See supra* note 138.
147. *See, e.g.*, *Current and Quotable, The Unitary Method of Taxation: Two Views*, 20 TAX NOTES 1045 (1983) (a letter to Treasury Secretary Regan from Franklin A. Cole, Chair of the Board of the Walter E. Heller Corporation, in opposition to the worldwide application of the unitary-business/formula apportionment method).
148. *See, e.g.*, *Current and Quotable, The Unitary Method of Taxation: Two Views*, 20 TAX NOTES 1045 (1983) (a letter to President Reagan from Illinois Governor James R. Thompson, Chair of the National Governor's Association, in support of the worldwide applicaton of the unitary-business/formula apportionment method; Governor Thompson's letter refers to agreement between the nation's governors and President Reagan on the principles of the New Federalism).
149. *See supra* note 126. *See also Seventeen Senators Defend Unitary Method*, 14 TAX NOTES 221 (1982) (a letter to Treasury Secretary Regan from seventeen Senators defending the states' use of the unitary-business method).
150. *Unitary Tax*, DAILY TAX REPORT (BNA) No. 185, at G-5 (Sept. 22, 1983). Without the Solicitor General's *amicus curiae* brief, Container Corporation had virtually no hope for rehearing. *Unitary Taxes*, DAILY TAX REPORT (BNA) No. 197, at G-1 (Oct. 11, 1983).
151. *Administration Seeks Unitary Method Compromise*, 20 TAX NOTES 1026 (1983).
152. *Unitary Tax*, *supra* note 6, at G-5.
153. Admittedly, *Chicago Bridge & Iron v. Caterpillar Tractor Co.*, was closely related to the *Container* case. However, based on the numerous factors and the divergent political concerns which are involved with this issue, the Court would have had good reason to not accept the Solicitor General's opinion as determinative even if such an opinion had been specifically filed in *Container*. Acceptance of the Solicitor General's opinion as determinative would have circumvented the political process. *But see* WhiteNack, *supra* note 3, at 778-79 (claiming the Supreme Court was the appropriate forum for this issue).

tional grounds. Such an action by the Court would have taken the question from the essentially political (legislative and executive) forum in which the question clearly belongs. In the absence of explicit congressional directives, the Court has been reluctant to fashion specific constitutional limitations to restrain state powers of taxation; thus, the Court has permitted the political process to come to an appropriate political resolution.[154]

IV. CONCLUSION

The *Container* decision encompassed the major issues of state corporate income taxation through the use of apportionment of worldwide income: the determination of a unitary-business, the distortion of income through apportionment, and the foreign commerce clause considerations of double taxation and federal uniformity. In the determination of a unitary-business, the Court refused to restrict the states to a "flow of goods" test. The Court reaffirmed the "flow of value" test and the functional inquiry into economies of scale and value transfers, indicating, in rather clear language, that an initial state court determination should not be reversed as long as that court uses the proper standards and reaches a decision which is within "the realm of permissible judgment." In the determination of a unitary-business, the states are left with a full range of constitutional taxing power, subject only to self-imposed restrictions.

The Court found that Container Corporation's evidence, demonstrating differing international economic conditions and a resultant 14 percent difference between apportionment and separate accounting figures, did not present a level of income distortion warranting rejection of the formula apportionment method in the international context. The Court left open the question of how great a difference is necessary to invalidate the use of apportionment. However, the Court's emphasis on the 250 percent difference struck down in *Hans Rees' Sons*, and its reliance on the lack of a "gross distortion," appear to indicate that a very large difference, with supporting analysis and evidence, will be necessary to invalidate worldwide income apportionment in a given case.

154. Even critics of the *Container* decision concede that Congressional action could clearly resolve the issue, and have called for Congrss to act. *See, e.g.*, WhiteNack, *supra* note 3, at 772. Disagreement with the tax policy, however, should not lead to the conclusion that the Court incorrectly decided the case, even if Congress chooses to limit or eliminate the states' options in this area. The issue is clearly one for Congress and the President to resolve as a matter of policy. Absent the necessary federal pre-emption, the restraints on state taxation should only be limited by the broad constitutional limitations enunciated by the Court.

Foreign commerce clause objections were also insufficient to warrant rejection of the apportionment method. Despite the existence of *actual* double taxation, the Court, for a number of reasons, found the double taxation in *Container* to have been tolerable. The Court also failed to find any explicit federal directive prohibiting the states from using the apportionment method in the international context. Nor did the Court find that the tax implicated foreign policy matters which constitutionally must be left to the Federal Government. Absent an explicit federal directive, the *Container* decision permits the states to employ the apportionment method despite the possibility of foreign trade retaliation.

The result of *Container* is to allow states a very full range of permissible taxing activity. Absent federal action to restrict the states, the Court is not inclined to impose many restrictions of a constitutional nature. Considering the present political divisiveness on the limitation of the state taxing power permitted by *Container*, and the search for a compromise at the executive and legislative levels, the Court's decision appears to be a sound one. The *Container* decision forces the issue to resolution at the federal policy level, where a final, more informed, and politically sensitive resolution may be reached without unnecessary constitutional restraints.

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