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Constitutional Law: Requiring States to Treat Foreign and Domestic Subsidiaries Alike

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CONSTITUTIONAL LAW: REQUIRING STATES TO TREAT FOREIGN AND DOMESTIC SUBSIDIARY DIVIDENDS ALIKE*

Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance, 112 S. Ct. 2365 (1992)

I. STATEMENT OF THE CASE AND FACTS

Petitioner was a corporate taxpayer in Iowa.[1] In computing taxable income for its 1981 Iowan tax return, Petitioner deducted dividends received from its foreign[2] subsidiaries despite contrary provisions in

* This work is dedicated to Jodi, my wife, whose love and often unacknowledged support have given me continuous encouragement.

1. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2367 (1992).

2. Throughout this commentary, "foreign" will relate to things from non-U.S. sources. Conversely, "domestic" will relate to things from U.S. sources. *E.g.*, 26 U.S.C.A. § 7701(a)(4) (West 1989) (defining "domestic corporation" as a corporation "created or organized in the United States or under the law of the United States or of any State").

Iowa's tax law.[3] Iowa's tax law, which merely replicated the federal definition of taxable income,[4] only granted deductions for domestic subsidiary dividends.[5] Thus, Respondent was assessed a deficiency.[6] Petitioner unsuccessfully challenged the assessment by filing an administrative protest.[7] Petitioner subsequently tested the deficiency assessment in Iowa's courts.[8] Petitioner claimed that Iowa's differential tax treatment for domestic and foreign subsidiary dividends was facially discriminatory and, therefore, unconstitutional.[9] The Supreme Court of Iowa, like the lower court, disagreed with Petitioner.[10] Iowa's Supreme Court based its decision on Petitioner's failure to prove that the state's taxing scheme gave Iowa's businesses a commercial advantage over foreign commerce.[11] The United States Supreme Court granted certiorari[12] and accepted briefs from the United States and other amici.[13] After arguments, the Court reversed the lower court's decision,[14] and HELD, state tax schemes that do not allow a corporation to deduct foreign subsidiary dividends but permit a deduction for

3. 112 S. Ct. at 2368.

4. *See id.* at 2367 n.4 (referring to 26 U.S.C. § 243 (1988)).

5. *Id.* at 2367.

6. *Id.* at 2368.

7. *Id.*

8. *Id.*; *see* Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d 664 (Iowa 1991) (affirming lower courts' decisions denying a refund to Petitioner). From a legal realist's point of view, it is not surprising that the judicial arm of state government would uphold a taxation decision of the state's legislative and executive arms. However, Congress bars a party from seeking federal judicial relief in state taxation matters if the state provides some form of remedy. Tax Injunction Act, 28 U.S.C. § 1341 (1988) (barring federal district courts from enjoining, suspending or restraining the "assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had" in the state courts). *See also* Franchise Tax Bd. v. Alcan Aluminum Ltd., 493 U.S. 331 (1990) (upholding Tax Injunction Act as a bar to federal court's ability to hear claim of foreign corporation seeking declaratory judgment regarding the constitutionality of California's state tax).

9. 465 N.W.2d at 665.

10. *Id.* at 669.

11. *Id.* at 666-68.

12. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 931 (1992) (granting certiorari).

13. *See* Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 45 (1991) (inviting Solicitor General to file brief); Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 1467 (1991) (granting Solicitor General permission to participate in oral argument).

14. 112 S. Ct. at 2372. The Court voted 7-2 for reversal with Justices White, O'Connor, Scalia, Kennedy, Souter, and Thomas, joining in the majority opinion penned by Justice Stevens.

domestic subsidiary dividends, facially discriminate against foreign commerce, and therefore violate the Constitution's Foreign Commerce Clause.[15]

II. DEVELOPMENT OF FOREIGN COMMERCE CLAUSE JURISPRUDENCE

The Framers of the Constitution granted Congress broad powers to regulate commerce.[16] In fact, Congress' "commerce powers" were the primary force behind the failure of the Articles of Confederation and the adoption of the Constitution.[17] One effect of this grant of

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15. *Id.*; U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes").

16. *See, e.g.*, Dennis v. Higgins, 111 S. Ct. 865, 874 (1991) (Kennedy, J., dissenting) (stating that both the events surrounding and the writings documenting the failure of the Articles of Confederation and the drafting and ratification of the Constitution evidenced the framers' pre-occupation with creating an economic union); H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 533 (1949) (observing that the only reason Virginia began the movement which led to the adoption of the Constitution was "to take into consideration the trade of the United States; to examine the relative situations and trade of the said States; to consider how far a uniform system in their commercial regulations may be necessary to their common interest and their permanent harmony") (internal citation omitted); Henry B. Gonzalez, *The Relinquishment of Co-equality by Congress*, 29 HARV. J. ON LEGIS. 331, 333-34 (1992) (noting that under the Articles of Confederation, there was no central government that could raise revenues and prevent interstate competition for revenues).

17. *See* cases cited *supra* note 16; Michelin Tire Corp. v. Wages, 423 U.S. 276, 283 (1976) (observing that "[o]ne of the major defects of the Articles of Confederation, and a compelling reason for the calling of the Constitutional Convention of 1787, was the fact that the Articles essentially left the individual States free to burden commerce both among themselves and with foreign countries very much as they pleased"); Cook v. Pennsylvania, 97 U.S. 566, 574 (1878) (stating that the need to regulate commerce was the most pressing concern at the Constitutional convention).

> In granting to Congress the right to regulate commerce with foreign nations, and among the several States, and with the Indian tribes, and in forbidding the States without the consent of that body to levy any tax on imports, the framers of the Constitution believed that they had sufficiently guarded against the dangers of any taxation by the States which would interfere with the freest interchange of commodities among the people of the different States, and by the people of the States with citizens and subjects of foreign governments.

97 U.S. at 574.

power away from the states was a prohibition against discriminatory treatment of foreign commerce.[18]

A. Cook v. Pennsylvania: *The Court's First Case Involving the Foreign Commerce Clause*

The Court first addressed the problem of discriminatory taxation of foreign commerce in *Cook v. Pennsylvania.*[19] In *Cook,* the Court considered the validity of a Pennsylvania statute that levied a tax on the proceeds of items sold at auction.[20] Two provisions of the sales tax statute provided for the equal taxation of foreign and domestic goods and merchandise; a third provision granted domestic products an exemption from the levy.[21] Finding the tax to be discriminatory in nature, the Court held that the levy violated the Foreign Commerce Clause.[22]

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18. *See supra* text accompanying note 8. Although *Michelin* focuses its historical review on the Import-Export clause of the Constitution, this history is relevant to the Foreign Commerce Clause's jurisprudential development due to the overlap between both clauses. *See, e.g.*, Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 449-50 n.14 (observing that "[t]he policies animating the Import-Export Clause and the Commerce Clause are much the same"); Department of Revenue v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 754-55 (1978) (applying four-prong test from Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), to challenge under Commerce Clause).

> The Framers sought to ensure that measures bearing an inherent risk of international commercial retaliation would lie within the sole discretion of the national government, acting in the collective self-interest of all the states, rather than within the power of each individual state acting by its own rights. If it be otherwise, a single State can, at her pleasure, embroil us in disastrous quarrels with other nations.

Chy Lung v. Freeman, 92 U.S. 275, 280 (1875).

19. 97 U.S. at 566.

20. *Id.* at 569-70.

21. *Id.* at 569 (noting that duty due on auction sales was on all domestic articles and groceries at one-half of one percent and on foreign drugs, glass, earthenware, hides, marble-work, and dye-woods at three-quarters of one percent; however, the law was modified to except merchandise of American growth or manufacture).

22. *See id.* at 575. The Court also found that the taxing statute violated the Import-Export Clause of the Constitution. *Id.* at 573.

Two years earlier, the Court held that a state statute which discriminated against out-of-state goods was unconstitutional. *See* Welton v. Missouri, 91 U.S. 275 (1875). On the other hand, if a tax was found to not discriminate between in-state and out-of-state goods, the Court, prior to *Cook*, upheld these taxing statutes. *See, e.g.*, Woodruff v. Parham, 75 U.S. 123 (1869) (upholding auction sales tax on domestic goods and goods from sister states); Hinson v. Lott, 75 U.S. 148 (1869) (upholding a $.50/gallon tax on "spirituous liquors" manufactured in or out of the state).

In reaching this decision, the Court rebuffed the state's assertions that the tax was on the auctioneer or, alternatively, on the privilege of selling the goods at auction.[23] The Court found that the tax was on the foreign articles sold.[24] The *Cook* Court based its reasoning on past interstate commerce cases that analogously found discriminatory taxation of out-of-state goods to be unconstitutional.[25] Thus, the Court concluded that since a tax applied only to foreign goods, in effect, it placed a duty on imports and was unconstitutional.[26]

B. Japan Line, Ltd. v. County of Los Angeles: *The Court Sets Forth the Test for Evaluating Statutes Under the Foreign Commerce Clause*

More than a century after the *Cook* decision, the Court in *Japan Line, Ltd. v. County of Los Angeles* set forth the test for evaluating state taxing statutes under the Foreign Commerce Clause.[27] In *Japan Line*, the appellant Japanese shipping companies' vessels carried cargo containers that, like the ships, were owned by appellants, were based, registered, and subjected to property tax in Japan, and were used exclusively in foreign commerce.[28] Some of the appellants' containers, however, were temporarily present in Los Angeles, and the county levied a nondiscriminatory ad valorem property tax on the containers.[29] The *Japan Line* Court ruled that the tax violated the Foreign Commerce Clause.[30]

Hearing the case on appeal,[31] the Supreme Court set forth the two step process for determining whether a non-federal taxing statute

23. 97 U.S. at 570.

24. *Id.* at 570-71 (rejecting argument that without an auctioneer's license the auctioneer could not even have sold domestic goods and that the auctioneer collected the tax from the purchasers of the foreign goods).

25. *Id.* at 573-75.

26. *Id.* at 573.

27. 441 U.S. 434 (1979).

28. *Id.* at 436-37.

29. *Id.* at 437. Property present in California on March 1, the "lien date" under California law, is subject to ad valorem property tax. *See* CAL. REV. & TAX. CODE §§ 117, 405, 2192 (West 1992) (sections set forth provisions defining lien date, annual assessment, and lien date, respectively). The Court accepted the assertion that the number of appellants' containers physically present in appellees' jurisdictions on the "lien date" fairly represented the containers' average presence in the county during the year. 441 U.S. at 437.

30. 441 U.S. at 453-54, 457.

31. *Id.* at 440. The Court took jurisdiction under 28 U.S.C. § 1257(2) (1911) (current version at 28 U.S.C. § 1257(a) (1988)).

satisfied the Foreign Commerce Clause.[32] When a non-federal statute tries to tax instrumentalities of foreign commerce, the tax must first pass scrutiny under standard Commerce Clause analysis.[33] This analysis examines whether the tax (1) is applied to an activity having a substantial nexus with the taxing jurisdiction, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the jurisdiction.[34] Second, a court must also determine whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation and whether it prevents the federal government from speaking with "one voice" in an area in which it is essential for the federal government to speak with one voice — regulating commerce with foreign nations.[35]

The *Japan Line* Court found that the property tax did not satisfy the second part of the Foreign Commerce Clause analysis.[36] Under the multiple taxation factor, the Court found that the containers were actually subject to an unapportioned property tax in their domicile of Japan.[37] Therefore, the Court concluded that the property tax resulted in the multiple taxation of an instrumentality of foreign commerce.[38] Under the "one voice" factor, the Court said that since the United States was a member of an international convention dealing with containers, the tax prevented the federal government from speaking with

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32. 441 U.S. at 445-47.

The Court avoided deciding this case under the "home port doctrine," which asks whether the mere use of international routes is enough to insulate property from tax anywhere but in the "home port" taxing jurisdiction. *Id.* at 442-43. The Court's unwillingness to invoke the "home port doctrine" can be explained, however, by the Court's adoption of apportionment and other methods to determine whether goods, services or income are properly taxed by a state. *Id.* at 442. *See, e.g.*, Braniff Airways, Inc. v. Nebraska State Bd. of Equalization & Assessment, 347 U.S. 590, 602 (1954) (interpreting away "home port doctrine" to allow taxation based on use of airplanes within taxing jurisdiction); Standard Oil Co. v. Peck, 342 U.S. 382, 384 (1952) (interpreting prior cases to permit other states other than those of the corporate domicile to tax boats in interstate commerce on the apportionment basis in accordance with their use in the taxing state).

33. 441 U.S. at 445; *see also* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279, 287 (1977) (developing the four-part test for evaluating state taxing statutes under the Interstate Commerce Clause).

34. 441 U.S. at 444-45 (adopting test from *Complete Auto*, 430 U.S. at 279).

35. *Id.* at 449-51 (adopting two-part test from Michelin Tire Corp. v. Wages, 423 U.S. 276, 285 (1976) (evaluating a state levy under Import and Export Clause)).

36. *Id.* at 451-52.

37. *Id.* at 452 n.17.

38. *Id.* at 452.

"one voice."[39] Since the tax was at odds with a federal policy and subjected the foreign property to multiple taxation, the Court found the tax to be unconstitutional.[40]

C. Container Corp. of America v. Franchise Tax Board: *The Court Finds That the Foreign Commerce Clause Does Not Prohibit Taxation of an International Unitary Business*

Invoking the *Japan Line* analysis, the Court upheld a franchise tax against a challenge that the levy violated the Foreign Commerce Clause in *Container Corp. of America v. Franchise Tax Board.*[41] In *Container Corp. of America*, the appellee tax board said that the appellant should have treated its foreign subsidiaries as part of its unitary business[42] and included the subsidiaries' income as part of its

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39. *Id.* Appellants' containers entered the United States pursuant to the Customs Convention on Containers. *Id.* at 446 n.10. The Customs Convention on Containers "grants containers 'temporary admission free of import duties and import taxes and free of import prohibitions and restrictions,' provided they are used solely in foreign commerce and are subject to re-exportation." *Id.* Customs Convention on Containers, May 18, 1956, art. I(b), 20 U.S.T. 301, 304, *quoted in* Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 435 n.1 (1979). There is also a tax convention between Japan and the United States that seeks to minimize multiple taxation and specifically addresses the problem of containers used in international commerce. Convention for the Avoidance of Double Taxation, Mar. 8, 1971, United States-Japan, 23 U.S.T. 967, 1084-85.

40. 441 U.S. at 453-54, 457.

41. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 185-96 (1983).

42. "Unitary Business" method and "Arm's Length" or "Separate Accounting" method are taxation methodologies for determining taxable income. *Id.* at 165, 184-85. The Unitary Business method determines whether a corporation subject to tax in a jurisdiction is part of a larger unitary business. *Id.* at 165-66. If it is part of a unitary business, the taxed entity must include within its taxable income the income of the entire "unitary business" (generally, income from other corporations) for apportionment by the taxing state. *Id.* at 165, 167-69. In determining whether there is an unitary business, courts examine whether there is a flow of capital resources from taxpayer to its subsidiaries through loans and loan guarantees and the managerial role played by taxpayer in its subsidiaries' affairs. *Id.* at 180 n.19.

The Arm's Length or Separate Accounting method treats corporations as independent businesses. *Id.* at 184-85 & n.21. This method relies on standard bookkeeping methods to keep distinct corporations' incomes separate. *Id.*

Some cases explaining the two methods of assembling a tax base and addressing some problems arising under state "unitary business" schemes are: ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 327 (1982) (mere dividend payments from domestic subsidiary corporations did not create unitary business); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354, 362, 368-69 (1982) (mere dividend payments from international subsidiary corporations did not create unitary business since mere potential to operate as a unit is not enough); and Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 224-26 (1980) (vertically integrated company can have all income subjected to a state's apportionment formula without the need for the state to attempt to assign particular values to situs states). *See generally* James M. Kane, *International Tax Treaties and State Taxation: Can the Federal Government Speak With One Voice?*, 10 VA. TAX REV. 765 (1991).

taxable income.[43] The appellant paid the assessment under protest and was subsequently denied a refund by the state courts.[44]

On appeal, the Supreme Court evaluated the tax by applying the two-part test announced in *Japan Line* to an income tax context.[45] First, the Court found that the tax satisfied the standard four-part commerce clause analysis.[46] The Court then examined the tax under the second part of the *Japan Line* test to determine if the levy created multiple taxation or prevented the federal government from speaking with one voice.[47]

Regarding multiple taxation, the Court acknowledged that the state's use of the unitary taxation method was at odds with the international norm and caused multiple taxation.[48] The Court concluded, however, that multiple taxation was not an inevitable result of the state's taxing method and, moreover, differences in application and characterization of facts could cause multiple taxation even if the state and international community utilized the same method.[49] Therefore, the state's tax did not substantially increase the risk of multiple taxation.[50] The Court also noted under its multiple tax analysis that, unlike *Japan Line*, the incidence of the tax fell on a domestic corporation.[51]

The Court then examined the tax under the federal uniformity or "one voice" standard.[52] The Court stated that, if a state tax involves foreign policy issues that must be left to the federal government, or if it violates a clear federal directive, then the tax must be struck down.[53] As to foreign policy implications, the Court noted that the greatest threat presented by the state's levy was the risk of offending foreign trading partners who might retaliate against the United States.[54] The Court stated, however, that it was unable to balance a particular risk of retaliation against the sovereign rights of the states to tax as they saw fit.[55] Faced with this inability, and with no direct

43. 463 U.S. at 163.
44. *Id.* at 175.
45. *Id.* at 185.
46. *Id.* at 185-86.
47. *Id.* at 186.
48. *Id.* at 191. *Cf.* 135 CONG. REC. E780 (daily ed. Mar. 14, 1989) (statement of Rep. Frenzel).
49. 463 U.S. at 191-93.
50. *Id.* at 192-93.
51. *Id.* at 194.
52. *Id.* at 193-94; *see* Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 448, 453 (1979).
53. 463 U.S. at 194.
54. *Id.*
55. *Id.*

action by Congress, the Court evaluated the tax under certain objective standards that reflected its general observations about the imperatives of international trade and international relations.[56]

The Court set forth several factors that satisfied those objective standards.[57] For example, the Court observed that the tax was imposed, and its legal incidence fell, on a domestic corporation, not a foreign corporation as in *Japan Line*.[58] The Court also noted that the state had the right to tax some portion of the corporation's income, and the state could increase that portion by raising its tax rate.[59] These factors, in addition to the fact that the federal government had not filed an amicus brief, led the Court to conclude that foreign policy was not endangered by the tax.[60] The Court also noted that the tax had not been preempted by a direct federal directive, nor was there a treaty or convention in place that precluded the state's tax.[61] As a result, the Court upheld the state's unitary business taxing scheme against the Foreign Commerce Clause challenge.[62]

III. Instant Case

In the instant case, the Court determined that the state taxing scheme violated the Foreign Commerce Clause since it mandated dissimilar taxation of foreign subsidiary dividends and domestic subsidiary dividends.[63] Since the state taxing scheme allowed domestic subsidiary dividends to be deducted from taxable income, foreign subsidiary dividends were required to be given the same favorable tax treatment.[64] Although there was no dispute that Petitioner, as an unitary business, was amenable to the state's taxation of its income, absent a provision granting like tax treatment, the instant Court held

56. *Id.* at 194.

57. *Id.*

58. *Id.* at 195.

59. *Id.*

60. *Id.* at 195-96 (observing that in *Container Corp. of Am.*, unlike *Japan Line*, the Executive Branch decided not to file an amicus curiae brief in opposition to the state tax).

61. *Id.* at 196.

62. *Id.* at 197. The dissent's analysis found the tax to be in clear violation of the Foreign Commerce Clause. Although agreeing with the distinctions between the *Container Corp. of Am.* and *Japan Line* situations, the dissent found the facts identical on "the critical questions of double taxation and federal uniformity," the second half of *Japan Line* analysis. *See id.* at 197-205.

63. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2371-72 (1992).

64. *See id.*

that Iowa's tax scheme facially discriminated against foreign commerce.[65]

The instant Court reasoned that the flow of value between a domestic parent corporation and its foreign subsidiaries was foreign commerce entitled to constitutional protection.[66] Although a multi-national corporation could avoid Iowa's discriminatory tax by changing the domicile of its subsidiary corporations, the instant Court held that this possibility did not justify differences in tax treatment.[67] The instant decision also suggested that a state's preference for domestic commerce over foreign commerce is inconsistent with Commerce Clause analysis even if the state's own economy is not the direct beneficiary of the discrimination.[68] Thus, an absence of local benefit did not eliminate the international implications of discriminatory taxation.[69]

The instant Court focused on the international implications rather than on the federal government's brief and arguments in favor of Iowa's tax system.[70] The Court also found that the adoption of the federal taxation system in whole or in part did not shield a state tax statute from Commerce Clause scrutiny.[71] The Court also rejected Iowa's assertion that the corporate taxation scheme was justified since

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65. *Id.* Besides the cases in the text above, the principle that a state may not impose a tax that discriminates against interstate commerce has been repeatedly reaffirmed by a long line of United States Supreme Court decisions. *See, e.g.*, Amerada Hess Corp. v. New Jersey Dep't of the Treasury, 490 U.S. 66 (1989); American Trucking Ass'n v. Scheiner, 483 U.S. 266 (1987); Maryland v. Louisiana, 451 U.S. 725 (1981); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963). The Court's bar against discriminatory taxation applies even when it is in the form of tax credits. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984).

Although the instant Court rejected Iowa's statutory method of calculating a state's tax base, the Court had previously upheld the state's single factor sales-based apportionment formula against Due Process Clause and Commerce Clause challenges in Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978). *See* IOWA CODE ANN. § 422.33(2) (West 1992). Thus, for a corporation like Petitioner, the calculation of taxable income for Iowa would look like this: (Iowa Gross Sales / Total Gross Sales) x (Federal Taxable Income adjusted per Iowa Law) = Iowa Taxable Income. Shell Oil Co. v. Iowa Dep't of Revenue, 488 U.S. 19, 23 (1988).

66. 112 S. Ct. at 2369.

67. *Id.*

68. *Id.* at 2370.

69. *Id.*

70. *See id.* at 2370-71 (expressly addressing claims jointly made by Iowa and the United States and then, rejecting them).

71. *Id.* at 2369.

it promoted administrative convenience.[72] Finding no justification for the discrimination, the Court struck down the tax.[73]

IV. Analysis of Instant Case

A. *The Instant Case Expanded the Breadth of the Foreign Commerce Clause*

The instant decision expanded the breadth of Foreign Commerce Clause jurisprudence.[74] Unlike *Container Corp. of America* which sustained a state levy on a domestic corporation because the United States filed a brief supporting the tax, the instant Court held that the taxing scheme failed although this support was present;[75] the instant Court overlooked the presence of the federal government's amicus brief and upheld the domestic corporation's Foreign Commerce Clause challenge.[76] The Court also went beyond *Container Corp. of*

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72. *Id.* at 2371-72.

73. *Id.* at 2372.

74. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 191 n.30 (1983). The *Container Corp. of Am.* Court did not address the question presented in the instant case, however, dicta in *Container Corp. of Am.* indicated that the instant decision could have been decided differently.

> Another problem arises out of the treatment of inter-corporate dividends . . . . In which State that dividend could be taxed is not particularly important, since the issue here is international rather than interstate double taxation. It also could be argued that this would not, strictly speaking, result in double taxation, since the income taxed would be income "of" the parent rather than income "of" the subsidiary. The effect, however, would often be to penalize an enterprise simply because it has adopted a particular corporate structure. In practice, therefore, most jurisdictions allow for tax credits or outright exemptions for inter-corporate dividends among closely-tied corporations, and provision for such credits or exemptions is often included in tax treaties. No suggestion has been made here that appellant's dividends from its subsidiaries would have to be exempt entirely from domestic state taxation. And the grant of a credit, which is the approach taken by federal law, does not in fact entirely eliminate effective double taxation: the same income is still taxed twice, although the credit insures that the total tax is no greater than that which would be paid under the higher of the two tax rates involved. *Moreover, once the Federal Government has allowed a credit for foreign taxes on a particular inter-corporate dividend, we are not persuaded why, as a logical matter, a State would have to grant another credit of its own, since the federal credit would have already vindicated the goal of not subjecting the taxpayer to a higher tax burden that it would have to bear if its subsidiary's income were not taxed abroad.*

Id. (internal citations omitted) (emphasis added).

75. *See* 112 S. Ct. at 2370-71.

76. *Id.*

America's additional rationale that recognized that any shortfall created by the Court's removal of foreign dividends from a state's tax base could be eliminated by increases in the tax rate or by changes in the state's apportionment formula.[77]

The Court also expanded the Foreign Commerce Clause by recognizing foreign dividends as articles of commerce.[78] This recognition of intangible property goes beyond *Cook*'s prohibition against discriminatory taxation of tangible foreign goods and merchandise.[79] Thus, the instant decision afforded greater Foreign Commerce Clause protection to a broader class of foreign commerce.[80]

The instant Court also took a step away from *Japan Line*. Although the instant decision diminished the possibility of multiple taxation, the Court increased the potency of the "one voice" idea.[81] The instant decision no longer limits the federal government's "one voice" to areas where it is essential.[82] This expansion of the "one voice" factor to more areas of foreign commerce is evident by the instant Court's failure to follow the Executive branch's suggestion that "one voice" was not necessary in this case.[83]

B. *The Court's Expanded Role in the Regulation of International Commerce*

The expansion of the areas requiring federal uniformity, however, indicate a move by the Court to substitute its own voice in place of the Executive branch's in those areas where the Court finds that it need not follow the federal government's briefed position.[84] Thus, it

77. *Id.*

78. *Id.* at 2369.

79. *See supra* note 21 and accompanying text.

80. 112 S. Ct. at 2369.

81. *See* 463 U.S. at 193-94 (stating that if a state tax merely has foreign resonances, but does not implicate foreign affairs, the Court could not infer that foreign income must be treated the same at the state and federal levels); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 448 (1980) (requiring explicit directive from Congress before Court infers that state taxes must conform with federal guidelines).

82. *See* Japan Line, Ltd. v. County of L.A., 441 U.S. 434, 448-49 (1979) (stating that the phrase "one voice" refers to whether the tax "may impair federal uniformity in an area where federal uniformity is essential") (quoting Michelin Tire Corp. v. Wages, 423 U.S. 276, 285 (1976)).

83. 112 S. Ct. at 2370-72. The United States, in its brief, urged the Court to uphold Iowa's taxing scheme. *Id.*; *International Commerce Issues*, FIN. TIMES LIMITED, July 1992, *available in* LEXIS, Nexis Library, Omni File.

84. 441 U.S. at 448-49.

was the Court's "one voice" and not the federal government's voice that spoke with the international community in this case.[85] This was a departure by the Court from prior decisions, like *Japan Line*, in which the Court said that it lacked the capacity to make foreign policy decisions.[86] Although the President and his subordinates probably still play the primary role in deciding how the United States will act in the international community, this case demonstrates the important role played by the Court.[87] In particular, the instant case displays the need for foreign governments and businesses affected by state regulation of international commerce to make their voices heard through amicus briefs when the Court considers international issues.[88]

C. *Limiting the Scope of State and Local Taxation*

With the expansion of the Foreign Commerce Clause, the instant decision also sharply curtailed the ability of state and local governments to raise revenues and levy taxes.[89] Following this case, states

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85. Whether the Court will continue to speak to the international community directly or, whether it will follow the suggestions of the United States as presented in their amicus briefs, will probably become evident when the Court renders its decision in Itel Containers Int'l Corp. v. Cardwell, 814 S.W.2d 29 (Tenn. 1991), *cert. granted sub nom.* Itel Containers Int'l Corp. v. Huddleston, 112 S. Ct. 1158 (1992). In this case, which is before the Supreme Court at the time this Comment is penned, Tennessee, the only state in the union that applies its general sales tax to the act of leasing cargo containers that are used exclusively in international commerce, is supported by the United States, which has filed an amicus brief on the state's behalf. *International Commerce Issues, supra* note 83.

86. 463 U.S. at 194; *see supra* text accompanying notes 45-62.

87. *See supra* text accompanying note 85. The important role of the Court has been recognized by the international community. For example, in *Itel Containers Int'l Corp.*, the United Kingdom has filed an amicus brief with the Court. *International Commerce Issues, supra* note 83.

88. *See supra* text accompanying notes 85 & 87; *International Commerce Issues, supra* note 83.

89. However, states may react to the threat to their revenues by raising their tax rates or by changing their apportionment formulae instead of seeking to modify their tax bases. The Court has heretofore given states wide latitude with determining rates of taxation and developing apportionment formulae.

The only limits placed on state tax rates by the Court have been on the application of rates. *See, e.g.*, McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco, Dep't of Business Regulation, 496 U.S. 18 (1990) (determining remedy for party unconstitutionally taxed by state taxing scheme that allowed for a rate reduction for alcoholic products containing products indigenous to Florida). Non-federal tax rates may be limited, however, from other sources like state constitutions. *E.g.*, FLA. CONST. art. VII, § 9(b) (limiting ad valorem tax rate chargeable by municipalities); GA. CONST. art. VII, § 1, ¶ II(a) (limiting rate of state ad valorem taxes on tangible personal property). The Court has not yet addressed whether the Constitution limits the rates that states can levy.

The Court has placed some limitations on apportionment formulae. These limitations, however, have not been significant. *See, e.g.*, Allied-Signal, Inc. v. Director, Div. of Taxation, 112 will now have to attempt to cure any discriminatory treatment of foreign subsidiary dividend taxation. Because of other constitutional limitations on state taxation, it is unlikely that states will react by taxing both foreign and domestic dividends.[90] Thus, states will probably have to go beyond the federal code and grant foreign subsidiary dividends a deduction.[91]

However, rewriting state tax provisions that affect dividends may be difficult. For example, the instant decision put states on notice that mere adoption of the federal code provisions does not mean that the state tax scheme will automatically be found constitutional.[92] In addition, the need to avoid Foreign Commerce Clause problems is augmented by the instant Court's decision that discriminating tax schemes must be supported by a "significant justification."[93]

Beyond the Foreign Commerce Clause, the instant decision also calls state taxation of domestic interstate dividends into question. The instant case, in the manner of *Cook*, may be applied analogously to standard Commerce Clause cases.[94] The Court's willingness to look beyond the issue of whether a tax scheme discriminates in favor of in-state commerce seems to indicate that the Court may expand standard Commerce Clause analysis to consider a taxing scheme's effect on the nation as a whole.[95]

S. Ct. 2251, 2259 (1992) (states have "wide authority" to devise apportionment formulae); Trinova Corp. v. Michigan Dep't of Treasury, 498 U.S. 358 (1991) (upholding Michigan's business tax, which is a value added tax, as a proper apportionment formula); Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66, 73 (1989) (approving three factor apportionment formula); Shell Oil Co. v. Iowa Dep't of Revenue, 488 U.S. 19, 22-23 (1988) (approving Iowa's single factor apportionment formula based on sales alone); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) (approving standard three factor apportionment formula).

90. Besides the Foreign Commerce Clause, the Constitution sets other limits on the states' ability to tax corporations. For example, *Kraft* challenged the instant taxing scheme Equal Protection grounds in addition to its Foreign Commerce Clause challenge. Kraft Gen. Foods v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2368 (1992).

91. The federal tax scheme allows a foreign dividends deduction in computing taxable income or alternatively, the scheme allows a tax credit. I.R.C. §§ 243, 901, 902 (West 1992).

92. *See* 112 S. Ct. at 2367-69.

93. *Id.* at 2371.

94. *See* discussion *supra* pp. 2-3.

95. 112 S. Ct. at 2370 (stating that discrimination that does not benefit taxing jurisdiction is still discrimination and thus unconstitutional); *see* Barclay's Bank Int'l Ltd. v. Franchise Tax Bd., 10 Cal. App. 4th 1678, 14 Cal. Rptr. 2d 537, 542 n.3 (Cal. Ct. App. 1992) (observing that tax that benefits locals is discriminatory under the Constitution).

As used here, the idea that the Court is looking at the effect of the tax on the nation as a whole is a reflection of the Court's perceived role in foreign commerce. More specifically, the

Besides these future problems, the instant decision left unanswered an important question that will have an immediate effect on state treasuries. Specifically, the instant decision did not provide a remedy for Petitioner. Because the Court did not indicate whether the instant case would apply prospectively or retroactively, many corporate taxpayers may now seek refunds for taxes paid on foreign dividends that were, according to the instant decision, unconstitutionally taxed.[96]

V. CONCLUSION

The instant case's ultimate impact on state and local taxation of foreign commerce remains to be seen.[97] Undoubtedly, the problems with drafting constitutional tax statutes and the lack of a remedy for unconstitutionally taxed foreign dividends will be addressed in the future.[98] The ultimate effect of the Court's expanded role within this

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Court is examining what effect the tax will have on the nation as a result of the tax's effect on foreign commerce.

This is a different perspective than the Court utilizes when it looks at the whole United States during standard Commerce Clause analysis of discrimination. Under the Commerce Clause, the Court determines whether the state levy is internally and externally consistent. The Court's evaluation, however, is confined to an analysis of the tax's effect on the 50 states, and does not consider the ramifications of the particular levy on foreign commerce. *See* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 169-70 (1983) (laying down tests for internal and external consistency of apportionment formulae).

96. Prior to the instant case, the Court has indicated the manner in which remedies for unconstitutional state tax levies should be addressed by the states. James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991) (discussing the ways a decision may be applied in the past and the future for remedial purposes); *see also* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 277 n.14 (1984) (suggesting that it is permissible to make retroactive refunds of unconstitutional levies). However, there continues to be confusion as to whether and, if so, to what extent, the Court's decisions are to be prospective or retroactive.

This issue should be significantly clarified by *Harper v. Virginia Dep't of Taxation*, a case currently before the Court on certiorari at the time this Comment is penned. Although this case will probably lay to rest this issue relating to remedies, the history of this case demonstrates the difficulty faced by a taxpayer, who seeks a remedy for an unconstitutional tax, and also demonstrates the added costs created by the Court's failure to remand cases to state courts with clear instructions and orders. *See* Harper v. Virginia Dep't of Taxation, 401 S.E.2d 868 (Va. 1991), *cert. granted and judgment vacated sub nom.* Lewy v. Virginia Dep't of Taxation, 111 S. Ct. 2883 (1991), *on remand*, Harper v. Virginia Dep't of Taxation, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 112 S. Ct. 1934 (1992).

97. *See supra* text accompanying note 85.

98. Congress could address the problem of interstate and foreign taxation under its broad Commerce Clause powers. *See, e.g.*, Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 976-88 (1992) (proposing that Congress, under the Commerce Clause, fix the tax base that states may levy upon and leaving each state only the power to set the rate of the tax). Congress, however, has been slow to respond to interstate

area of taxation, however, will probably result in greater uniformity between each state's interstate and international taxing schemes.[99] To this end, the instant Court reasserted its supremacy in this area and began the work of bringing state schemes of corporate taxation back within the limits of the Foreign Commerce Clause.[100]

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and foreign taxation problems. For example, Congress did not exercise its powers to restrict state and local taxation of interstate commerce until 1959 when it enacted Public Law 86-272. 15 U.S.C.A. § 381(a) (West 1992) (barring states from taxing out-of-state corporations that do not have significant contact with the taxing jurisdiction). Since that time, Congress has only rarely exercised its power. Walter Hellerstein, *State Taxation of Interstate Business: Perspective on Two Centuries of Constitutional Adjudication*, 41 TAX LAW. 37 (1987).

99. This uniformity in developing what a state may tax as taxable income, however, may be offset by the Court's acceptance of a multiplicity of taxing schemes. *See supra* note 89. *See, e.g.*, *Trinova Corp.*, 111 S. Ct. at 818 (approving a state business tax which applies an apportionment formula unlike any other in the Union).

100. The Court's willingness to take the lead in determining how state taxation can constitutionally impact foreign commerce is in sharp contrast to the Court's expressed unwillingness to play the same role domestically. *See* Quill Corp. v. North Dakota, 112 S. Ct. 1904, 1916 (1992) (observing that Congress is in a better position to deal with interstate tax problems — at least with regard to use taxes — and expressing that Congress has the constitutional power to solve those problems). *See also supra* text accompanying note 98 (noting Congress' lack of attention to interstate tax problems).