# IMMIGRATION AS AN INTRA-COMPANY TRANSFEREE AND THE PITFALL OF THE CALIFORNIA UNITARY TAX

Only a decade ago the term multinational corporation automatically implied that a United States firm was doing business abroad,[1] while today it may imply that a foreign firm is doing business in the United States. During the 1970's, the major corporations of Europe and Asia — Philips of the Netherlands, Unilever of Great Britain, Siemens and Thyssen of Germany, Mitsubishi and Matsushita of Japan — began to significantly challenge American corporations in their efforts to dominate the world marketplace.[2] As American investment overseas diminished, foreign investment in the United States skyrocketed.[3] In 1978 over 358 foreign firms invested $40.9 billion in United States manufacturing.[4] This total is the largest since World War II.[5] As economic and political uncertainty proliferate abroad more and more foreign corporations and entrepreneurs are finding the United States a desirable place in which to live and invest.

While visiting the United States as temporary business visitors,[6] many foreign businessmen are attracted by the lower cost of

1. Brittain, *Foreign Direct Investment in the U.S.*, 45 VITAL SPEECHES OF THE DAY 431 (1979).

2. Gray, *The New Realities of Business*, 45 VITAL SPEECHES OF THE DAY 536 (1979).

3. Jaffe, *Foreign Investors in the U.S. — the Pace Quickens*, FORBES, Apr. 2, 1979, at 73.

4. Foreign Direct Investment in the United States

| | Foreign direct investment position in the United States at year-end 1978. | | Addition to foreign direct investment position in the United States during 1978. | |
|---|---|---|---|---|
| | Billions of Dollars | Percent | Billions of dollars | Percent |
| 4 largest positions: | | | | |
| Netherlands | 9.8 | 23.9 | 1.9 | 31.1 |
| United Kingdom | 7.4 | 18.1 | 1.0 | 15.6 |
| Canada | 6.2 | 15.1 | .5 | 8.3 |
| Germany | 3.2 | 7.8 | .7 | 10.6 |
| Other coutries | 14.3 | 35.1 | 2.1 | 34.4 |
| Total | 40.9 | | 6.2 | |

Sources: Survey of Current Business of the U.S. Department of Commerce.

5. Brittain, *supra* note 1, at 431.

6. Temporary visitors for business enter the United States on a B-1 visa. This is perhaps the most obvious type of nonimmigrant and by far the most numerous. To qualify, the alien must satisfy three requirements: an unabandoned residence in a foreign country, a

producing goods in the United States than in their home countries,[7] the size[8] and growth potential of the United States market, and the "bargain buys" their strong currencies now command. Hoping to tap this lucrative market and fearful of political unrest at home,[9] these businessmen often seek to relocate their families and themselves by establishing a business in the United States. Foreign executives frequently solicit advice from American counsel on how to proceed before returning home.[10] On the one hand, immigration attorneys who deal with these alien businessmen are finding that they must have a basic understanding of business and tax law if they are to effectively serve these clients.[11] On the other hand, tax attorneys are realizing they too must have a rudimentary understanding of immigration law.

The purpose of this Comment is to provide attorneys with a more complete understanding of the complexity of the immigration and state tax problems facing owners and shareholders of closely-held foreign companies desiring to set up affiliated offices in the United States, particularly in California. This Comment will first present the history and changes in the immigration law with an explanation of why the "intra-company transferee"[12] has become one of the more viable vehicles for foreign businessmen wishing to immigrate[13] to the United States. The promotion of foreign investment as the underlying policy of the law pertaining to intra-company transferees will then be examined. Attention will then focus on the policy of the California unitary tax[14] system and how it

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temporary visit, and a mission for business or pleasure. 1 C. GORDON & H. ROSENFELD, IMMIGRATION LAW AND PROCEDURE, § 2.8a, at 2-55 (1979).

7. U.S. NEWS & WORLD REPORT, Feb. 13, 1978, at 79.

8. *Id.*

9. *Id.*

10. Interview with Dennis Mukai, Esquire, Nishiyama, Mukai, Leewong & Henry, Los Angeles, California (Jan. 15, 1980). Mr. Mukai practices immigration law.

11. *Id.*

12. An intra-company transferee in this context is an alien who, immediately preceding his admission into the United States, has been employed continuously for one year by a foreign or United States firm in a managerial or executive capacity, or in a position requiring specialized knowledge. The alien must seek to enter the United States on a temporary basis (one to three years) to render services to the same employer firm. *See* notes 29-36 *infra* and accompanying text.

13. By seeking temporary or permanent residency. GORDON & ROSENFELD, *supra* note 6, § 2.1b, at 2-13.

14. Several states, notably California, employ a unitary method of taxation to determine the amount of taxable income of a multinational corporation doing business in the state. To compute the amount of taxes owing to the state the worldwide income of the corporation is multiplied by a percentage that corresponds to the amount of property, payroll and sales that

frustrates the Congressional intent behind the immigration law. Owners of closely-held foreign companies seeking to establish a branch office[15] or subsidiary[16] of the international enterprise in California may encounter adverse state tax consequences. A chilling effect upon investment in California is the unfortunate result. The detrimental consequences of the state unitary tax upon the international business relations of the United States and its possible Constitutional ramifications will then be discussed. Finally, this Comment will recommend present and long-term solutions to the policy conflicts between federal immigration law and state tax law.

## I. IMMIGRATION OPPORTUNITIES FOR ALIEN EMPLOYEES OF INTERNATIONAL COMPANIES

### *A. Obtaining Temporary Residence in the United States as an Intra-Company Transferee*

In order to understand the application of immigration law to foreign executives seeking to relocate in the United States, a brief explanation of the immigration quota system is necessary. In addition, the various methods of securing temporary or permanent residence in the United States need to be discussed.

Current immigration law allows 290,000 individuals to become permanent residents of or immigrants[17] to the United States annually. Under the "quota" or numerical limitation system, aliens are divided into two categories: (1) Immigrants — those seeking permanent residence and (2) Nonimmigrants — those admitted for

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the company has in the state. This income amount may substantially differ from the actual income amount earned if the company's in-state activities were treated separately from its out-of-state activities. *See* notes 93-108 *infra* and accompanying text.

Several articles have appeared regarding the federal taxation of resident and nonresident aliens. *See* Navarro, *Do's and Don'ts in Tax Planning for Nonresident Aliens*, 117 TRUSTS & EST. 484 (1978); Rosenberg & Packman, *Taxation of Foreign Executives in the U.S.*, 57 TAXES 9 (1979); Shaw, *Controlled Foreign Corporations: Determining Control Under Subpart F*, 11 CORNELL INT'L L.J. 343 (1978); Sturm, *Taxation of the Foreign Investor in the United States*, 55 TAXES 542 (1977).

15. A branch office is a subdivision of a single corporation. It will often be referred to as an affiliated or related corporation throughout this Comment. An affiliate is a person directly or indirectly controlled by a common owner. 17 C.F.R. § 230.405(a) (1980).

16. A subsidiary is a company directly or indirectly controlled by another company owning all or a majority of its shares. 17 C.F.R. § 230.405(u) (1980). For purposes of immigration law, the definition of subsidiary and affiliate remain unsettled. *See* notes 47-69 *infra* and accompanying text.

17. Immigrants are those who come for permanent stay in the United States and who eventually may be naturalized as American citizens. Nonimmigrants are those admitted for temporary sojourn. GORDON & ROSENFELD, *supra* note 6, § 2.1b, at 2-13.

temporary stay.[18] Every alien is presumed by law to be an immigrant unless he can establish that he is a nonimmigrant.[19] A nonimmigrant is not subject to the quota, whereas an immigrant is required to conform to numerical restrictions and to stricter documentation requirements, since no more than 20,000 immigrants per country are allowed to immigrate in any one year.[20]

The quota system classifies immigrants into seven different preferences or priorities,[21] each consisting of a certain percentage of the overall 20,000 "allotted" to each country.[22] Any portion of the yearly quota not used by the seven preference groups becomes the eighth preference or "nonpreference" category under which other qualified immigrants may apply.[23] One "nonpreference" category consists of aliens desiring to become immigrants or permanent United States residents by investing $40,000.00 in a business in which they will be a principal manager.[24]

Many foreign businessmen with the requisite $40,000.00 have

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18. During its first hundred years the United States placed no limits on immigration. The Temporary Quota Act of 1921 was enacted in response to demands for numerical limitations on immigration. The Immigration and Nationality Act of 1952, known as the McCarran-Walter Act, subsequently codified all immigration laws into one statute. *Id.* § 2.1a, at 2-11. Restrictions on immigration sought to achieve two purposes: To reduce the number of immigrants and to preserve the racial balance of our population. *Id.* § 2.5(a), at 2-41.

19. *Id.* § 2.25, at 2-182.26.

20. The statutory system of classification has crucial significance in a number of respects:

1. It facilitates the administration of the immigration system.
2. It controls the terms and the documents under which an alien may be admitted; otherwise he may be subject to exclusion.
3. It determines the scope of the entrant's activities in the United States.
4. It determines eligibility for naturalization.

*Id.* § 2.5b, at 2-43. The following aliens are excluded from the quota system: "immediate relatives" (spouses, minor children and parents of United States citizens), and "special immigrants." *Id.* § 2.18(c), at 2-138, & §§ 2.19-.24, at 2-181.

21. a) First preference: unmarried sons and daughters of United States citizens. *Id.* § 2.27b, at 2-194.

b) Second preference: spouses and unmarried sons and daughters of lawfully resident aliens. *Id.* § 2.27c, at 2-196.

c) Third preference: professionals, scientists, artists. *Id.* § 2.27d, at 2-197.

d) Fourth preference: married sons and daughters of United States citizens. *Id.* § 2.27e, at 2-205.

e) Fifth preference: brothers and sisters of United States citizens. *Id.* § 2.27f, at 2-206.

f) Sixth preference: immigrants coming to perform labor. *Id.* § 2.27g, at 2-209.

g) Seventh preference: refugees. *Id.* § 2.27h, at 2-211.

22. *Id.* § 2.27a, at 2-193.

23. *Id.* § 2.27i, at 2-224.

24. Business investor: One coming to engage in a commercial or agricultural enterprise in which he has invested, or is actively in the process of investing, capital totalling at least $40,000 in an enterprise in the United States in which he will be a principal manager and

become aware of this investor category[25] and would prefer to immigrate to the United States in this manner.[26] Unfortunately, because the seven preference categories are becoming increasingly exhausted,[27] visas in the "business investor" category are currently unavailable and will remain so for the indefinite future.[28]

The most viable substitute to the investment alternative under present law is immigration as an intra-company transferee. This temporary visa category was established by Congress in 1970 and it defines an intra-company transferee (L-1) as:

> (L) an alien who, immediately preceding the time of his application for admission into the United States, has been employed continuously for one year by a firm or corporation or other legal entity or an affiliate or subsidiary thereof and who seeks to enter the United States temporarily in order to continue to render his services to the same employer or a subsidiary or affiliate thereof in a capacity that is managerial, executive, or involves specialized knowledge, . . .[29]

The purpose of the law was two-fold. First, to facilitate temporary admission to the United States of executive, managerial, and specialist personnel of international enterprises. Second, to encourage foreign investment in the United States by allowing foreign corporations to set up affiliates in this country.[30] Prior to the enactment of the statute foreign employees could not be admitted for temporary assignment to a United States-based affiliate of a foreign or American company.[31] Notwithstanding their intention to remain temporarily in the United States,[32] alien employees were forced to apply for permanent rather than temporary visas.[33] This resulted in an "oversubscription" of resident visas and a lengthy waiting period for those executives seeking a transfer to the United

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which will employ a person or persons in the United States who are American citizens or lawful resident aliens. 8 C.F.R. § 212(b)(4) (1980); 8 U.S.C. § 1182(14) (1952).

25. *Id.*

26. Interview with D. Mukai, *supra* note 10.

27. Yonemura & Ungar, *Representation of Foreign Investors and International Personnel*, 56 INTERPRETER RELEASES, 491, 492 (1979).

28. *Id.* at 492.

29. 8 U.S.C. § 1101(a)(15)(L) (1970).

30. S.2593, 91st Cong., 2d Sess. (1970). 116 CONG. REC. 31 (daily ed. Mar. 3, 1970).

31. No such provisions existed. *Id.* at 1422.

32. A significant number of foreign nationals who may be brought to the United States by international companies either intend to return to their home countries or go to third countries in higher management positions. H.R. REP. NO. 91-851, 91st Cong., 2d Sess. 2750, 2752 (1970).

33. It is significant to note that United States corporations generally do not experience similar difficulties in transferring personnel from the United States to other countries. *Id.*

States.[34] This "undue delay" in immigration procedures seriously hampered "normal business operations,"[35] and it was hoped that this legislation would remedy the situation.[36]

1. *The Intra-Company Transferee: Employee or Entrepreneur? The California Problem.* The Congressional history indicates that the employer "firm, corporation or other legal entity" was intended to include partnerships, sole proprietorships, and labor organizations.[37] Thus, if a foreign businessman were the owner of a closely-held company, he could have someone with the requisite intra-company transferee qualifications[38] sent to the United States to join an already existing office or to set one up.[39] Alternatively, he could leave someone in charge of the home office and transfer himself. A valid business reason for his United States office must exist, or the Immigration and Naturalization Service (INS)[40] might view the entire transaction as a sham and deny the L-1 visa application.[41]

The Western Regional office of the INS[42] has recently assumed an anti-business stance which severely restricts owners and shareholders of closely-held companies who seek to avail themselves of L-1 status. On October 31, 1979, the Western office denied an L-1 visa to a one-third owner of a London-based investment holding company who was to become President of an Arizona subsidiary engaged in the same business.[43] The Regional office held that the

34. Delays of a year or more have resulted. *Id.* at 2754.

35. *Id.*

36. *Id.* at 2755.

37. "It is anticipated that the words 'firm' and 'legal entity' will be interpreted in the broad sense to include all bona fide forms of business organizations including partnerships, sole proprietorships and labor organizations." *See supra* note 30, at 2793.

38. A manager, executive or one with specialized knowledge. *See* note 29 *supra*.

39. The corporation need not have an established United States office before intra-company transferee status is granted. As long as a bona fide intent to begin business in the United States can be shown, the petition will be approved. Matter of LeBlanc, 13 Int. Dec. 816 (B.I.A. 1971).

40. The Immigration and Naturalization Service headquarters is known as the Central Office and is located in Washington, D.C. The Central office has the authority to review decisions of the Regional offices under 8 C.F.R. § 103.3(e) (1980). The INS is a division of the Department of Justice. GORDON & ROSENFELD, *supra* note 6, § 1.9a, at 1-45.

41. Yonemura & Ungar, *supra* note 27, at 500.

42. A reorganization of the INS resulted in a decentralization of all case work from the Central Office in Washington, D.C. to four regional offices: the Eastern Regional Office in Burlington, Vt.; the Northern Regional Office, in Minneapolis and St. Paul, Minn.; the Southern Regional Office in Dallas, Texas; and the Western Regional Office in San Pedro, California. GORDON & ROSENFELD, *supra* note 6, § 1.9b, at 1-46. *See also* 8 CFR § 100.4(a) (1980).

43. Matter of Aphrodite Investment Ltd., 17 Int. Dec. - Int. Dec. No. 2826 (B.I.A. 1980), *rev'd*, Acting Associate Commissioner's decision (August 22, 1980). *See also* Amicus Curiae

word "employed" as used in the L-1 statute means employee and not owner, stockholder or partner in the United States or foreign organization and that the Congressional purpose behind the L-1 statute was to aid "larger international corporations in the transfer of key managers, executives and employees. . . ." and not to allow entrepreneurs to immigrate under the L-1 status.[44] This position was contrary to that taken by other regional offices.

Upon review by the Central Office, in Washington, this decision was reversed and the L-1 visa was granted.[45] Relying upon an earlier decision which held that a sole stockholder of a corporation was able to be employed by that corporation as the corporation has a separate legal entity from its owners or even its sole owner, the Central Office reasoned that "if we were to adopt the definition of employee [that the Western Regional Office has suggested,] we would exclude some of the very people the statute intends to benefit: executives." As the Central Office's decision is a precedent decision it is binding upon the Western Regional Office.[46]

2. *Required Company Relationships to Accomodate Transferee Status: Affiliate or Subsidiary*. The statute grants L-1 status to an alien who has been employed by a "firm . . . or an affiliate or subsidiary thereof. . . ."[47] There is a split of authority among the Regions concerning the criteria necessary to establish affiliation[48] between two firms or corporations. Some intra-company financial interest must be shown through stock ownership by one company or by the individual shareholders in its affiliate or sister company, but exactly how much financial control is needed remains unsettled. Some decisions hold that a majority stock ownership in one company by the parent is required for two companies to be affiliated,[49] while other decisions hold that a franchise and licensing

brief for beneficiary, at 3, Matter of Aphrodite Investment Ltd., 17 Int. Dec. - Int. Dec. No. 2826 (1980). A copy of the brief is available from the office of the Association of Immigration and Nationality Lawyers, 233 Broadway, New York, New York.

44. *Id.* at 4.

45. *Id.*

46. "In addition to the decisions of the Attorney General and the Board, . . . Service Officers decisions selected by the Commissioner shall serve as precedents in all proceedings involving the same issue or issues and, except as they may be modified or overruled by subsequently selected decisions, shall be binding on all officers and employees of the Service in the administration of the Act." 8 C.F.R. § 103.3(e) (1980); 8 U.S.C. § 1103 (1952).

47. For the definition of affiliate and subsidiary *see* notes 15-16 *supra*.

48. Mailman, *Intra-Company Transferees*, 55 INTERPRETER RELEASES 223, 225, 230-31 (1978).

49. Matter of Makedent, Inc., LOS-N-20054, Western Region, *as cited in* Yonemura & Ungar, *supra* note 27, at 500. This case is unpublished, and to date is unavailable. The

agreement from the same parent between two otherwise unrelated companies will constitute affiliation.[50]

In *Matter of Makedent Inc.*,[51] a recent controversial case from the Western Region, it was held that the parent company must have a majority ownership interest in another company in order to consider them affiliates.[52] The effect of this opinion is to equate "affiliate" with "subsidiary." Under this decision foreign companies hoping to establish an affiliate in California must own a majority interest in the California firm for intra-company transfer purposes. This interpretation poses problems since two companies may be affiliated without majority ownership in the foreign company.[53] Present day business practice indicates that when two or more companies exchange research information, personnel, and advertising techniques, they will be deemed affiliates even in the absence of majority ownership.[54]

The Eastern Region[55] has taken a contrary view, holding that when other elements of control are present, majority ownership is not necessary for two companies to be affiliated. In that decision a major communications company owned a fifty percent interest in one cable manufacturer and forty-three percent interest in another. The communications company had an officer on the board of both firms who was responsible for transferring executive personnel and setting guidelines for technological, financial, and operating decisions between the two firms.[56] In the Regional Officer's opinion the two cable manufacturers were considered affiliates because the communications company was held to have exercised sufficient control over both.[57]

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general area is difficult to research because most of the later decisions have been made by Regional Commissioners of the various Regional Offices of the INS and are unpublished. It is difficult to obtain these decisions because they are kept filed chronologically in the reading rooms in the various district offices of the INS. Interview with D. Mukai, *supra* note 10.

50. Chicago Budget Rent-A-Car, CH1-N-9357 (May 18, 1979), *as cited in* Fragomen, *The Temporary Visa Categories: The Petition Classes*, in PRACTICING LAW INSTITUTE, TWELFTH ANNUAL IMMIGRATION AND NATURALIZATION INSTITUTE 88 (1979).

51. *See* note 49 *supra*. California is in the Western Region. GORDON & ROSENFELD, *supra* note 6, § 1.96, at 1-46.

52. *See* note 47 *supra*.

53. *Id.*

54. *See* notes 114-26 *infra*.

55. Matter of ______, NYC-N-55808 (1977), *as cited in* Mailman, *supra* note 48, at 230, 233 n.3. This decision is unpublished and to date is unavailable.

56. *Id.* at 230.

57. *Id.*

In another decision from the Eastern Region[58] affiliation was found to exist on the basis of a proposed joint venture. In that case an American firm successfully transferred an executive from its British partner to the United States.[59] Although neither firm retained a financial interest in the other, their contract to enter into a joint enterprise provided the necessary connection to support a finding of affiliation.[60]

There are, however, two Eastern Region cases which have held the requisite company connections lacking. In *Matter of Schick*[61] an American firm entered into a contract with a French firm for an exclusive ten-year license to import into the United States machinery to manufacture nylon zippers.[62] The American firm was unable to relocate a French technician to its plant as an intra-company transferee[63] because the relationship between the two firms was merely contractual and did not imply any joint ownership.[64] Moreover, the technician was not employed in a managerial capacity.[65]

The other Eastern Region case which found the requisite company connections inadequate involved the owners of Del Mar Ben, Inc., a Japanese steak house in New York who wanted to open another one in a nearby town.[66] Del Mar Ben applied to bring a native Japanese chef from Hi Cock, Inc., the claimed affiliate in Japan, to the United States as an intra-company transferee.[67] Despite stock ownership and an agreement to furnish goods and services, the Regional Commissioner denied the L-1 visa because Del Mar Ben and Hi Cock did not exercise sufficient financial control over one another to constitute an affiliation.[68]

In order to provide clarity and to facilitate investment, the

58. Matter of ________, ALB-N-4131 (1977), *as cited in* Mailman, *supra* note 48, at 231, 233 n.4.

59. *Id.*

60. *Id.*

61. Matter of Schick, 13 Int. Dec. 647 (B.I.A. 1970).

62. *Id.* at 648.

63. *Id.* at 649.

64. *Id.*

65. *Id.*

66. In Matter of Del Mar Ben, Inc., Int. Dec. No. 2303 (1974).

67. The owner claimed that "recently arrived nonassimilated" Japanese chefs were necessary to provide the "maximum Japanese authenticity and flavor." *Id.*

68. The two companies had an informal agreement whereby Hi Cock would provide chopsticks, saki, rice, china bowls and kimonos for the new restaurant. Del Mar Ben, in return, planned to furnish Hi Cock with supplies to open pizza houses in Japan. Since neither company had made direct financial investments in the other, it was held that no financial control existed. *Id.* at 2.

meaning of the term affiliate needs to be further defined and more consistently applied by the Regional Offices. As mentioned earlier, the *Makedent* decision requires companies wishing to invest in California to own more than fifty percent of the California branch or subsidiary. This is unrealistic in light of present-day business practices. It is urged that in the absence of majority ownership, contractual and other business relationships,[69] such as exchange and sharing of personnel, interlocking directorates, exchange of research information and advertising techniques, be deemed a close enough affiliation for purposes of the law. As will be shown in the following section, the fifty-percent ownership requirement may result in some adverse state tax consequences to the foreign enterprise.

### *B. Prerequisites for the Individual Transferee*

For an alien to be granted L-1 status[70] he must have been employed for at least one year as either a manager or executive, or in a capacity involving specialized knowledge essential to the business.[71] In deciding whether or not the alien's experience qualifies as managerial, his salary and supervisory duties will be considered.[72] Positions such as manager for Far Eastern operations,[73] and service parts and operations manager[74] have qualified as executive and managerial assignments respectively.

Pursuant to the statute[75] it is required that the alien have a total year's experience with the firm "outside" the United States. This condition has been interpreted to mean that part of the year's employment may be spent physically in the United States. In *Matter of Continental Grain Company*,[76] the employer firm wanted to transfer an employee from its Canadian subsidiary to the United States to work as a grain merchandiser.[77] During the preceding year the employee had been a trainee in the United States for the

69. *See* the following textual section. Two recent decisions from the Eastern Region, Matter of Warburg Paribus Becker, NYC-N, 60780 (Reg. Comm. July 25, 1980) and Matter of Worldwide Marine, Inc., NYC-NG, 2056 (D.D. N.Y.C. May 5, 1980) support this view.

70. Visa classification for an intra-company transferee GORDON & ROSENFELD, *supra* note 6, § 2.16b, at 2-129.

71. 8 U.S.C. § 1101(a)(15)(L) (1970). *See* note 29 *supra*.

72. Fragomen, *supra* note 50, at 86.

73. Matter of Bocris, 13 Int. Dec. 601 (B.I.A. 1970).

74. Matter of Vallaincourt, 14 Int. Dec. 654 (B.I.A. 1970).

75. 8 U.S.C. § 1101(a)(15) (L) (1970).

76. Matter of Continental Grain Company, 14 Int. Dec. 140 (B.I.A. 1972).

77. *Id.*

first five months and had returned to Canada for the remaining seven months.[78] In light of Congress' intent to facilitate the entry into the United States of foreign managers, executives, and specialists, this was not regarded as interruptive of the one year requirement.

In a recent decision from the Northern Region[79] intra-company transferee status was granted to a qualified alien who was present in the United States as a business visitor while receiving compensation from the foreign office. Based on this holding the one year requirement may be liberally interpreted as allowing only a nominal stay abroad, so long as the compensation comes from the foreign office.

1. *Obtaining Permanent Residency as an Intra-Company Transferee*. While the intra-company transferee can become a temporary United States resident under the L-1 statute, as of 1977 it is also possible to become a permanent resident under Department of Labor regulations.[80] By following the Department's regulations, many intra-company transferees already present in the United States can "adjust" their status to that of permanent resident should they so desire.

Although the wording of the regulations is similar to that of the statute granting L-1 status,[81] there are some important subtle differences. The Department of Labor regulations refer to international "corporations or organizations," in contrast to the more varied wording of "firm, corporation, affiliate or subsidiary" used in the L-1 classification. Limiting the choice of entity through which to become a permanent resident or immigrant seems consistent with the underlying policy of the immigration law of subjecting immigrants to the quota system while allowing nonimmigrants to fall without the quota system because of the temporary nature of their

78. *Id.* at 141.

79. Matter of Ashby, File NYC-N-56125 (Oct. 27, 1978), *as cited in* PRACTISING LAW INSTITUTE, TWELFTH ANNUAL IMMIGRATION AND NATURALIZATION INSTITUTE, at 88 (1979).

80. Schedule A, Group IV:

> (1) Aliens who have been admitted to the United States in order to work, and who are currently working in managerial or executive positions with the same international corporations or organizations with which they were continuously employed for one year before they were admitted; and
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> (2) Aliens who will be engaged in the United States in managerial or executive positions with the same international corporations or organizations with which they have been continuously employed for the immediately prior year.

20 C.F.R. § 656.10(d) (1980); 8 U.S.C. 1182 (14) (1952).

81. *See* note 29 *supra*.

stay.[82] Further, it is unclear from the language of the regulations whether sole proprietorships are included. Although there is no precedent, it may be argued that a sole proprietorship is an "organization" if it has two or more offices, including one in the United States. Thus, if a closely-held foreign corporation establishes a branch or subsidiary in the United States, the owner could transfer himself to the United States and qualify for permanent resident status.[83]

Another difference between the L-1 and the labor regulation classifications is the nature of the employee's qualifying position. The Department of Labor regulations are more restrictive, applying only to managers and executives, not to employees with specialized knowledge.[84] Therefore, an individual with expertise, such as an accountant or engineer, cannot qualify for permanent residency under the regulations because he is neither a manager nor an executive.[85]

The Department of Labor would like the regulations to be amended to require the American branch office or subsidiary to be in existence at least one year before the alien executive or manager is eligible for permanent residence.[86] This amendment represents an effort to correct what seems to be a "circumvention" of the oversubscribed quota by business investors.[87] In contrast, the intra-company transferee intending to reside temporarily in the United States is not required to come to an already existing office;[88] so long as the petitioning company evidences "the bona fides of its intended operation" in the United States, such as acquiring physical premises, the L-1 petition will be approved.

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82. *See* notes 18-21 *supra*.

83. Interview with D. Mukai, *supra* note 10.

84. *See* note 80 *supra* for the wording of the regulations.

85. *Id.*

86. Bodin, *Labor Certifications*, in PRACTISING LAW INSTITUTE, TWELFTH ANNUAL IMMIGRATION AND NATURALIZATION INSTITUTE 191, 203 (1979).

87. 
> [I]t has become apparent to us that there are aliens who qualify for an L visa whom we did not intend for Schedule A certification. It was not our intent, to include aliens coming to the United States to form a new corporation, such as investors who use Group IV to circumvent the unavailability of nonpreference number, or aliens who were not managers and executives during their prior year of employment.

*Id.*

88. Matter of LeBlanc, *supra* note 39.

## II. STATE TAX CONSEQUENCES OF SETTING UP AN AMERICAN OFFICE

Owners or shareholders of closely-held foreign companies who contemplate using the intra-company transferee method for immigrating to the United States should be aware that the majority ownership requirement under the immigration laws and California tax laws presents a serious dilemma. As was shown in the previous section, an intra-company transferee must relocate to a United States based affiliate of a foreign company to qualify for L-1 status.[89] The *Makedent*[90] decision has rigidly interpreted affiliation to mean literally majority ownership of the American Company by the foreign firm. This presents a problem for the foreign company attempting to avoid the application of California's unitary tax. If, in order to avoid the unitary tax, the foreign company owned fifty percent or less of its California enterprise, its executive and managerial transferees would be ineligible for L-1 status. On the other hand, if the foreign company owned more than fifty percent of the California business to qualify its executives for L-1 status, then the two companies and perhaps a portion of the profits of other overseas affiliates may be subject to California income tax if the business is considered unitary.

A unitary business is one which is carried on partly within and partly without the taxing jurisdiction.[91] The unitary tax is most onerous to the foreign-owned enterprise beginning activities within California. Initially, newly-established businesses usually operate at a loss or at a minimal profit rate due to start-up costs and other factors. While a net operating loss will result in no taxes owed in most jurisdictions, in California taxes may still be due based upon the worldwide profits of the foreign parent or affiliated corporation.[92]

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89. *See* note 29 *supra*.

90. *See* notes 51-54 *supra*.

91. Keesling & Warren, *The Unitary Concept of the Allocation of Income*, 12 HASTINGS L.J. 42, 46 (1960). 18 Cal. Adm. Reg. 25101 (1955) defines a unitary business as "one where the operations for the portions of the business within the state is dependent upon or contributory to the operation of business outside the state." *See also* text accompanying notes 109-26 *infra*.

92. Sony Corporation ran into the ironic situation of seeing its estimated California state income tax liability (calculated on a worldwide unitary basis) soar when it added a television picture tube plant to its color television set assembly plant in San Diego. Unfortunately, United States (but not worldwide) earnings were down due to start-up costs, creating the ludicrous situation of an increase in California income taxes even while earnings declined. *Hearing on H.R. 5076 Before the Committee on House Ways and Means*, 96th Cong.,

In order to understand the principles of the unitary method of taxation, it would be useful to consider the following example:

> A closely-held foreign manufacturing and export concern has annual worldwide sales averaging $6,000,000. Desiring to increase its exports to the United States, the company has recently concluded that the West Coast, particularly California, would be a good place from which to penetrate the United States market. A California subsidiary, fifty-one percent owned by the family corporation and forty-nine percent owned by the owner's son is set up. The company accountant has prepared the following pro-forma financial statement of the subsidiary's activities for the first fiscal year:

SALES BREAKDOWN

| | Foreign parent | California subsidiary |
|---|---|---|
| California sales | $ 1,000,000 | $1,200,000 |
| Other sales | $ 5,000,000 | -0- |
| Total | $ 6,000,000 | $1,200,000 |

INCOME STATEMENT

| | Foreign parent | California subsidiary |
|---|---|---|
| Sales | $ 6,000,000 | $1,200,000 |
| Cost of sales | $ 5,000,000 | ($1,000,000) |
| Expenses | $ 200,000 | ($ 300,000) |
| Net Income | $ 800,000 | ($ 100,000) loss |

$700,000-total worldwide net income of the enterprise

ALLOCATION FACTORS FOR THE UNITARY GROUP

| | Worldwide | California subsidiary |
|---|---|---|
| Sales | $ 6,200,000 | $1,200,000 |
| Property | $20,000,000 | $ 500,000 |
| Payroll | $ 450,000 | $ 150,000 |

Under the separate accounting method[93] the subsidiary's busi-

2d Sess. 209 (1980) (statement of the Sony Corp. of America) [hereinafter cited as *Hearing on H.R. 5076*]. The unitary approach to taxation of income allocable to the state "assumes that profit rates in different units of a multinational corporation are the same, even if the facts clearly demonstrate start-up losses." Caveney, *U.K.-U.S. Income Tax Treaty and U.K. Tax Planning: 1978 Update*, INTERNATIONAL TAX INSTITUTE (1978).

93. Ordinarily states restrict taxation of domestic and foreign corporations to sources within the taxing state. If a corporation derives income from activities within and outside the state, the income from the in-state activities will be segregated from that of the company as a whole by an accounting method known as separate accounting. In this fashion, the income is determined as though the corporation's entire operation were confined solely to that state. Keesling & Warren, *supra* note 91, at 43. Comment, *Taxation of the Multistate Business: The Ownership Requirement of the Unitary Concept*, 14 CALIF. W. L. REV. 92 (1978).

ness activities within California would be treated "separately and distinct" from the parent's activities outside the state. Since it operated at a loss for the taxable year, the subsidiary would realize no income subject to the California franchise tax.[94] However, if the business is treated as unitary, under the formula method of accounting,[95] the parent corporation's worldwide income would be included in the calculation of the subsidiary's California tax liability[96] in the following manner.

First, the portion of the parent's worldwide income that is subject to taxation in California must be determined. To do this, the average of the percentages for each of the three allocation factors for the year is computed. The ratios of each of the allocation figures are then added together and divided by three, resulting in an apportionment factor of twenty percent.[97] The twenty percent is then multiplied by the company's worldwide net income of $700,000 to give $140,000,[98] the amount of worldwide income to be allocated to the California subsidiary. The $140,000 would in turn be multiplied by the California state tax rate of 9.6 percent.[99] The subsidiary would now owe $13,440 in California taxes for the given year. Thus, under the unitary concept, the subsidiary would be

94. A franchise tax is imposed on California corporations and on foreign corporations doing business in California. This tax is imposed for the privilege of exercising the corporate franchise for the taxable year. J. HARGROVE, CALIFORNIA TAXES § 2.1 (1978).

95. Most states compute unitary business income by an apportionment formula known as the Massachusetts formula. In California this formula consists of three income-producing or allocation factors: 1) property: the average value of real and tangible property; 2) payroll: wages, salaries and other employee benefits; 3) sales: gross sales less return allowances. *Id.* at § 2.67. The law provides that allocation and apportionment of income is required where business activities are taxable within and outside California. CAL. REV. & TAX. CODE §§ 25129-25136 (Deering's 1970).

96. The effect of including the parent's worldwide income into the determination of the subsidiary's state tax liability is to provide California with a larger tax basis. This results in a higher amount of taxes owed. Interview with William K. Norman, Esq., Finley, Kumble, Wagner, Heine, Underberg, Los Angeles, California (January 25, 1980). Mr. Norman specializes in international taxation.

97.
$$\frac{\text{California sales}}{\text{total sales}} = .19$$
$$\frac{\text{California property}}{\text{total property}} = .083$$
$$\frac{\text{California payroll}}{\text{total payroll}} = .33$$
$$\frac{.19 + .083 + .33}{3} = .20 \text{ (apportionment factor)}$$

HARGROVE, *supra* note 94, § 2.72, at 163.

98. $700,000 x .20 = $140,000. *See* Interview with William Norman, *supra* note 96.

99. $140,000 x 9.6 = $13,440. *Id.*

subject to California income taxation even though it operated at a loss.

In addition to an increase in the amount of taxes owing, the foreign parent may incur "horrendous administrative burdens."[100] In order to measure the income of all of its overseas subsidiaries and affiliates, the foreign parent will have to wade through a complex maze of diversity of language, currency translations, tax laws and accounting practices.[101] "While this is bad enough for the American multinational, it is even worse for the foreign parent."[102] An American multinational has to measure its worldwide income since it is required to file a federal income tax return every year. This is not so for the foreign parent.[103] Furthermore, the release of certain tax information may violate the laws of foreign jurisdictions.[104] For example, if a California aerospace company needs income and expense information from its British subsidiary and there is a British law prohibiting a taxpayer from releasing this information because the work is defense related, this information would be unavailable to the California company.[105] Finally, the cost of additional "paperwork"[106] incurred in reporting the company's worldwide income will be passed along to the consumer[107] and ultimately hinder the California subsidiary from effectively competing in the United States domestic market.[108]

### *A. Tests for Finding a Unitary Business*

1. *Common Ownership*. A unitary business for California tax purposes must have common ownership, directly or indirectly, of more than fifty percent of the company's voting stock.[109] The ownership requirement applies not only to parent-subsidiary companies, but also to affiliated companies, i.e., those not directly related to each other but which possess common shareholders.[110] The fifty

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100. *Hearing on H.R. 5076*, *supra* note 92, at 165 (statement of Paul W. Cook on Behalf of the National Association of Manufacturers).

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 171.

106. *Id.*

107. Petersen & Walsh, *U.S.: The Impact of the California Unitary Business Concept on the Taxation of Multinational Corporations*, 3 INTERTAX 107, 115 (1978).

108. *Id.*

109. CAL. REV. & TAX. CODE § 25105 (Deering's 1970).

110. *See* notes 15-16 *supra*.

percent requirement has been liberally construed to mean that in the absence of a majority interest by one company in an affiliate, controlling ownership will be deemed to exist if there is supervision over "operational matters."[111] For example, in the case of *Appeal of Signal Oil and Gas Company*[112] the parent company did not own a majority interest in the subsidiary, but because it controlled the prices of the products the subsidiary sold, the State Board of Equalization (SBE) found sufficient "controlling ownership" to establish a unitary relationship.[113]

2. *Unity of Use and Unity of Operation*. Once the ownership requirement is established, a unitary business will be found if either: 1) the business's commercial activities within California contribute to and are dependent upon its activities outside the state,[114] or 2) there is a unity of ownership, use, and operation between the California company and other members of the group.[115]

The California tax authorities tend to balance several elements in determining whether either of these two tests has been met. Unity of operation includes central purchasing,[116] advertising, accounting, and financing.[117] Unity of use is evidenced by a centralized executive force and interlocking directorates.[118] In *Butler Bros. v. McClogan*,[119] one of the leading California cases defining a unitary business, the court reasoned that because centralization of corporate services such as accounting, advertising, and purchasing

111. Zak, *Current Unitary Tax Developments*, 80 INT'L TAX REP. 1, 2 (1980).

112. CAL. TAX. REP. (CCH) ¶ 242-247 (S.B.E. 1970).

113. *Id.*

114. Honolulu Oil Corp. v. Franchise Tax Board, 60 Cal. 2d 417, 424-25, 386 P.2d 40, 34 Cal. Rptr. 532 (1963).

115. Butler Bros. v. McClogan, 17 Cal. 2d 664, 678, 111 P.2d 334 (1941), *aff'd* 315 U.S. 501 (1942).

116. Purchasing the same products or raw materials and components. Edison California Stores v. McClogan, 30 Cal. 2d 472, 183 P.2d 16 (1947).

117. For example, if one company loans money to another even though it could have borrowed from lending institutions. Chase Brass & Copper Co. v. Franchise Tax Board, 7 Cal. App. 3d 99, 86 Cal. Rptr. 350 (1970), *reh'g denied*, 10 Cal. App. 3d 496, 87 Cal. Rptr. 239 (1970), *appeal dismissed and cert. denied*, 400 U.S. 961 (1970).

118. The integration of executive forces is a significant element in determining whether unity of use exists.

> Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, . . . not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of [its parent] is an invaluable resource.

10 Cal. App. 3d at 504, 87 Cal. Rptr. at 242.

119. 17 Cal. 2d 664, 111 P.2d 334 (1941). This case was decided before the California statute defining a unitary business was enacted.

resulted in a lower cost per unit when spread out over several stores of the same business, a unitary business was held to exist.[120]

On the other hand, if the operation conducts different types of businesses in various states, a unitary business will not be found. In *Appeal of Allied Properties*[121] a hotel operation in California and a cattle ranch in Nevada were considered to be two distinct businesses, even though both had a common owner.[122] The SBE[123] reasoned that due to their diverse needs, unrelated businesses "do not lend themselves to centralization of functions";[124] the economic benefit to be gained from such centralization is at a "minimum."[125] Similarly, if the various divisions within an organization operate independently of one another, the requisite "interdependence of business activities"[126] will not exist and no unitary business will be found.

It has been contended by American and foreign executives[127] that the two tests[128] used to determine whether a business is unitary are "arbitrary, unreasonable and inherently vague"[129] in their application. Instead of a "clear and understandable objective standard for a unitary group,"[130] the California state tax authorities[131] tend to balance several elements[132] in determining whether unity of use and operation exists. Thus, the final determination of whether

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120. The court enunciated the three unities test for determining whether a unitary business exists: unity of use, ownership and operation. 17 Cal. 2d at 678, 111 P.2d at 341.

121. CAL. TAX. REP. (CCH) ¶¶ 202-416 (S.B.E. 1964).

122. *Id.*

123. The State Board of Equalization is an administrative agency which hears appeals from the FTB of claims for refunds. CAL. REV. & TAX CODE § 26077 (Deering's 1970) and claims for deficiency assessments CAL. REV. & TAX CODE § 25667 (Deering's 1970).

124. "For example, due to differences in the transactions to be recorded, there is little to be gained by centralizing the accounting functions of a hotel and a ranch. In a situation of that kind 'centralized accounting' is an empty phrase." Appeal of Allied Properties, *supra* note 121.

125. *Id.*

126. Appeal of Lear Siegler, Inc., CAL. TAX REP. (CCH) ¶ 202-633 (S.B.E. 1967).

127. Coco-Cola Co., Honeywell Inc., Dutch Employers Federation, Sony Corp., Xerox Corp., Volkswagen of America, Inc., are but a few. *See Hearing on H.R. 5076, supra* note 92.

128. Unity of ownership, use and operation and whether interdependency exists between affiliated corporations in their various functions, *see* notes 114-26 *supra*.

129. *Hearing on H.R. 5076, supra* note 92, at 169, 183.

130. *Id.* at 169.

131. The tax authorities include the courts, the Franchise Tax Board (FTB), and the State Board of Equalization (SBE). The SBE is an administrative agency which hears appeals from denials by the FTB of claims for refunds, CAL. REV. & TAX CODE § 26077 (Deering's 1970), and claims for deficiency assessments, CAL. REV. & TAX CODE § 25667 (Deering's 1970).

132. *See* notes 109-26 *supra*.

a unitary relationship is present is often the "subjective opinion" of an auditor or of a court years after the transaction at issue occurred.[133]

3. *International Application of the Unitary Business Concept.* The capricious[134] and arbitrary[135] nature of the unitary concept is magnified in its international application because a distortion[136] results in the application of the three factor apportionment formula[137] to the combined domestic and foreign income of a unitary group of companies. Furthermore, because there is a split of authority, it is difficult for domestic and foreign corporations to predict what steps to take in order to avoid the unitary tax as the cases go in both directions.

In the case of *Appeal of Beecham*[138] a California subsidiary was included in a unitary business with its parent, an English pharmaceutical house with subsidiaries in Canada, Argentina, Mexico, Brazil, Venezuela, and Australia.[139] Beecham owned 100 percent of the stock in all the subsidiaries and exercised absolute control in electing the directors.[140] "Mutuality of interest" throughout the "affiliated Beecham family" was further assured by the exchange of research and product information, common trademark usage and inter-company product flow.[141] Pursuant to the California statute,[142] the conglomerate's worldwide income was included in the apportionment formula to determine the state tax liability of the California subsidiary.[143]

*Appeal of Scholl, Inc.*[144] has a contrary holding. There it was held that Scholl was not a unitary business despite the shared usage of the Scholl trademark and the majority ownership of stocks by the Chicago-based parent in eighteen overseas subsidiaries. These two elements, considered to be significant in *Beecham*,[145] were held

133. *Hearing on H.R. 5076, supra* note 92, at 183.
134. *Id.* at 211.
135. *Id.*
136. Distortion is caused by higher wage rates and property values in the United States, skewing the formula to attribute too much income to the taxing state. *Id.* at 165.
137. Payroll, property and sales. *See* notes 95-97 *supra*.
138. CAL. TAX. REP. (CCH) ¶¶ 205-634 (S.B.E. 1977).
139. *Id.* ¶¶ 205-635.
140. *Id.*
141. *Id.* ¶¶ 14,897-14,898.
142. CAL. REV. & TAX. CODE § 25101 (Deering's 1970).
143. *Id.*
144. CAL. TAX. REP. (CCH) ¶ 206-000 (S.B.E. 1978).
145. *See* notes 138-43 *supra*.

to be "significantly reduced by other factors" in the Scholl case.[146] Of vital importance was the testimony of the parent company's comptroller of twenty-four years. He testified that he had scheduled a trip to the London office[147] but was advised not to come when its director informed him, "I do not want anyone from Chicago looking over my shoulder."[148] Five years later the comptroller was permitted to visit the London branch but was not allowed to inspect the books of any of the subsidiaries.[149] In its opinion the SBE considered this testimony "particularly illuminating"[150] as evidence of the absence of centralized control between the parent corporation and its subsidiaries. Other factors which the SBE considered in its holding included the "independent and parallel" development of the foreign and domestic markets,[151] the absence of an international advertising department,[152] and the absence of any transfer of employees among the various subsidiaries.[153]

### 4. *Evaluation of the Unitary Tax*

The negative impact of the worldwide application of the unitary tax should not be underestimated by multinational business entities.[154] While this method of taxation may produce equitable results at the domestic level, it does not do so at the international level.

First, the unitary method of taxation subjects multinational taxpayers to "time-consuming and costly"[155] administrative burdens in order to determine the proper amount of income allocable

146. Appeal of Scholl, Inc., *supra* note 144, at 14,909-107.

147. The Scholl subsidiaries in the Eastern hemisphere were directed from London by Frank J. Scholl, Sr., who was the chief executive solely responsible for making all managerial decisions and implementing them through his subordinates. Accounting was done locally by locally-trained personnel. *Id.* at 14,909-104.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. (A) States which apply the unitary concept to corporations located within the United States (domestic): Alaska, Arizona, Arkansas, California, Colorado, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Main, Massachusetts, Mississippi, Montana, Nebraska, New Hampshire, New York, North Carolina, North Dakota, Oklahoma, Oregon, Utah, Virginia, West Virginia. (B) States which apply the unitary concept to corporations located within and/or outside the United States (worldwide): Alaska, California, Colorado, Idaho, Illinois, Indiana, Massachusetts, Montana, North Carolina, North Dakota, Oregon, Utah. *Hearing on H.R. 5076, supra* note 92, at 358-59.

155. *Id.* at 254.

to California. Smaller companies based outside the United States find compliance with California's accounting requirements more onerous because a different method of accounting from that practiced in their own jurisdictions is often required and they frequently lack the personnel to do the work.[156] Moreover, this tax information may be difficult for the foreign taxpayer to obtain and may also violate the corporate policy and laws of foreign jurisdictions.[157]

Second, the unitary method "assumes that all the diverse units of a worldwide business operate in a homogeneous market where every dollar spent . . . will earn profits at approximately the same rate."[158] This is an erroneous economic assumption.[159] The unitary method fails to observe that property costs and wages in the United States are generally higher than almost anywhere else in the world which attributes more income to affiliates in the United States than to those in other locations.[160] Distortion of the apportionment factors is the inequitable result.

Third, the distortion produced by the unitary tax results in "unwarranted double taxation."[161] This offends accepted international standards of income allocation and determination as set forth in the 1977 OECD Model Income Tax Convention[162] for the avoidance of double taxation in which the United States and its major trading partners are members. The unitary tax also contravenes international custom as the United States is the only major country to employ this tax system.[163]

Fourth, the unitary tax significantly deters foreign investment in California.[164] While the tax burden is not the only factor involved in a company's decision to locate in California, it is one of the factors considered.[165] Specifically, Rolls Royce recently consid-

156. *Id.*

157. *Id.* at 226.

158. *Id.* at 259.

159. *Id.*

160. Peterson & Walsh, *supra* note 107, at 113.

161. "Distortion arises because the system is not designed to recognize the higher rate of return necessarily earned in high risk locations like Iran or Nicaragua. The result is the attribution of foreign income which has already been taxed to the taxing state and taxing it again. No foreign tax credit is used at the State level." *Id.* at 165, 260.

162. *Id.* at 179, 304 & 391.

163. In the international setting, the custom of States is persuasive evidence of the standard of reasonable conduct. The overwhelming practice of foreign taxing jurisdictions of the United States government, and of the major industrial states is to require separate tax accounting for the income of the enterprise maintained in a taxing jurisdiction. *Id.* at 311-12.

164. *Id.* at 144 & 151.

165. *Id.* at 145.

ered establishing a new aircraft engine plant in California but decided against it because of the unitary tax.[166] Sony Corporation's chairman, Mr. Akio Morita, personally attempted to persuade the State of California that its tax policy discouraged foreign investment.[167] Likewise, other Japanese manufacturers are investing in states with more favorable tax structures, such as Tennessee.[168]

## III. PLANNING TECHNIQUES TO AVOID THE IMPACT OF CONFLICTING FEDERAL AND STATE LEGISLATIVE POLICIES

It would appear that California's tax laws and immigration as an intra-company transferee are incompatible, as there is no guarantee the foreign executive can maintain his L-1 status and assure his company's avoidance of the unitary tax. There are some steps however which should be considered.

Because California tax authorities tend to balance several factors in deciding whether a business in unitary, the owner of the overseas firm can minimize the state tax exposure of his company by breaking up the unity of use.[169] This can be done by:

> 1. Appointing and maintaining separate boards of directors. Although affiliated companies may share a common management philosophy, they should try to have distinct directors.

The foreign firm should also break up the unity of operation[170] by:

> 1. Setting up independent financing for the California branch. It should be sufficiently capitalized to obtain its own line of credit with the banks.
>
> 2. Avoiding the use of the same trademark or paying a royalty to the affiliated company for its use.
>
> 3. Developing independent research if possible.
>
> 4. Avoiding intercompany sales if possible.
>
> 5. Avoiding centralization of advertising. A different campaign in each country might be helpful.
>
> 6. Diligently maintaining records to show the independence of services, operations and management as evidence that the company is not part of a unitary business.[171]

If feasible, all ties except ownership should be eliminated to

166. *Id.* at 143.
167. *Id.* at 211.
168. *Id.* at 144.
169. *See* note 118 *supra*.
170. *See* notes 116-17 *supra*.
171. Petersen & Walsh, *supra* note 107, at 116.

demonstrate that the California business is "completely autonomous"[172] from the overseas firm.

If the United States branch were engaged in a completely different type of business from that of the overseas affiliate there may be sufficient diversity to remove the unitary character of the business. However, it may be so far removed from the nature of the foreign company's business that the INS may hesitate to qualify any foreign employee for L-1 status as being beyond the law's intention.[173] There is no precedent from which to determine just how diverse from the nature of the foreign firm's business a California company can be.

Another possibility would be to have the alien owner and a shareholder of the foreign company set up a California corporation as individual shareholders and seemingly remove the California operation from any connection with the overseas business. Thus, each shareholder could own less than the required fifty-one percent[174] and still control both companies. However, under the "working control" test applied in *Appeal of Signal Oil*,[175] this option would seem to be foreclosed.

### *A. Long Term Solutions*

1. *Challenge the Unitary Tax as Violative of the Commerce Clause of the United States Constitution*. Relief could be had from the problems created by the unitary tax if the United States Supreme Court were to rule that the unitary system of taxation violates the Commerce Clause of the Constitution.[176] This solution may be "too speculative to provide comfort"[177] however, as recent Supreme Court decisions have gone both ways. In *Japan Line, Ltd. v. County of Los Angeles*[178] the Supreme Court ruled that California could not impose an ad valorem property tax on Japanese-owned shipping containers used exclusively to transport cargo in

172. *Id.*

173. "It was not our intent, for example, to include aliens coming to the United States to form a new corporation, such as investors who use Group IV to circumvent the unavailability of nonpreference number, or aliens who were not managers and executives during their prior year of employment." Bodin, *supra* note 86, at 203.

174. CAL. REV. & TAX. CODE § 25105 (Deering's 1970).

175. *See* note 112 *supra*.

176. "Congress shall have Power . . . To regulate commerce with foreign nations, and among the several states, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl.3.

177. *Hearing on S. 983 Before the Senate Committee on Foreign Relations*, 96th Cong., 1st Sess. 119 (1979) (statement of Senator Cook).

178. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).

foreign commerce.[179] The Court reasoned that 1) a risk of multiple taxation was present since the containers were already subject to Japanese property taxes and 2) that a state tax on "instrumentalities of foreign commerce may impair federal uniformity. . . and prevent the Federal Government from speaking with one voice"[180] when regulating foreign commerce. Rather than openly declare the tax unconstitutional, the Court invited a federal legislative solution.[181]

Two later cases upheld the state's right to impose a unitary tax upon a multinational corporation's worldwide income. In *Mobil Oil Corporation v. Vermont Commissioner of Taxes*[182] and in *Exxon Corporation v. Department of Revenue of Wisconsin*[183] the Supreme Court upheld the state's right to tax income earned from investments in foreign affiliates and subsidiaries as constitutional under the Due Process and the Commerce Clauses.[184] In *Mobil Oil* the Court reiterated the rule that the income from a business operating in interstate commerce is not immune from fairly-apportioned state taxation so long as there is a "minimal connection" between the taxing state and interstate activities and a rational relationship between the income that is taxed and the services provided by the state.[185] The Court then distinguished *Mobil Oil* from *Japan Lines* in that the latter case involved a property tax while *Mobil Oil* involved an income tax in which the appellant did not argue "duplicative taxation at the international level."[186] Similarly in the *Exxon* case the Court found no risk of multiple taxation in not segregating Exxon's three principal operating departments — exploration and production, refining, and marketing — to their situs:

179. *Id.* at 436.

180. If the state imposes an apportioned tax, international disputes over reconciling apportionment formulas may arise. If a novel state tax creates an assymetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. *Id.* at 450.

181. Finally, appellees present policy arguments. If California cannot tax appellants' containers, they complain, the state will lose revenue, even though the containers plainly have a nexus with California; the state will go uncompensated for the services it . . . renders the containers . . . . These arguments are not without weight . . . These arguments, however, are directed to the wrong forum. 'Whatever the subjects of this [the commercial] power are in their nature national, . . . may justly be said to be of such a nature as to require exclusive legislation by Congress.' Cooley v. Board of Wardens, 53 U.S. (12 How.) 299, 319 (1852).

*Id.* at 456-57.

182. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980).

183. Exxon Corporation v. Wisconsin Department of Revenue, 447 U.S. 207 (1980).

184. *Id.*

185. Mobil Oil Corp., *supra* note 182, at 436-49.

186. *Id.* at 448.

"the geographic location of such . . . does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business."[187]

In both cases the Court took notice of the continuing controversy of state taxation of foreign source income and of the current legislative proposals in Congress. It seems that until national legislation is passed the controversy will remain, as the Supreme Court is not likely to infringe upon the domain of Congress.[188]

2. *Legislation: State and Federal*. In February of 1979 a bill was introduced into the California legislature that would have exempted from the unitary tax companies that are 1) created or organized under the laws of a foreign country, 2) not owned or controlled by a United States corporation or United States resident, and 3) have more than eighty percent of their operations outside the United States.[189] While there was support for the bill by such multinationals as Xerox, Ford Motor Company, and International Telephone and Telegraph Corporation,[190] it died in conference on August 31, 1980.[191]

At the federal level several bills curtailing state taxation of foreign-source income have been introduced in both the Senate and the House of Representatives.[192] The Senate bill, known as the Interstate Taxation Bill, provides for an optional three-factor formula for apportioning the income of multinational corporations.[193] The apportionment factors are to be adjusted accordingly, either by the state or by the corporation.[194] Foreign income is exempt from state taxation if "substantially all" of the taxpayer's income is derived from sources outside the United States. The "substantially all" test is met if at least eighty percent of the taxpayer's income is derived from sources outside the United States for the current taxable year and in each of the preceding two years. Both foreign and American

187. Exxon Corporation, *supra* note 183, at 230.

188. *See supra* note 178.

189. California Assembly Bill 525, 1979-80 Sess., introduced by Assemblymen Hughes & Mori, February 12, 1979.

190. Zak, *supra* note 112, at 3.

191. *Id.*

192. H.R. 5076, 96th Cong., 2d Sess. (1979); S.983, 96th Cong., 2d Sess. (1979); S.1688, 96th Cong., 2d Sess. (1979).

193. *Id. See also* Feinschreiber, *International Aspects of Interstate Taxation: Proposed Legislation*, 6 INT'L TAX J. 101 (1979).

194. *Id.*

corporations come under the exclusion.[195]

The House bill allows states to tax foreign source income only when it is subject to federal income tax.[196] During the hearing for H.R. 5076[197] there was testimony that all nine members of the European Common Market delivered a note to the House Ways and Means Committee Chairman[198] urging prompt passage of this bill. Of this group the Netherlands, the United Kingdom, and Germany are the first, second, and fourth largest foreign investors in the United States.[199] Therefore, in order to encourage foreign investment in the United States it is urged that Congress pass this bill. H.R. 5076 and S. 1688 have been reintroduced this year.[200] S. 983 will be reintroduced later in 1981. No action on either of the bills will probably occur until the latter half of 1981 when Congress considers the second phase of President Reagan's tax cut bill.[201] It is anticipated that these bills have a good chance of passing.[202]

## IV. CONCLUSION

Foreign companies contemplating establishment of a branch office in California find themselves at a decisional crossroad. On the one hand, the intra-company transferee status now allows multinational businesses to freely transfer international personnel to the United States on a temporary or permanent basis. On the other hand, California's imposition of a state tax upon the worldwide income of foreign companies provides a significant disincentive to foreign investors, particulary in the closely held company situation. If instead of the formula method the separate accounting method were used, more foreign companies would be encouraged to invest in California because their overseas profits would not be subject to California taxes. Thus, Californians would be provided with more jobs and the state treasury with more tax revenue. However, the fear of being subjected to double taxation often causes foreign busi-

195. *Id.*

196. *Hearing on H.R. 5076, supra* note 92, at 7-8.

197. *Id.*

198. Rep. Al Ullman, D-Oregon.

199. *See* note 4 *supra*.

200. Conversation with Charles Borden, legislative aide for Sen. Charles McC. Mathias, Jr. (March 24, 1981). H.R. 5076 has been renumbered H.R. 1983, S.1688 has been renumbered S.655.

201. *Id.*

202. *Id.*

nesses to locate in states with more favorable tax structures.[203]

The policy conflict between federal immigration law and the tax law of states such as California needs to be resolved. Conflicting state tax rules provide an unwanted diversification in the field of taxation. The objective of foreign businessmen is uniformity and predictability in determining their tax liability.[204] They seek relief from the additional expense[205] and paperwork[206] of complying with unnecessarily complicated tax laws so they can remain competitive.[207] Conversely, state authorities seek to receive their fair share of the tax burden, to prevent tax evasion, and to hold enforcement costs to a minimum.[208]

In the absence of federal legislation, foreign owners of closely-held companies may take certain steps to minimize their tax exposure by decentralizing corporate services and corporate management.[209] As this Comment has shown, however, they may find that immigration as an intra-company transferee may not be possible if tax planning takes precedence.

If the United States Supreme Court were to rule that the unitary tax violated the Commerce Clause of the Constitution the problem would be eliminated. However, it appears from recent cases that the Court considers federal legislation to be the most appropriate remedy.[210]

Another solution would be to initiate a series of tax treaties between the United States and various countries, thereby restricting the states from applying the unitary tax to the worldwide profits of foreign multinationals. While tax treaties are a vital element to the free international flow of capital and technology, this remedy would solve the problem on a piecemeal basis.[211] Of recent note, the United States-U.K. Income Tax Treaty[212] attempted to do that

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203. *Hearing on S. 983 Before the Senate Committee on Foreign Relations*, 96th Cong., 1st Sess. 119 (1979).

204. *Id.* at 4464 (statement of Senator McC. Mathias).

205. *Id.*

206. *Id.*

207. *Id.*

208. *Id.*

209. *See* notes 169-72 *supra*.

210. *See* note 181 *supra*.

211. *Hearings Before the Senate Foreign Relations Committee, On Six International Tax Treaties and Protocols*, 96th Cong., 1st Sess., at 3 (statement by Sen. McC. Mathias).

212. United States — United Kingdom Income Tax Treaty, December 31, 1975, TAX TREATIES (CCH) ¶¶ 8103DB-1 (1979).

The text of Article 9(4) is the following:

(4) Except as specifically provided in this Article:

via article 9(4) of the treaty. However, the United States Senate deleted this article and the treaty "went through a prolonged period of uncertainty in Parliament."[213] Parliament's subsequent ratification in February of 1980 was conditioned upon reassurances that a legislative solution to the unitary tax problem would pass in the United States Congress in the near future.[214]

Of the various avenues of relief, the legislative approach is the most promising. What is needed is an equitable solution at the federal level addressing the extraterritorial taxing power of each state. Federal legislation has the advantage of solving the problem uniformly and efficiently, rather than on a gradual treaty or state by state legislative basis. As nations become more and more economically interdependent it is incumbent upon the United States as a leading commercial force in the world to take the necessary steps to provide a harmonious international business environment.

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(a) where an enterprise doing business in one Contracting State:
(i) is a resident of the other Contracting State; or
(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and
(b) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:
(i) a controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the general principle thereof); nor
(ii) created or organised under the laws of the first-mentioned State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State:
then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, or in a political subdivision or local authority of that State, such State, political subdivision or local authority shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first-mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise.

213. *Hearing on H.R. 5076, supra* note 92, at 138.

214. Mr. Roger Moate, Member of Parliament, speaking in the House of Commons on February 18, 1980, during the debate before the final ratification of the treaty, summarized the feelings of the British at that time:

> I hope therefore, that if we agree to the motion tonight and if the Government proceed [sic] to ratify the treaty, those in the United States Senate will understand that we are doing so on the basis of trust and are placing an immense amount of faith in the proposals about which we have heard and in the Senate's determination to rectify what is a grossly unsatisfactory situation.

*Id.* at 152.