

A state requires all corporations that operate in the state to file their annual income tax returns with the state's tax board for the purpose of calculating the amount of income tax that each corporation owes. The board requires corporations to provide reasonable approximations of their income earned on a worldwide basis. The board then calculates the income tax that a corporation owes based on the amount of income attributable to its operations within the state.

Several foreign corporations that operate in the state and do not use the state's method of accounting have sued the board in state court, arguing that the state tax is unconstitutional.

Is the state tax constitutional?

- A. No, because Congress has the sole power to tax foreign corporations.
- B. No, because the state tax discriminates against foreign commerce.
- C. Yes, because the state tax was enacted pursuant to the state's police power, which takes precedence over the negative implications of the commerce clause.
- D. Yes, if the court determines that the state tax does not impede federal uniformity in foreign commerce.

Explanation:

The commerce clause grants Congress the power to regulate foreign commerce. The negative implication of this clause (ie, the **dormant commerce clause**) prohibits states from discriminating against or otherwise **unduly burdening foreign commerce**. However, a state may still tax foreign persons and entities that earn income in the state if the state tax satisfies the *Complete Auto* and federal uniformity requirements (**Choice A**). Here, the **state tax** satisfies the ***Complete Auto* requirements** (see image above) because the tax:

- is applied to the foreign corporations' business activities in the state (**substantial nexus**)
- is based on a rational formula that only taxes income earned in the state (**fairly apportioned**)
- applies equally to domestic and foreign corporations (**nondiscriminatory**) (**Choice B**) *and*
- is reasonable compared to services and benefits provided by the state, like infrastructure (**fairly related**).

Additionally, the state tax must satisfy **federal uniformity requirements**. This means that the tax **must not** create an **inevitable risk of international multiple taxation** OR **prevent** the federal government from **speaking with one voice** in international trade or foreign affairs. Therefore, the state tax is constitutional if the court determines that it satisfies these additional requirements.

(Choice C) The Tenth Amendment gives states all powers that are not expressly granted to the federal government by the Constitution—eg, police power to impose taxes on activities in the state. But pursuant to the [supremacy clause](#), state police powers do *not* take precedence over other constitutional provisions, including the negative implications of the commerce clause.

Educational objective:

A state tax affecting foreign commerce must satisfy the *Complete Auto* requirements (substantial nexus, fairly apportioned, nondiscriminatory, and fairly related). Additionally, such a tax must not create an inevitable risk of international multiple taxation OR prevent the federal government from speaking with one voice in foreign affairs.

References

- U.S. Const. art. 1, § 8, cl. 3 (commerce clause).
- *Barclays Bank Pub. Ltd. Co. v. Franchise Tax Bd. of Cal.*, 512 U.S. 298, 311 (1994) (setting forth the requirements for determining whether a state tax that affects foreign commerce violates the commerce clause).

State taxation of foreign commerce

***Complete Auto* requirements**

- Substantial nexus between state & taxed person/activity
- Fairly apportioned pursuant to rational formula
- Not discriminatory against foreign commerce
- Fairly related to state services or benefits

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Federal uniformity requirements

- No inevitable risk of international multiple taxation
- Federal government able to speak with one voice

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State tax constitutional