CONSTITUTIONAL LAW—Tax Law Favoring Domestic Subsidiaries Over Foreign Subsidiaries Is Facially Discriminatory and Violates the Foreign Commerce Clause—*Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 112 S. Ct. 2365 (1992).

I. INTRODUCTION

Kraft General Foods, Inc. (Kraft), in calculating its taxable income on its 1981 Iowa income tax return, deducted the dividends received from its foreign subsidiaries, even though Iowa law did not allow this deduction.[1] As a result, the Iowa Department of Revenue and Finance (DORF) assessed a deficiency in income taxes against Kraft.[2] After its administrative protest was denied, Kraft brought suit in district court against DORF, complaining of unequal treatment of dividends between foreign and domestic subsidiaries, a violation of the Commerce Clause[3] and the Equal Protection Clause[4] under the United States Constitution.[5] Both the district court and the Iowa Supreme Court rejected these arguments.[6]

The federal tax scheme for calculating taxable income does not include earnings of foreign subsidiaries, but it does include earnings of domestic corporations.[7] To avoid multiple taxation on domestic subsidiaries,[8] the federal government generally allows a deduction for dividends received by these domestic entities.[9] A similar deduction, however, is not allowed for foreign subsidiaries.[10] In order for these foreign entities to avoid multiple taxation, the federal government permits the parent corporation to claim a credit "for the foreign taxes paid on the dividends and on the underlying foreign earnings."[11]

Iowa adopted the federal definition of net income through Iowa Code section 422.35.[12] Under these guidelines, Iowa only taxes the subsidiary's income if the subsidiary does business in Iowa.[13] Iowa follows the federal tax scheme for computing taxable income and allows corporations to deduct dividends received from domestic subsidiaries, but allows *no* deduction for those dividends received

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1. Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d 664, 666 (Iowa 1991).
2. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2368 (1992).
3. "Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the various States . . . ." U.S. CONST. art 1, § 8.
4. "No State shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend. XIV, § 1.
5. Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d at 665.
6. *Id.*
7. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2367 (1992).
8. Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d 664, 665 (Iowa 1991).
9. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2367; *see* 26 U.S.C. § 243 (1988).
10. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2367; *see* 26 U.S.C. § 243 (1988).
11. 26 U.S.C. § 243 (1988); *see id.* §§ 901-02.
12. IOWA CODE § 422.35 (1993); *see* Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d at 665.
13. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2367 (1992).

by foreign subsidiaries.[14] Iowa's tax calculation differs from the federal scheme because Iowa does not permit the parent corporation to take a credit for taxes paid on foreign earnings and foreign dividends.[15] This deviation from the federal definition resulted in multiple taxation on foreign earnings and dividends.[16] The court stated:

> If a domestic subsidiary transacts business in Iowa, its *income* is taxed, but if it does not do business in Iowa, neither its income nor the dividends paid to its parents are taxed. In the case of the foreign subsidiary doing business abroad, Iowa does not tax the corporate income, but does tax the dividends paid to the parent.[17]

In Iowa, the parent corporation receives no credit for these taxes on its foreign subsidiaries as the federal rules provide.[18]

II. IOWA SUPREME COURT ANALYSIS

A. *Commerce Clause Argument*

Respondent DORF contended the Iowa tax scheme did not provide advantages to Iowa activities to the detriment of non-Iowa activities, and, therefore, did not violate the Commerce Clause.[19] Kraft agreed case law supported the need for showing some advantage to local business in the *interstate* context, but argued rules involving *foreign* commerce required different treatment.[20]

The Iowa Supreme Court noted United States Supreme Court decisions were ambiguous on whether a finding of local bias was necessary to allege discrimination against foreign commerce.[21] The Iowa court decided, however, "Kraft [had to] show, as in the case of alleged interstate discrimination, that Iowa businesses receive[d] a commercial advantage over foreign commerce due to Iowa's taxing scheme."[22] The Iowa Supreme Court rejected Kraft's argument that "local businesses [were] advantaged because taxpayers [who] receive[d] dividends from domestic subsidiaries [were] benefited in the form of a lower Iowa income tax than if dividends from both foreign and domestic subsidiaries were taxed alike."[23] The court found Kraft's comparison of Iowa businesses to non-Iowa businesses unpersuasive and concluded the Iowa tax did not unconsti-

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14. *Id.*
15. *Id.* at 2368.
16. *Id.* at 2367.
17. *Id.* at 2367-68.
18. *Id.* at 2368.
19. Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d 664, 667 (Iowa 1991).
20. *Id.*
21. *Id.* at 668.
22. *Id.*
23. *Id.*

tutionally discriminate.[24] The court concluded the tax "does not differentiate between in-state or out-of-state taxpayers."[25]

B. Equal Protection Argument

Kraft's second argument alleged the Iowa tax scheme violated the Equal Protection Clauses of both the Iowa and United States Constitutions.[26] According to the court, Kraft would have to "*negat[e] every reasonable basis which may support the statute*" in order to sustain its burden of proof in showing an equal protection violation.[27] After applying a rational relation test,[28] the court held the advantages of using the federal formula to determine net income constituted a legitimate purpose to which the Iowa tax statutes sections 422.33 and 422.35 were rationally related.[29]

The United States Supreme Court granted certiorari,[30] and *held*, reversed.[31] The principal issue involved was "whether, on its face, the Iowa statute discriminates against foreign commerce."[32] In reversing the decision of the Iowa court, the Supreme Court declared the Iowa statute, which treated dividends received from domestic subsidiaries more favorably than those received from foreign subsidiaries, "facially discriminate[d] against foreign commerce and therefore violate[d] the Foreign Commerce Clause."[33] *Kraft General Foods v. Iowa Department of Revenue & Finance*, 112 S. Ct. 2365 (1992).

III. UNITED STATES SUPREME COURT OPINION

Iowa argued five justifications for upholding the constitutionality of the tax statutes: (1) A corporation's domicile is not necessarily indicative of whether its business is foreign or domestic;[34] (2) by changing domiciles, a taxpayer could avoid the discrimination in taxing;[35] (3) Iowa subsidiaries do not receive favorable treatment because of the taxing scheme;[36] (4) the tax benefits enjoyed by

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24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* (quoting City of Waterloo v. Seldon, 251 N.W.2d 506, 508 (Iowa 1977)).
28. *Id.* at 669. The Court used the rational relation test because "no suspect classification or fundamental right is claimed in this case." *Id.*
29. *Id.* The Court noted the following advantages of "coupling Iowa net income with the federal formula": 1) convenience for the taxpayer; 2) a less complex tax form saves the taxpayer time and money; 3) savings to the state; 4) opportunity for the state "to rely on federal regulation and interpretation"; and 5) quickness in checking taxpayers' accuracy in their returns. *Id.*
30. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 931 (1992).
31. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2372 (1992).
32. *Id.* at 2368. Because the Court reversed on the Foreign Commerce Clause issue, it did not reach Kraft's Equal Protection Clause challenge. *Id.* at 2372 n.25.
33. *Id.* at 2372. The Foreign Commerce Clause is found within the Commerce Clause: "Congress shall have the Power . . . [t]o regulate Commerce with foreign Nations, and among the several States . . . ." U.S. CONST. art. 1, § 8.
34. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2368.
35. *Id.* at 2369.
36. *Id.* at 2370.

domestic subsidiaries are offset by taxes in other states and the federal government;[37] and (5) the statute's intention is to "promote administrative convenience rather than economic protectionism."[38]

A. Nonindicativeness of a Corporation's Domicile

DORF argued a corporation's domicile does not necessarily indicate "the locus of its business operations."[39] It contended a domestic corporation doing business abroad might receive dividends representing earnings from its foreign component.[40] DORF reasoned this "disparate treatment of dividends from foreign and domestic subsidiaries d[id] not translate into discrimination based on the location or nature of business activity and [was] thus not prohibited by the Commerce Clause."[41] The Court acknowledged a subsidiary's domicile did not necessarily correspond to the location of its business operations.[42] The Court, however, declared "by its nature, a unitary business is characterized by a flow of value among its components."[43] The Court recognized the "flow of value," or dividends Kraft received, came from its foreign subsidiaries and, therefore, represented foreign commerce.[44]

The Court decided the tax scheme also depended on the "location of the subsidiary's business activities."[45] Iowa's tax scheme allows deductions on dividends received by domestic subsidiaries only if the dividends from a foreign subsidiary reflect domestic business.[46] As a result, dividends from foreign subsidiaries reflecting foreign earnings are the only dividends not deductible under the Iowa statute.[47]

DORF attempted to justify the statute by arguing no discrimination occurred against foreign earnings because domestic subsidiary dividends could reflect foreign earnings and those dividends were not taxed.[48] The Court held the mere fact that dividends received by domestic subsidiaries on foreign earnings were not taxed was not a valid justification to sustain the statute's disparate impact.[49]

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37. *Id.* at 2371.
38. *Id.*
39. *Id.* at 2368.
40. *Id.*
41. *Id.*
42. *Id.* at 2368.
43. *Id.* at 2369; *see* Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 178 (1983).
44. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2369 (1992).
45. *Id.*
46. *Id.*
47. *Id.*; *see supra* notes 12-18 and accompanying text.
48. *Id.*
49. *Id.*

B. Changing Domiciles to Avoid the Tax

DORF next argued Kraft could change the domicile of its foreign subsidiaries so the dividends from foreign earnings would be received by domestic subsidiaries, and the dividends received would be deductible.[50] DORF tried to show "it [was] not foreign commerce, but, at most, a particular form of corporate organization that [was] burdened."[51] The Court did not address the practicality of tax avoidance for the subsidiary.[52] Instead, the Court noted its disbelief over a state's ability to pressure taxpayers to channel foreign business through a domestic subsidiary to shun discriminatory taxation.[53]

The Court distinguished DORF's proposition of changing domiciles from tax avoidance by changing business forms.[54] In *Amerada Hess Corp. v. Director, N.J. Division of Taxation*,[55] the Court found a tax law did not violate the Commerce Clause when differential tax treatment of two categories of companies "results solely from differences between the nature of their businesses, not from the location of their activities."[56] *Amerada* involved a 1980 federal act[57] which assessed "a tax on the 'windfall profit' that a crude-oil producer receives from the oil it produces."[58] Congress allowed a deduction for this windfall tax for federal income tax purposes,[59] but did not require the states to allow the deduction for state income taxes.[60] New Jersey did not allow the deduction, and New Jersey oil companies brought suit claiming the denial of the deduction unjustly favored independent retailers who did not produce oil.[61] The *Amerada* Court found no discrimination against interstate commerce and concluded any effects from disallowing the deduction on those two types of companies "result[ed] solely from differences between the nature of their businesses, not from the location of their activities."[62] The Court in *Kraft* recognized the validity of its *Amerada* holding, but distinguished the *Kraft* proposition of avoidance of tax discrimination by changing domiciles from the *Amerada* proposition and found the proposition was without authority.[63]

In fact, prior cases point to the opposite conclusion.[64] In *Westinghouse Electric Corp. v. Tully*,[65] a New York tax scheme included a tax credit on accu-

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50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.* at 2370.
55. Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66 (1989).
56. *Id.* at 78.
57. Crude Oil Windfall Profit Tax Act of 1980, 26 U.S.C. §§ 4985-4998 (1988).
58. Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. at 69.
59. *Id.*; *see* 26 U.S.C. § 164(a)(5) (1988).
60. Amerada Hess Corp. v. Director, Div. of Taxation, 490 U.S. 66, 70 (1989).
61. *Id.*
62. *Id.* at 78.
63. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2370 (1992).
64. *Id.*; *see* Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 406 (1984); Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1963).
65. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984).

mulated income of subsidiary Domestic International Sales Corporations (DISC).[66] This tax provision provided a larger tax credit for a parent company on its DISC income if its DISC subsidiary moved more of its shipping activities into New York.[67] The New York tax scheme "penalized increases in the DISC's shipping activities in other States."[68] The Supreme Court found this tax incentive violated the Commerce Clause.[69]

In *Halliburton Oil Well Cementing Company v. Reily*,[70] Louisiana assessed a use tax against labor and shop overhead costs of specialized goods bought elsewhere and brought into Louisiana.[71] If these costs were incurred during assembly of the equipment in Louisiana, no use tax was assessed.[72] The Supreme Court concluded this incentive to assemble in Louisiana was discrimination under the Commerce Clause.[73]

C. *Iowa Receives No Benefit*

A state may not, without a compelling justification, advance its goals by facially discriminating against foreign commerce.[74] DORF contended, however, that no discrimination against commerce had occurred because the state's local interests did not benefit from the tax scheme.[75] The Iowa Supreme Court previously found this argument persuasive in upholding the Iowa tax scheme.[76]

DORF indicated "[t]o the extent corporations do business in Iowa, an apportioned share of their entire corporate income is subject to Iowa tax."[77] The dividends received by the domestic parent company from a foreign subsidiary doing business abroad would be taxed, but only on that subsidiary's dividends.[78] DORF argued Iowa businesses are actually disfavored because "'[m]ore earnings of the domestic subsidiary, which has income producing activities in Iowa, than earnings of the foreign subsidiary, which has no Iowa activities, are included in the preapportioned net income base for the unitary business as a whole.'"[79]

The Supreme Court conceded Iowa businesses received no favorable treatment from the statute,[80] but found this irrelevant in establishing a violation of

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66. *Id.* at 400. Domestic International Sales Corporations is a United States Internal Revenue Code classification; a qualifying corporation has "substantially all its assets and gross receipts [as] export-related." *Id.* at 390-91 (citing 26 U.S.C. §§ 992(a), 993 (1988)).

67. *Id.* at 400.

68. *Id.* at 401.

69. *Id.* at 407.

70. Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963).

71. *Id.* at 66.

72. *Id.*

73. *Id.* at 75.

74. *See* Maine v. Taylor, 477 U.S. 131, 148 n.19 (1986); Philadelphia v. New Jersey, 437 U.S. 617, 626-28 (1978).

75. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2370 (1992).

76. *See supra* notes 19-25 and accompanying text.

77. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2370.

78. *Id.*

79. *Id.*

80. *Id.*

the Foreign Commerce Clause.[81] In *Japan Line, Ltd. v. County of Los Angeles*,[82] the Supreme Court stated, "[T]he constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce."[83] The Court recognized two concerns as a result of a state "seek[ing] to tax the instrumentalities of foreign commerce."[84] First, the Court identified the risk of "multiple taxation."[85] Second, the Court acknowledged the possibility of "impairing federal uniformity in an area where federal uniformity is essential."[86] In *Kraft*, the Court concentrated on the concern of federal uniformity.[87]

The Court speculated on how a state's taxation of foreign commerce might adversely affect federal uniformity.[88] First, if the tax is based on apportionment, the United States might experience "international disputes over reconciling apportionment formulae."[89] Second, foreign nations experiencing a greater state tax burden in comparison to other foreign nations may become disgruntled and retaliate against American-owned entities in their jurisdictions.[90] Finally, if a state copied another state's taxing scheme which was discriminatory of foreign commerce, "various instrumentalities of commerce [might be] subjected to varying degrees of multiple taxation, a result that would plainly prevent [the United States] from 'speaking with one voice' in regulating foreign commerce."[91]

A state tax preventing the federal government's "speaking with one voice" in regulating commerce would violate the Commerce Clause.[92] Even though Iowa businesses received no benefit, the discriminatory impact of the tax scheme still affected foreign commerce.[93] The lack of local benefit, therefore, did not shield DORF's discriminatory acts from the prohibitions of the Commerce Clause.[94]

D. Domestic Activity Not Favored Over Foreign Activity

DORF asserted the Iowa tax scheme did not favor domestic business over activity abroad.[95] A subsidiary located in another state would be subject both to that state's tax and the federal government's tax.[96] DORF argued foreign subsidiaries might pay fewer taxes in Iowa than other subsidiaries might pay in

81. *Id.*
82. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979).
83. *Id.* at 445-46.
84. *Id.* at 446.
85. *Id.*
86. *Id.* at 448.
87. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2370 (1992).
88. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 450 (1979).
89. *Id.*
90. *Id.*
91. *Id.* at 450-51.
92. *Id.* at 451.
93. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2370 (1992).
94. *Id.*
95. *Id.*
96. *Id.* at 2371.

another state.[97] DORF also argued the tax scheme was not discriminatory because of the possibility of lower taxes in Iowa than in other states.[98] The Court, however, did not see the importance of looking to the tax burdens of other states.[99] The Court did not find authority supporting DORF's argument that "discrimination against foreign commerce can be justified if the benefit to domestic subsidiaries might happen to be offset by other taxes imposed not by Iowa, but by other States and by the Federal Government."[100]

E. Statute Promotes Administrative Convenience

Finally, DORF contended "administrative convenience, rather than economic protectionism" was the reason the statute followed the federal definition of "'taxable income,' which include[d] foreign subsidiary dividends."[101] The Court noted it is unconstitutional for state laws, "[a]bsent a compelling justification, . . . [to] advance its legitimate goals by means that facially discriminate against foreign commerce."[102] "[S]tate laws that amount to 'simple protectionism' . . . have been subject to a 'virtually *per se* rule of invalidity.'"[103]

DORF contended the advantages of using the federal definition constituted administrative convenience and therefore, justified the tax statute.[104] The advantages enumerated by the Iowa Supreme Court in upholding the tax statute included convenience for the taxpayer,[105] savings in time and money from not using a complex form,[106] savings to the state,[107] opportunity for the state "to rely on federal regulation and interpretation,"[108] and quickness in checking taxpayers' accuracy in their returns.[109]

The United States Supreme Court, however, did not find these advantages to be a compelling justification for the discrimination.[110] The Court did not wish to "minimize the value of having state forms and auditing procedures replicate federal practice."[111] The Court, however, reiterated its position that only a compelling state interest would permit a state to discriminate against foreign commerce.[112] The Court implied it would have upheld the statute if Iowa had no

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97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. Maine v. Taylor, 477 U.S. 131, 148 (1986) (quoting Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978)).
104. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2371 (1992).
105. Kraft, Inc. v. Iowa Dep't of Revenue & Fin., 465 N.W.2d 664, 669 (Iowa 1991).
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.*
110. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2371-72 (1992).
111. *Id.* at 2371.
112. *Id.*; *see* Maine v. Taylor, 477 U.S. 131, 148 n.19 (1986); City of Philadelphia v. New Jersey, 437 U.S. 617, 626-28 (1978).

reasonable and nondiscriminatory alternative method with which to advance its goals.[113] The Court determined, however, an alternative was available in this case.[114] Iowa could have obtained substantially the same benefits if, in addition to keeping the federal definition of "net income," it would have "ma[de] adjustments that avoid[ed] the discriminatory treatment of foreign subsidiary dividends."[115]

In dismissing DORF's arguments, the Court stressed implementation of a federal definition in a state statute will not "shield a state tax statute from Commerce Clause scrutiny."[116] The Iowa law could not pass this scrutiny; therefore, the Court held the law to be an unconstitutional violation of the Foreign Commerce Clause.[117]

IV. DISSENT

Chief Justice Rehnquist, joined by Justice Blackmun, dissented.[118] The dissent criticized the majority's holding for two reasons. First, the dissent argued the litigant should have been required to "show that 'no set of circumstances exist[ed] under which the Act would be valid'" because of the substantial burden "when making a facial challenge to the constitutionality of a statute."[119] Second, the dissent noted that even if it was sufficient to show non-Iowa domestic commerce enjoyed the only benefit, the record did not support such a showing.[120]

The dissent stated Kraft bore a heavy burden in bringing a facial challenge against Iowa's taxing scheme.[121] It concluded that "'the fact that [the tax] might operate unconstitutionally under some conceivable set of circumstances is insufficient to render it wholly invalid.'"[122]

The dissent distinguished *Japan Line, Ltd.*,[123] the only case relied on by the majority involving the Foreign Commerce Clause,[124] from the case at bar.[125] The dissent asserted the property tax involved in *Japan Line, Ltd.* was an *ad valorem* tax on all Japanese cargo containers,[126] and the containers, which were used ex-

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113. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2371 (citing New Energy Co. v. Limbach, 486 U.S. 269, 278 (1988)); *see, e.g.*, Maine v. Taylor, 477 U.S. 138, 151 (1986); Sporhase v. Nebraska *ex rel.* Douglas, 458 U.S. 941, 958 (1982); Hughes v. Oklahoma, 441 U.S. 322, 336-37 (1979); Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951).

114. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2371.

115. *Id.*

116. *Id.* at 2372.

117. *Id.*

118. *Id.* (Rehnquist, C.J., dissenting).

119. *Id.* (Rehnquist, C.J., dissenting) (quoting United States v. Salerno, 481 U.S. 739, 745 (1987)).

120. *Id.* at 2373 (Rehnquist, C.J., dissenting).

121. *Id.* at 2372 (Rehnquist, C.J., dissenting).

122. *Id.* (Rehnquist, C.J., dissenting) (quoting United States v. Salerno, 481 U.S. at 745).

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

124. *See supra* notes 82-94 and accompanying text.

125. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2372 (1992) (Rehnquist, C.J., dissenting).

126. Japan Line, Ltd. v. County of Los Angeles, 441 U.S. at 437.

clusively in foreign commerce,[127] should lend a different result to the case at bar.[128]

The dissent likened *Kraft* to a case in which the Court upheld a California statute in the face of a Foreign Commerce Clause challenge,[129] contending *Container Corp. of America v. Franchise Tax Board*[130] should have controlled.[131] The Court noted two distinctions between *Container Corp. of America* and *Japan Line, Ltd.*[132] First, in *Container Corp.*, the tax was imposed on a domestic corporation instead of a foreign entity.[133] Second, the executive branch in *Container Corp.* remained neutral in its opinion on the statute, whereas the executive branch in *Japan Lines, Ltd.* filed an *amicus curiae* brief opposing the state tax.[134] The dissent argued the similarity between *Kraft* and *Container Corp.* meant *Container Corp.* should control, which would result in finding the statute constitutional.[135]

The dissent also stressed Iowa's lack of benefit from the tax scheme should have been an indication of an unselfish motive, setting the statute apart from those struck down in past Commerce Clause decisions.[136] Specifically, the dissent cited *Bacchus Imports, Ltd. v. Dias* [137] in support of this contention.[138] In *Bacchus Imports*, Hawaii levied an excise tax on all wholesale liquors, but exempted several locally produced liquors.[139] The Hawaii legislature originally exempted liquors to aid local industries by promoting increased consumption.[140] The Court viewed this motive as "sufficient to demonstrate the State's lack of entitlement to a more flexible approach permitting inquiry into the balance between local benefits and the burden on interstate commerce."[141]

Finally, the dissent contended that even if it were sufficient to show all domestic commerce benefited from the tax scheme to the disadvantage of foreign commerce, the record did not support this showing.[142] The dissent based this

127. *Id.* at 436.

128. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2372 (Rehnquist, C.J., dissenting).

129. *Id.* (Rehnquist, C.J., dissenting).

130. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983).

131. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2372 (1992) (Rehnquist, C.J., dissenting).

132. *Id.* (Rehnquist, C.J., dissenting).

133. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. at 195.

134. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2372 (Rehnquist, C.J., dissenting).

135. *Id.* (Rehnquist, C.J., dissenting).

136. *Id.* at 2373 (Rehnquist, C.J., dissenting).

137. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984).

138. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2372 (1992) (Rehnquist, C.J., dissenting).

139. Bacchus Imports, Ltd. v. Dias, 468 U.S. at 265-66.

140. *Id.* at 269.

141. *Id.* at 270.

142. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2373 (Rehnquist, C.J., dissenting).

conclusion on the lack of evidence in the record showing the amount of foreign commerce affected by the tax statute.[143]

V. CONCLUSION

Kraft is a sound decision supported by authority. The tax scheme in dispute in *Kraft* affected entities based on their domicile and the location of their business activities. The fact some dividends received by domestic subsidiaries on foreign earnings were not taxed was not a valid justification to sustain the statute's disparate impact. Unlike the scheme upheld in *Amerada Hess* where discrimination could be avoided by a change in business forms, avoidance of the tax scheme in *Kraft* required a change in domicile, not supported by case precedent. A state cannot force a business to rechannel its foreign commerce through a domestic subsidiary to avoid taxation. Furthermore, a state cannot offer an incentive which encourages business through domestic channels rather than foreign ones.

The fact that Iowa businesses did not receive any beneficial treatment did not preclude a finding of a Foreign Commerce Clause violation. In addition, it is irrelevant that the effects of the Iowa tax scheme might be less than what subsidiaries—both foreign and domestic—would pay in other states. No authority exists to justify discrimination where a benefit for domestic subsidiaries might be offset by taxes in other states or nations.

Although DORF advanced several examples of administrative convenience from the tax, the Court pointed out other non-discriminatory alternatives with the same convenience. For example, DORF could have adopted the tax credit scheme, which would have eliminated the discriminatory effects and still offered the same administrative convenience. Taxes which discriminate against foreign commerce could adversely affect the nation's ability to "speak with one voice" in regulating foreign commerce.

The dissent would rely on *Container Corp.* where the Court upheld a California statute against a Foreign Commerce Clause challenge. The dissent found it significant that the executive branch remained neutral in its opinion of the California statute, but the executive branch filed an *amicus curiae* brief in *Kraft*, urging the statute was constitutional.[144] The dissent, however, cites no authority for its proposition that support from the executive branch shields statutes from findings of unconstitutionality. In fact, "[t]he lack of such a submission is by no means dispositive."[145]

The dissent also urged a finding of constitutionality because Iowa received no local benefit, which was indicative of an unselfish motive. However, the *Bacchus* case, on which the dissent relied, involved only interstate commerce,[146] and *Kraft* involved foreign commerce.[147] As the majority noted, the prohibitions

143. *Id.* at 2372 (Rehnquist, C.J., dissenting).

144. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. 2365, 2372 (1992) (Rehnquist, C.J., dissenting).

145. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 195-96 (1982).

146. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984).

147. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue & Fin., 112 S. Ct. at 2365.

against state taxation of foreign commerce are broader than in interstate commerce. Thus, when foreign commerce is involved, local benefit is not relevant in establishing a Foreign Commerce Clause violation.

The *Kraft* decision may have several consequences. First, corporations paying taxes under this provision and under similar provisions in other states[148] might be able to obtain refunds for these taxes before the tolling of the statute of limitations.[149] Second, this decision should alert states that adopting parts of federal definitions will not shield it against Commerce Clause scrutiny. Instead, states adopting parts of the federal tax scheme will have to contemplate the effects of not adopting the other parts of the federal scheme. Third, a state cannot assume the lack of benefit will protect it from Foreign Commerce Clause scrutiny, because of the broader protection against state taxation on foreign commerce. Finally, this decision could open the gates for foreign corporations to challenge other state tax laws which are discriminatory of domicile.

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148. "Eleven other states and the District of Columbia have tax code provisions similar to Iowa's." Steven J. Dickinson & Kelly L. McCarty, *U.S. Supreme Court Hits Back at State Tax Authorities*, INT'L FIN. L. REV. 30, 32 (1992).

149. *Id.*