european community

May 3, 1993
No. 18/93

NEWS

EC COMMISSION CONCERNED BY U.S. GOVERNMENT RETREAT FROM SUPREME COURT CASE ON UNITARY TAXATION

Christiane Scrivener, Member of the EC Commission with special responsibility for taxation, has expressed her concerns about recent developments in the United States in the long-running legal dispute over California's system of taxing foreign companies on a 'Unitary' basis.

In earlier proceedings the petitioner of the test case (Barclays Bank) had the support of the US administration. But in the latest and final stage, the new US administration has just decided not to file a brief in support of the petitioner. It is this withdrawal of support which has given rise to considerable concern in different member states.

Mrs. Scrivener, concerned about the impact that an adverse decision in the US Supreme Court could have on Community-based businesses operating in the US, has taken a close interest in the test case, and considers its conclusion to be an important issue.

The dispute originated in the early 1980s when California introduced a system of taxing multinational companies operating in the State on the basis of a proportion of their worldwide profits rather than separately calculating profits arising in the State.

This system of applying a formula based on property, payroll and sales in the State as a proportion of those worldwide was seen as simpler by California.

The constitutional validity of this method of taxing foreign multinationals was challenged by the American subsidiary of a European company and a test case is now before the US Supreme Court.

BACKGROUND NOTE

Unitary taxation is used by a number of US States to determine their share of income arising within the US as a whole. This has been broadly accepted because accounting standards and tax rules are largely compatible. The problem with the wider approach used by some of the States in the early 1980s was that it went beyond the US and looked at worldwide income.

Given differences in worldwide accounting standards, and differences in tax regimes the unitary method as applied by California was seen as both unfair and difficult to administer (for comparability worldwide accounts had to be prepared to Californian standards, for example). Following considerable pressure from both US federal authorities and other countries (which included empowering legislation in the UK permitting retaliation) most of the States revised their legislation between 1984 and 1988 so that for the most part the unitary method only applies to US source income.

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However, the problems were not entirely solved by those changes and the possibility of 'worldwide' unitary taxation still remains a threat in some of the US States. For example, California still retains the right to tax multinationals on a worldwide unitary basis at its sole discretion, although in practice it has not been applied. The Californian rules nowadays allow a multinational company to elect out of unitary tax treatment, but only in return for a substantial non-returnable fee.

The problems that now remain relate to whether the US States should retain their current powers to tax multinational companies on a worldwide basis, and also the resolution of outstanding litigation on individual cases begun under legislation before 1988.

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