

In The
Supreme Court of the United States

October Term, 1988

◆

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED and
IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

◆

**On Writ Of Certiorari To The United States
Court Of Appeals For The Seventh Circuit**

◆

**BRIEF OF THE MULTISTATE TAX COMMISSION,
AS AMICUS CURIAE,
IN SUPPORT OF PETITIONERS**

◆

ALAN H. FRIEDMAN
General Counsel
PAULL MINES*
Counsel
Multistate Tax Commission
444 No. Capitol Street, N.W.
Suite 500
Washington, D.C. 20001
(202) 624-8699

**Counsel of Record*

QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary;

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iii
INTEREST OF THE AMICUS CURIAE	1
INTRODUCTION AND SUMMARY OF ARGUMENT	4
ARGUMENTS	7
THE DOCTRINE OF "OUR FEDERALISM" WHICH IS MANIFESTED IN THE TAX INJUNC- TION ACT AND IN THE PRINCIPLE OF COMITY REQUIRES THIS MATTER TO BE DISMISSED ...	7
A. <i>The Alleged Injuries Of Alcan And Imperial At Best Are Indirect And Derivative Of The Direct Injuries Their Domestic Subsidiaries Would Neces- sarily Have Suffered As The Actual Taxpayers ..</i>	13
B. <i>The Tax Injunction Act Applies, Because The For- eign Parents Have An Effective Remedy Under California Law.....</i>	18
C. <i>The Principle of Comity Applies, Because There Has Been No Clear Showing That The Interests Which The Foreign Parent Corporations Seek To Preserve Cannot Otherwise Be Protected By Resort To Their Subsidiaries' State Remedies, Thereby Avoiding Unnecessary Federal Action.....</i>	19
CONCLUSION	25

TABLE OF AUTHORITIES

	Page
CASES:	
<i>Allee v. Medrano</i> , 416 U.S. 802 (1974)	12, 22
<i>Bob Jones University v. Simon</i> , 416 U.S. 725 (1974)	19
<i>California v. Grace Brethren Church</i> , 457 U.S. 393 (1982)	8, 9, 18, 22
<i>Colorado River Water Conservation District v. United States</i> , 424 U.S. 800 (1976)	10
<i>Container Corp. v. Franchise Tax Board</i> , 463 U.S. 159 (1983)	14, 15, 23
<i>Doran v. Salem Inn, Inc.</i> , 422 U.S. 922 (1975)	11, 12, 22
<i>Ex parte Young</i> , 209 U.S. 123 (1908)	21
<i>Fair Assessment in Real Estate Assn. v. McNary</i> , 454 U.S. 100 (1981)	<i>passim</i>
<i>Ford Motor Co. v. Dept. of Treasury</i> , 323 U.S. 459 (1945)	21
<i>Great Lakes Dredge & Dock Co. v. Huffman</i> , 319 U.S. 293 (1943)	7, 8, 9, 10, 20, 21
<i>Great Northern Life Ins. Co. v. Read</i> , 322 U.S. 47 (1944)	21
<i>Hicks v. Miranda</i> , 422 U.S. 332 (1975)	11, 12, 19, 22, 23
<i>Huffman v. Pursue, Ltd.</i> , 420 U.S. 592 (1975)	10
<i>Juidice v. Vail</i> , 430 U.S. 327 (1977)	10
<i>Matthews v. Rogers</i> , 284 U.S. 521 (1932)	8
<i>Middlesex County Ethics Committee v. Garden State Bar Assn.</i> , 457 U.S. 423 (1982)	11, 19

TABLE OF AUTHORITIES – Continued

	Page
<i>Ohio Civil Rights Commn. v. Dayton Christian Schools, Inc.</i> , 477 U.S. 619 (1986)	10, 11
<i>Pennzoil Co. v. Texaco, Inc.</i> , 481 U.S. 1 (1987)	10, 11, 19, 20
<i>Rosewell v. LaSalle Nat'l Bank</i> , 450 U.S. 503 (1981)	9
<i>Samuels v. Mackell</i> , 401 U.S. 70 (1971)	10
<i>South Carolina v. Regan</i> , 465 U.S. 369 (1984)	19
<i>Steffel v. Thompson</i> , 415 U.S. 452 (1974)	12
<i>Younger v. Harris</i> , 401 U.S. 37 (1971)	10
<i>U.S. Steel v. Multistate Tax Commission</i> , 434 U.S. 452 (1978)	2
U.S. CONSTITUTION:	
U.S. Const., art. I, § 8, cl. 3 (Foreign Commerce Clause)	3
STATUTES:	
Anti-Injunction Act, 26 U.S.C. §7421(a)	19
Tax Injunction Act, 28 U.S.C. §1341	<i>passim</i>
MISCELLANY:	
<i>Rev. Rul. 78-430</i> , 1978-2 C.B. 181	16

No. 88-1400

In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED and
IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

**On Writ Of Certiorari To The United States
Court Of Appeals For The Seventh Circuit**

**BRIEF OF THE MULTISTATE TAX COMMISSION,
AS AMICUS CURIAE,
IN SUPPORT OF PETITIONERS**

INTEREST OF AMICUS CURIAE

The Multistate Tax Commission is the administrative arm of the Multistate Tax Compact (the "Compact"). The Compact has been agreed to by 18 member states and the

District of Columbia and by 10 states as associate members. Its purposes as stated in the Compact are to facilitate proper determination of state and local tax liability of multistate taxpayers, to promote uniformity or compatibility of tax systems, to facilitate taxpayer convenience and compliance, and to avoid duplicative taxation. The validity of the Compact was recognized by the Court in *U.S. Steel v. Multistate Tax Commission*, 434 U.S. 452 (1978).

To further the purposes of the Compact, the Multistate Tax Commission conducts joint audits for its members. The Commission maintains audit offices in New York, Chicago and Houston, a headquarter's office in Washington, D.C., and a branch legal office in California.

The Seventh Circuit's decision has the potential to upset what the Multistate Tax Commission had understood was settled doctrine – federal constitutional challenges of state taxation must in the first instance be made in state forums which permit a full and fair consideration of the federal rights sought to be preserved. By establishing an exception for state tax challenges brought by a shareholder of a corporation subject to state tax, the Seventh Circuit has raised the real possibility that parties indirectly and derivatively affected by state taxation will fashion an independent theory of attack which could be heard by the federal courts. In effect, the Seventh Circuit's decision, if allowed to stand, permits shareholders who are at best indirectly and derivatively affected by the state taxation of their corporations to seek a remedy which would not otherwise be available to the taxpayer corporation itself.

While this case involves a challenge based upon the Foreign Commerce Clause, the Multistate Tax Commission believes the principles created by the Seventh Circuit will be used in other multijurisdictional contexts by shareholders of corporations. For example, the Seventh Circuit's decision may well permit any unsettled question involving unitary taxation, whether applied on a worldwide or domestic basis, to be fashioned into an alleged injury at the shareholder level which is justiciable in the federal courts. Likewise, the claimed injuries here used to justify federal court intervention in state tax administration appear flexible enough to be repeated in the context of state taxation not involving foreign commerce. Thus, a shareholder whose corporation is involved in interstate commerce may be equally able to complain about administrative burdens resulting from compliance with state taxation principles and about discrimination against the form of business organization by which it chooses to conduct its interstate business.

In addition to these concerns, the Seventh Circuit's decision makes it possible that any state participating in the Multistate Tax Commission's joint audit program could be required to defend its assessments proposed under their respective laws in the federal courts of any of the jurisdictions in which the Multistate Tax Commission maintains offices, irrespective of the nature of the claim. The Multistate Tax Commission is therefore concerned that the Seventh Circuit's decision in this case will result in opening the federal courts to a new class of federal constitutional litigation: shareholders litigating in federal court the state tax claims of their corporations in states other than the state whose laws have been called into

question. The Multistate Tax Commission believes state tax challenges in our federal system are more properly brought in the first instance in the taxing state's own forums.

INTRODUCTION AND SUMMARY OF ARGUMENT

Foreign parent corporations bypassing their subsidiaries' available state remedies to challenge in federal court their domestic subsidiaries' state taxes must clear at least two hurdles. First, a parent corporation must establish a justiciable claim arising out of its domestic subsidiary's payment of the state tax being challenged. This is the issue of standing. Second, assuming standing, a parent corporation must also establish the federal court's authority in the first instance to entertain and resolve the state tax claim. This is the question of whether the Tax Injunction Act, 28 U.S.C. §1341, or considerations of comity and federalism, require dismissal. In this brief, the latter concerns are called "Our Federalism."¹

While standing and "Our Federalism" can be interrelated as they are in this case, the two issues raise different considerations. Standing deals with a specific party's accessibility to judicial proceedings to resolve a specific claim. Dismissal under the doctrine of "Our Federalism," on the other hand, preserves our federal system by requiring a litigant with standing to resort to available

¹ *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100, 103 (1981), notes that "Our Federalism" encompasses both the Tax Injunction Act and the principle of comity.

state remedies in the first instance. Alcan and Imperial have not established their standing nor have they established sufficient reasons for avoiding dismissal under the doctrine of "Our Federalism."

This brief limits its discussion to consideration of the second issue - why the doctrine of "Our Federalism" requires dismissal. The Multistate Tax Commission limits its discussion to "Our Federalism", because it believes the strength of that doctrine supports a general rule that parent corporations, whether foreign or domestic, may not bypass in federal court state remedies available to their subsidiaries.

In furtherance of the Multistate Tax Commission's restricted treatment of this case, this brief's discussion of the alleged injuries of Alcan and Imperial is for the limited purpose of demonstrating that their claimed injuries can only be indirect and derivative. While the indirect and derivative nature of these injuries supports the Franchise Tax Board's position that Alcan and Imperial have no standing, the indirect and derivative nature of the claimed injuries also supports application of the doctrine of "Our Federalism." Dismissal should occur here, because the parent corporations' injuries, no matter how described, are simply too intertwined with the refund claims of the subsidiaries now pending in state proceedings to be considered independently by the federal courts.

Dismissal will promote our federal system by providing the California state courts the first opportunity to resolve a matter of important state interest. The importance of state tax administration is manifested in federal

legislation, such as the Tax Injunction Act, 28 U.S.C. §1341, the principle of comity, and the numerous decisions of the Court. "Our Federalism" is appropriately applied here, because (i) Alcan and Imperial have not made any attempt to determine if they can vindicate their interests through the pending state tax refund proceedings of their subsidiaries; and (ii) application of this Court's derivative preclusion concepts² indicates that adequate state remedies are in any event available to resolve all of the complaints of the actual taxpayers and their parent corporations. The facts of this case are not significantly different from other state tax and non-state-tax cases in which the Court has applied the doctrine of "Our Federalism" as manifested in the Tax Injunction Act and the principle of comity.

The fact that the underlying issues of these cases involve foreign commerce does not detract from these conclusions for two reasons. First, the ultimate issue – the constitutionality of applying the world-wide unitary business principle in the taxation of a domestic subsidiary corporation of a foreign parent – is not yet properly before the Court. Second, this Court has not deviated from its principle that where adequate state remedies exist, state tax cases are best resolved in the first instance in state forums. In effect, as to the preliminary issue of what forums are available to a litigant to resolve federal

² "Derivative preclusion" in this context refers to the application of the principle of comity where there is an inter-relationship among the federal court plaintiffs (the parent corporations), the state litigants (the tax paying subsidiaries), and the issues presented by each of these entities. See pp. 11-12, 20-25, *infra*.

constitutional challenges to state taxes in the first instance, the United States has spoken with uniformity: the federal government respects federalism by avoiding intrusive interference with state taxation until after state forums have had the full opportunity to review the matter themselves.

◆

ARGUMENT

THE DOCTRINE OF "OUR FEDERALISM" WHICH IS MANIFESTED IN THE TAX INJUNCTION ACT AND IN THE PRINCIPLE OF COMITY REQUIRES THIS MATTER TO BE DISMISSED.

There are two separate elements to "Our Federalism" which have application here: the Tax Injunction Act, 28 U.S.C. §1341, and the principle of comity.³ Both grounds are derivative of federalism and can be jointly discussed.

Prior to the adoption of the Tax Injunction Act in 1937, Act of August 21, 1937, 50 Stat. 738, federal courts sitting in equity had exercised their prerogative to withhold relief in favor of public interest (state tax administration) when the private rights sought to be vindicated would not suffer. *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 297-98 (1943). Supreme Court review of any federal question remaining after conclusion of the state legal proceedings sufficiently protected the private

³ The Court in *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100, 103 (1981), noted that the Tax Injunction Act and the tradition of withholding federal court review of state taxes are derived from "Our Federalism."

litigant's rights without disturbing state administration of taxes. *Id.* at 301. This judicial protection of state tax administration, which has not changed, *Fair Assessment in Real Estate Assn. v. McNary*, 454 U.S. 100 (1981), appropriately reflects considerations of federalism:

"The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it." . . . Interference with state internal economy and administration is inseparable from assaults in the federal courts on the validity of state taxation, and necessarily attends injunctions, interlocutory or final, restraining the collection of state taxes. These are the considerations of moment which have persuaded federal courts of equity to deny relief to the taxpayer. [*Great Lakes Co.*, 319 U.S. at 298 (quoting *Matthews v. Rogers*, 284 U.S. 521, 525 (1932))].

Congress recognized and gave sanction to this practice of the federal equity courts by its passage of Tax Injunction Act. *Id.* Subsequently, the application of the same principle of comity was applied to cases which could be described as sounding in law. *Fair Assessment, supra.*

The legislative history of the Tax Injunction Act discloses that the primary concern of Congress in passing the Act was the divestiture of federal court jurisdiction to interfere with state tax administration and not so much the form of the remedy available in the federal courts. *California v. Grace Brethren Church*, 457 U.S. 393, 409 n.22 (1982). To accommodate these concerns and to be faithful

to this congressional intent, the “plain, speedy and efficient remedy” exception to the Tax Injunction Act is narrowly construed. *Id.* at 413.

Consistent with the narrow interpretation of the “plain, speedy and efficient remedy” exception to the Tax Injunction Act, the Court has interpreted that Act to bar claims which are not within its literal language but whose consideration by the federal courts would be inconsistent with the purpose of the Act. *Grace Brethren, supra* (Tax Injunction Act applies to declaratory judgment cases even though the statutory language speaks in terms of injunctions). The Court has further indicated that a separate claim which does not directly involve the enjoining, suspending or restraining of the assessment, levy or collection of a state tax may nevertheless be barred by the Tax Injunction Act. Thus, a claim challenging a federal law, and not a state tax, is still barred within the same lawsuit, when the resolution of the question of the federal law would necessarily resolve the state tax claim, which is obviously also barred. *Grace Brethren, supra* at 418 n.38. To hold otherwise would not promote the policy of drastically limiting federal interference in the administration of state taxes. *Id.*

The Tax Injunction Act does not supplant possible application of the principle of comity in federal court cases involving state taxation. *Great Lakes Co., supra* at 299; *Fair Assessment, supra*. Therefore, “even where the Tax Injunction Act would not bar federal-court interference in state tax administration, principles of federal equity practice may nevertheless counsel the withholding of relief.” *Rosewell v. LaSalle Nat’l Bank*, 450 U.S. 503, 526 n.33 (1981).

The principle of comity in state tax cases is attributable to considerations of federalism. *Fair Assessment, supra*. *Younger* abstention, which is derived from the seminal case of *Younger v. Harris*, 401 U.S. 37 (1971), also reflects comity and federalism. *Younger* abstention originated in the context of federal courts interfering with ongoing state criminal proceedings. Today *Younger* abstention has been extended to ongoing state civil proceedings involving matters of significant state interest. E.g., *Ohio Civil Rights Commn. v. Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986) (ongoing state *administrative* hearing). The Court has indicated that *Younger* abstention reflects the concern of comity and not merely the existence of ongoing state proceedings. *Juidice v. Vail*, 430 U.S. 327, 334 (1977).

Younger abstention is closely related to the principle of comity which is applied in state tax cases. *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 816 (1976) (*Younger* abstention and state tax comity classified as the same general type of abstention); *Samuels v. Mackell*, 401 U.S. 70 (1971) (bases *Younger* abstention in declaratory judgment action on *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943)).⁴ If anything, historically it was more difficult to invoke *Younger* abstention than state tax comity, because *Younger* abstention was at first thought applicable only where there was an ongoing state criminal, or at least civil, *judicial* proceeding. Compare *Younger, supra*, *Huffman v. Pursue, Ltd.*, 420 U.S. 592

⁴ In any event the various forms of abstention are not "rigid pigeonholes into which federal courts must try to fit cases." *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 11 n.9 (1987).

(1975), and *Fair Assessment*, *supra* at 112, with *Dayton Christian Schools*, *supra*. *Younger* abstention illustrates the principle of comity which bars federal suits in the state tax area. *Fair Assessment*, *supra* at 112.

The Tax Injunction Act, the principle of comity in state tax cases and *Younger* abstention do not apply, if the ongoing state proceedings are inadequate to protect the federal interests sought to be vindicated. 28 U.S.C. §1341 ("plain, speedy and efficient remedy" exception); *Fair Assessment*, *supra* at 116. But where "a litigant has not attempted to present his federal claim in related state court proceedings, a federal court should assume that state procedures will afford an adequate remedy, in the absence of unambiguous authority to the contrary." *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15 (1987).

The *Younger* abstention requirement that the federal plaintiff be involved in ongoing state proceedings has not prevented the Court from recognizing that federal plaintiffs who are not involved *as parties* in the state proceedings may nonetheless be barred by *Younger* abstention. *Middlesex County Ethics Committee v. Garden State Bar Assn.*, 457 U.S. 423, 437 n.17 (1982); *Hicks v. Miranda*, 422 U.S. 332, 348-49 (1975). Thus, derivative preclusion under *Younger* abstention applies when the interests of the non-party federal plaintiffs are intertwined with the state parties and interference with the pending state proceedings is sought. *Hicks*, *supra* at 348-49. In the Court's view, it is the interrelationship of the parties as to "ownership, control and management" which determines whether the interests of the nonparty federal plaintiff are so intertwined with the state party that *Younger* dismissal is required. *Doran v. Salem Inn, Inc.*, 422 U.S. 922, 928-29

(1975). Basically, the Court has indicated that derivative preclusion will apply in *Younger* abstention, if the non-party federal plaintiff by reason of his relationship with the state party can preserve and vindicate his rights. *Hicks, supra* at 348-49. *Doran, supra* at 928-29.

Thus, the Court has held that an employer who operated a theater showing the film *Deep Throat* was nonetheless barred by *Younger* abstention from maintaining a federal action challenging state obscenity laws where state proceedings were ongoing which involved the employer's employees and the film itself. *Hicks, supra*. In addition, some Justices of the Court would similarly apply this form of derivative preclusion under *Younger* abstention to a union seeking to assert in federal court the interest of its members, even though the organization had some interests which may be separate and independent of its members. *Allee v. Medrano*, 416 U.S. 802, 830-31 (1974)(Burger, C.J.)(concurring and dissenting opinion). This view has apparently found some favor with a majority of the Court. See *Hicks, supra* at 340 (quoting favorably a portion of Chief Justice Burger's observations in *Allee v. Medrano*).

The Court has not applied derivative preclusion in *Younger* abstention, however, where the federal court plaintiffs and the state party are totally unrelated, *Doran, supra* (three independent bar owners who were unrelated as to ownership, control and management but who had a common issue); or where the unrelated state court party is asserting an interest personal to her, *Steffel v. Thompson*, 415 U.S. 452 (1974) (two unrelated handbillers where there was no factual indication state criminal defendant would seek or be able to vindicate the nonparty federal plaintiff's rights).

Application of the foregoing authorities to the facts in this case results in the conclusion that both the Tax Injunction Act and the principle of comity bars these actions.

A. The Alleged Injuries Of Alcan And Imperial At Best Are Indirect And Derivative Of The Direct Injuries Their Domestic Subsidiaries Would Necessarily Have Suffered As The Actual Taxpayers.

As a preliminary matter, your *Amicus* will demonstrate that the claimed injuries of Alcan and Imperial at best are described as indirect and derivative of the direct injuries their domestic subsidiaries would necessarily have to suffer as the actual taxpayers. Our purpose here is not to argue standing which has already been effectively accomplished by the Franchise Tax Board. Rather, your *Amicus* submits that the indirect and derivative nature of the claimed injuries of Alcan and Imperial establish that these injuries are inextricably intertwined with the issues presented by the subsidiaries in their pending state tax refund proceedings. This close interrelationship requires that these actions be dismissed under "Our Federalism."

In the course of these proceedings, Alcan and Imperial identified two injuries to support their access to federal court, both of which the Seventh Circuit rejected:

1. Use of the unitary business principle results in an alleged substantial compliance burden on the foreign parent corporations; and
2. Use of the unitary business principle results in alleged double taxation of income in which the

foreign parent corporations have an interest. Pet. for Writ of Cert. A-13 to A-14.

The Seventh Circuit on its own developed a third possible injury:

Use of the unitary business principle allegedly burdens foreign companies' decisions to conduct business through subsidiaries (allegedly resulting in a higher state tax burden) than if they used an independent contractor (allegedly resulting in a lower state tax bill). Pet. for Writ of Cert. A-15 to A-17.

The above proffered injuries at best establish an indirect and derivative injury in the parent corporations.

Part of the problem with contending that the above identified injuries are the separate injuries of the parent corporations is that it is unclear whether this argument is premised on the unitary business principle or the "arm's length/separate accounting" principle. The Multistate Tax Commission submits that notwithstanding this confusion, analysis of the claimed injuries under either the unitary business principle or the arm's length principle supports the conclusion that the parent corporations' claimed injuries are indirect and derivative.

1. *Unitary principle.*

Alcan and Imperial do not contest in these proceedings that the foreign parent corporations and their domestic subsidiaries are engaged in a unitary business.⁵

⁵ In this context, unitary business means a business the activities of whose members (in the case of a multicorporate structure) are so functionally integrated as to be engaged in a single enterprise. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 165, 178-79 (1983).

(J.A. 54, para. 30; J.A. 63, "Issues;" J.A. 68-9, para. 17). The absent parent corporations establish their alleged injury, if any, through the state taxation of their subsidiaries, which are supplying the nexus for state taxation. *See Container, supra* at 164-66. The alleged injuries of the parent corporations cannot be viewed as direct and independent when the instate, domestic subsidiary is engaged in a unitary business.

Thus, alleged double taxation cannot exist, for example, unless the taxing state is using the unitary principle to tax *through the instate subsidiary* income which, under the standards of the foreign commerce clause, is not properly attributable to the subsidiary. Similarly, the administrative compliance burden of being a unitary business rests directly upon the instate domestic subsidiary which must pay any tax or penalty resulting from its failure to comply. Finally, the instate domestic subsidiary corporation must pay the alleged discriminatory tax which purportedly makes utilization of the instate subsidiary unattractive to the absent parent.

In short, under the unitary principle the instate subsidiary corporation can be the only directly injured party, because it is the actual taxpayer supplying the nexus for taxation and no injury can even indirectly occur to the parent at all without the very same injury directly occurring to the subsidiary.

2. *Arm's length principle.*

Utilizing the arm's length principle to analyze the parent corporations' claimed injuries is conceptually difficult. The arm's length principle treats each corporate

entity as separate so that action taken against one corporation conceptually could not cause a *direct* injury against another corporation which was absent from the state taking the action. Nonetheless, assuming one can find causation using the arm's length principle, your *Amicus* does not see how the parent corporation's claimed injuries can be viewed as direct and independent.

Under the arm's length principle, alleging double taxation is tantamount to claiming that the taxing state is taxing income which is not properly apportioned or attributed to the instate subsidiary. Alcan and Imperial have advanced no reason why the instate subsidiary, as the taxpayer whose income has been thus inappropriately increased, is not the party directly injured.

The compliance burden under the arm's length principle cannot be placed at the level of the parent corporation at all. Under the arm's length principle, the instate, domestic subsidiary would be obligated to reimburse the foreign parent corporation for its work. Cf. *Rev. Rul. 78-430*, 1978-2 C.B. 181 (arm's length rules of §482 of the Internal Revenue Code require arm's length compensation for management, bookkeeping and consulting services rendered by another corporation).

The alleged discrimination arising from the choice of business organization with which to conduct foreign commerce injures the domestic subsidiary, because according to the Seventh Circuit's logic *the domestic subsidiary* incurs higher taxes than would an independent contractor. Here again, it is the instate, domestic subsidiary which should complain.

It should be apparent from the foregoing discussion that the claimed injuries of the parent corporations in this case are indirect and derivative of their subsidiaries' claims under either unitary or arm's length principles. After all, it is the factors used to calculate the *instate subsidiaries'* taxable income which are being called into question.

The instate, domestic subsidiaries, as the directly injured parties, are the appropriate representatives to challenge California's use of the unitary business principle to the unitary business. The Multistate Tax Commission cannot understand how the final resolution of the domestic subsidiaries' direct injury in the pending state tax refund proceedings, which includes a possible appeal to this Court, would not necessarily also resolve any claim the parent corporations may have, no matter what the nature of the parents' claims. This means that the parents' claims, however described, are too inextricably intertwined with the refund claims of the subsidiaries to be independently resolved by the federal courts. The parent corporations by virtue of their absolute ownership and control of their wholly owned subsidiaries can preserve their federal rights by controlling their subsidiaries' utilization of the available state remedies. (J.A. 41, para. 6; J.A. 66, para. 8 and Ex. 1 to Alcan Stip.). The remaining portions of this brief will demonstrate under the Court's precedent why this is so.

B. The Tax Injunction Act Applies, Because The Foreign Parents Have An Effective Remedy Under California Law.

No one questions the adequacy of California's remedy, *qua* remedy. The only question presented by Alcan's and Imperial's opposition to application of the Tax Injunction Act is whether the California remedy is available to vindicate the parents' interests.

Given the true nature of the parent corporations' injuries, it belies reality to argue that the remedy available to the foreign parents through their wholly owned domestic subsidiaries does not afford an adequate remedy within the meaning of the Tax Injunction Act. The indirect and derivative injuries allegedly suffered by the parent corporations are in fact best represented by the domestic subsidiary whose direct economic interest is at stake.

To apply the "plain, speedy and efficient remedy" exception of the Tax Injunction Act here would not give proper deference to Congressional intent to divest the federal courts of jurisdiction to interfere with the administration of state taxation. *Grace Brethren, supra* at 409 n.22. After all, the Tax Injunction Act requires dismissal of a challenge to a federal law which does not directly involve a challenge to a state tax, when resolution of the federal question will necessarily resolve the state law claim, which is also being dismissed. *Grace Brethren, supra* at 418 n.38. It should be equally appropriate to apply the Tax Injunction Act to intertwined, related *parties* as the Court does to intertwined *issues*, where resolution of the

related state party's case will necessarily resolve the federal plaintiffs' case. This Court will be available to review the federal law claims which a related (or derivative) party does not believe were properly resolved in the related state proceedings.

The Court has suggested as much in cases dealing with the analogous circumstance involving the Anti-Injunction Act, 26 U.S.C. §7421(a). In cases involving the Anti-Injunction Act, the Court has suggested that formalisms in the identities of the parties will not avoid dismissal. *South Carolina v. Regan*, 465 U.S. 369, 381 n.19 (1984) (organization of taxpayers could not successfully argue that it was without alternative remedies); *see also Bob Jones University v. Simon*, 416 U.S. 725, 747 n.21 (1974) (third parties in suits involving taxes may be able to afford a taxpayer a sufficient remedy).

C. The Principle of Comity Applies, Because There Has Been No Clear Showing That The Interests Which The Foreign Parent Corporations Seek To Preserve Cannot Otherwise Be Protected By Resort To Their Subsidiaries' State Remedies, Thereby Avoiding Unnecessary Federal Action

Federal plaintiffs seeking to bypass state remedies available in related state proceedings have a special burden to establish that their interests cannot be protected in these related state proceedings. *See Pennzoil, supra* at 14-17; *Middlesex County Ethics, supra* at 435 (inadequacy of state remedy must plainly appear); *Hicks, supra* at 349 (federal plaintiffs must make "clear showing" state remedies are inadequate). Alcan and Imperial have failed

in this endeavor. Indeed, Alcan's and Imperial's failure to attempt to vindicate their alleged interests through the state remedies available to their domestic subsidiaries justifies this Court assuming that such rights could be vindicated in the pending state tax refund proceedings. *Pennzoil, supra* at 15.

The fact that the parent corporations may not be actual state parties in the pending state refund proceedings should not prevent the Court from applying *Pennzoil*, because it is clear that the parents absolutely control their domestic subsidiaries through 100% ownership of the subsidiaries' stock. In addition, the parents' derivative claims will necessarily be resolved in the subsidiaries' pending state tax refund claims. Resolution of the federal constitutional claim held by the subsidiaries will necessarily resolve the parents' claims. To the extent there is any ambiguity in California law on this point, which the Multistate Tax Commission submits is not the case, Alcan and Imperial may not be heard to complain. *Pennzoil, supra* at 14-15. The record discloses that no harm will occur to Alcan and Imperial from dismissing their injunctive and declaratory actions in favor of the pending state tax refund proceedings which have been commenced by their domestic subsidiaries. *Great Lakes Co., supra* at 297-98. These preliminary observations alone support the dismissal of this case under the principle of comity.

Apart from relying on Alcan's and Imperial's failure of proof, the record itself supports the Franchise Tax Board's assertion that the principle of comity is applicable in any event. Thus, the facts indicate that apart from the derivative party and derivative issue aspects of this

case, the threshold for applying *Younger* abstention exists.⁶ The facts of this case do not even require reference to the special class of state tax cases which deal with the principle of comity. This means that the derivative preclusion principles which have been developed in *Younger* abstention cases would have independent operation without regard to this case involving state taxes. Direct application of *Younger* abstention, as opposed to state tax comity, in this case is, however, somewhat theoretical, because the Court has recognized that the comity principle applied in *Younger* abstention is illustrative of the same principle to be applied in state tax comity cases. *Fair Assessment, supra* at 111-12. Indeed, the principle

⁶ The threshold for applying *Younger* abstention appears easily met here, because this matter involves an application for the intervention of the federal courts in ongoing state judicial and quasi judicial proceedings involving matters of substantial importance to the states (taxation). *E.g., Fair Assessment, supra; Great Lakes, supra*. Whether the difference in parties and the alleged issues would avoid *Younger* abstention is discussed in the main text.

Your *Amicus* parenthetically notes at this point that this action is especially intrusive, because the Franchise Tax Board, which is a California state governmental agency, is a party defendant in these proceedings and there are at the same time pending state tax refund proceedings. While *Ex parte Young*, 209 U.S. 123 (1908), allows the bringing of a prospective injunctive (or now a declaratory) action against state officials who are alleged to have exceeded their authority under federal law, that exception does not apply when the suit is directly against a state. In addition, the presence of ongoing state tax refund proceedings make these actions exceedingly close to a federal suit for the refund of state taxes, which is clearly not permitted. *Ford Motor Co. v. Dept. of Treasury*, 323 U.S. 459 (1945); *Great Northern Life Ins. Co. v. Read*, 322 U.S. 47 (1944).

of comity applied in state tax cases has suggested the same kind of practical solution to derivative preclusion which is advocated here. *Grace Brethren*, *supra* at 418 n.38 (derivative *issue* preclusion applied). So regardless of whether this matter is treated as a *Younger* abstention case or a state tax comity case, the result should be the same.

Dismissal in this case is appropriate notwithstanding the fact (i) the parent corporations allege they are asserting an independent interest and (ii) the parent corporations themselves are not involved in the pending state proceedings and apparently cannot participate as a state party. The Court's opinions in *Hicks*, *supra*, and *Doran*, *supra*, prove the point.

Hicks and *Doran* have advocated a practical approach to applying comity in situations involving the possible application of derivative preclusion. Since application of comity seeks to avoid unnecessary federal intrusion where the federal rights can still be preserved through state proceedings, the focus of the Court is on whether the state proceedings will be available to vindicate the nonparty federal plaintiff's rights. Specifically, the Court has indicated that a federal court should not proceed, if the issues presented by the nonparty federal plaintiff and the state party are intertwined and the parties are related by ownership, management and control. *Hicks*, *supra* at 348-49; *Doran*, *supra* at 928-29. It would elevate form over substance not to dismiss a nonparty federal plaintiff's suit where in practical effect the nonparty federal plaintiff controlled the ongoing state proceedings and is in a position to ensure that its rights are preserved. See *Allee v. Medrano*, 416 U.S. 802, 831 (Burger, C.J.) (concurring and

dissenting opinion) ("The requirements of Younger are not to be evaded by artificial niceties.")

The facts of this case clearly call for derivative preclusion application of the comity principle for several reasons. First, since Alcan and Imperial, for purposes of this proceeding, have not challenged the finding of a unitary business, it must be conceded that the business of the subsidiary is so functionally intergrated with that of the parent corporations as to be a single business. *Container, supra* at 165, 178-79. This relationship results in a flow of value not only from the functional integration, but also from centralization of management and economies of scale. *Id.* The underlying foreign commerce issue which will ultimately be presented, therefore, affects the instate subsidiaries as integral members of this unitary business. The instate subsidiaries are the corporate entities which must bear the direct burden of the alleged unconstitutional tax.

Second, the unitary business ensures that there is a single business with an identity of economic activities and interests among its separate members. It follows that there is no reasonable prospect that the subsidiaries for their own practical benefit will abandon the fight on behalf of the unitary group. If the Court was willing to apply derivative preclusion in favor of an ongoing state criminal proceeding with all its uncertainty in final resolution, *Hicks, supra*, then certainly it should be applied in the civil context where the interrelated, but separate, parties have the same economic interests.

Third, the only direct injury which can be identified is that of the instate subsidiaries which are subject to the

state tax at issue. The parent corporations' alleged injury is entirely derivative of the action being taken against their subsidiaries. Final resolution of the subsidiaries' ongoing state tax refund claims will necessarily fully resolve the parent corporations' claims.

Fourth, the parent corporations by virtue of their absolute control over the domestic subsidiaries arising from 100% ownership totally dominate and control the subsidiaries' ongoing state tax refund proceedings. Nowhere is this more evident than in the fact that the subsidiaries have not been pressing for resolution of their tax refund claims but the parent corporations have been quite active here.

Fifth, this action was obviously commenced to avoid the consequences of and to interfere with the ongoing state tax refund proceedings. This is established by Alcan's persistent forum shopping and by the fact that the subsidiaries are not pressing for the resolution of their tax refund claims. All parties apparently recognize that final resolution of the parent corporations' foreign commerce claims on the merits would necessarily eliminate the necessity of proceeding with the subsidiaries' refund claims. If the subsidiaries had any different interests to vindicate, your *Amicus* suggests they would independently be pushing to have their refund claims resolved. This federal suit has already had, therefore, an intrusive effect on an ongoing state proceedings involving matters of substantial importance to the states. As previously noted, the intrusive effect is heightened by the fact that resolution of the parent corporations' declaratory and injunctive claims will undoubtedly impose the

result to be applied in the refund proceedings. See n. 6, *supra*.

◆

CONCLUSION

While Alcan and Imperial have fashioned a claim they hope will keep them in federal court, application of "Our Federalism" prevents this attempt from being successful. Given the indirect and derivative nature of the claim pressed, either the Tax Injunction Act or the principle of comity bars these actions. Alcan and Imperial quite frankly have not met their burden of establishing that the related pending state tax refund proceedings do not provide them with the opportunity of vindicating their alleged federal constitutional rights. Indeed, the record affirmatively discloses that by utilizing their subsidiary corporations' pending state tax refund proceedings, Alcan and Imperial do enjoy the right to present their claims and preserve their alleged federal interests. This Court should not deviate from its uniform position that with rare exception any challenge to state taxation must be first heard in the forums of the taxing state.

Respectfully submitted,

ALAN H. FRIEDMAN
General Counsel

PAULL MINES*
Counsel

Multistate Tax Commission
444 No. Capitol, N.W.
Suite 500
Washington, D.C. 20001
(202) 624-8699

**Counsel of Record*

June 8, 1989