UCLA
UCLA Pacific Basin Law Journal

Title
The L-1 Visa and the Unitary Tax: Is the Immigration Lawyer's Dream the Tax Planner's Nightmare?

Permalink
https://escholarship.org/uc/item/6kr330km

Journal
UCLA Pacific Basin Law Journal, 4(1-2)

Author
Harrison, Michael David

Publication Date
1985

DOI
10.5070/P841-2021924

Copyright Information
Copyright 1985 by the author(s). All rights reserved unless otherwise indicated. Contact the author(s) for any necessary permissions. Learn more at https://escholarship.org/terms

Peer reviewed

eScholarship.org Powered by the California Digital Library
University of California

THE L-1 VISA AND THE UNITARY TAX: IS THE IMMIGRATION LAWYER'S DREAM THE TAX PLANNER'S NIGHTMARE?

Michael David Harrison*

The L-1 visa, commonly referred to as the intra-company transferee visa, was created by Congress in 1970[1] to allow multinational business entities with U.S. affiliates to transfer high-level or specially skilled employees from foreign operations to their U.S. operations, without having to follow the immigration "track." While in the U.S., an intra-company transferee may apply for an "adjustment" of visa status from non-immigrant to immigrant.[2] As one might expect, these features make the L-1 visa a popular tool among immigration lawyers and an enticing avenue for persons with sufficient capital to start operations in the U.S. to which they may transfer themselves.[3]

One seldom-considered ramification of using the L-1 visa as an immigration tool is the potentially adverse impact of the unitary taxing method, sometimes referred to as the unitary tax, which is used by over twenty states, including California.[4] Basically, the

---

* Beverly Hills, California; J.D., 1976, University of California at Los Angeles; A.B., 1973, University of California at Berkeley; Adjunct Professor of Business Law, School of Business Administration and Economics, California State University at Northridge.

1. The Immigration and Nationality Act, 8 U.S.C. §§ 1101-1525 (1952), was amended in 1970 by the Immigration and Nationality Act — Entry of Nonimmigrants, Pub. L. No. 91-255, 84 Stat. 116 (1970), in order to create the L-1 visa, among other things.

2. "Adjustments" to visa status are governed by the rules specified in 8 U.S.C. § 1255 (1952) and 8 C.F.R. § 245.1-.8.

3. In fiscal year 1971, 5,304 persons were admitted to the United States under the L-1 visa, while in 1978, 21,495 persons were admitted, together with their spouses and children (an additional 18,521 people). *Nonimmigrant Business Visas and Adjustment of Status: Hearing Before the Sub-Comm. on Immigration and Refugee Policy of the Comm. of the Judiciary*, 97th Cong., 1st Sess. 17 (1981) (statement of Doris Meissner, acting Comm'r, Immigration and Naturalization Service) [hereinafter cited as *Nonimmigrant Business Visas Hearing*]. As of 1981, the average length of stay for L-1 visa holders was 3 years. *Id.*

4. At the time this article was drafted, the following states had adopted the unitary tax method: Alabama, *see* ALA. CODE § 40-27-1 (1967); Alaska, *see* ALASKA STAT. § 43.19.010 (1970); Arizona, *see* ARIZ. REV. STAT. ANN. §§ 43-1131—1150

unitary taxing method calculates the taxable income of the in-state operations of multi-national enterprises as a fraction of the total income of the unitary business. This method ignores the actual reported incomes of the in-state operations in situations where the in-state operations contribute value to the income of the overall or "unitary" business. Because an L-1 visa applicant must admit affiliation between the foreign business from which the applicant is being transferred and the U.S. business which will receive the applicant, the applicant runs a strong risk of having his foreign business subjected to the unitary tax.

The objective of this article is to explore the often unforeseen interaction between the L-1 visa and the unitary taxing method. The L-1 visa and the unitary taxing method will be analyzed in isolation, followed by a discussion as to how the two bodies of law should interact. Recommendations will then be made as to ways in which an L-1 visa applicant can avoid the imposition of the unitary tax on his foreign employer.

I. THE L-1 VISA

A. Definition

To assess the possible state income tax[5] ramifications of using

---

(1983); Arkansas, *see* ARK. STAT. ANN. § 84-2063 (1961); California, *see* CAL. REV. & TAX. CODE §§ 25120-25140 (1966); Colorado, *see* COLO. REV. STAT. § 24-60-1301 (1963); Hawaii, *see* HAWAII REV. STAT. § 235-29 (1967); Idaho, *see* IDAHO CODE § 63-3027 (1959); Kansas, *see* KAN. STAT. ANN. § 79-3279 (1963); Kentucky, *see* KY. REV. STAT. § 141.120 (1950); Maine, *see* ME. REV. STAT. ANN. tit. 36, § 5211 (1969); Michigan, *see* MICH. COMP. LAWS § 205.581 (1969); Minnesota, *see* MINN. STAT. § 290.171 (1983); Missouri, *see* MO. REV. STAT. § 32.200 (1967); Montana, *see* MONT. CODE ANN. § 15-1-601 (1969); Nebraska, *see* NEB. REV. STAT. § 77-2901 (1967); New Mexico, *see* N.M. STAT. ANN. § 7-5-1 (1967); North Dakota, *see* N.D. CENT. CODE § 57-38.1-09 (1965); South Carolina, *see* S.C. CODE ANN. §§ 12-7-1110—12-7-1200 (1962); South Dakota, *see* S.D. CODIFIED LAWS ANN. § 10-54-1 (1976); Texas, *see* TEX. TAX CODE ANN. § 141.001 (1967); Utah, *see* UTAH CODE ANN. § 59-13-86 (1967); Washington, *see* WASH. REV. CODE § 82.56.010 (1967).

5. This article addresses only the state income tax ramifications of using the L-1 visa. The federal income tax consequences to either the foreign corporation or the L-1 visa applicant from using such a visa are not discussed.

Nonetheless, it should be noted that once the L-1 visa applicant commences employment in the U.S., the federal government will tax him on his worldwide income as soon as he attains residency status for tax purposes. Treas. Reg. § 1.871-1(a) (1957). An individual is deemed to have attained U.S. residency status when one of the following two events occurs: he has entered the U.S. as a lawful permanent resident under the immigration laws, *or* he has satisfied a substantial presence test, which requires him to have been present in the U.S. for at least 31 days during the calendar year and to have been present in the U.S. for a substantial period of time — as many as 183 days during a 3 year period weighted toward the present year. I.R.C. § 7701(b) (1984). An L-1 visa applicant will probably attain residency under the substantial presence test, because he has not been admitted as a "permanent" resident under the immigration laws. For the individual's tax treatment prior to attaining residency status, see Treas. Reg. § 1.871-8(b)(2) (1974); I.R.C. § 864(c) (1966).

the L-1 visa as an immigration tool, the general and specific attributes of the L-1 visa must be understood. An L-1 visa is a non-immigrant visa.[6] To be excepted from "immigrant" status, an L-1 visa applicant must meet several requirements. The applicant must have served for one year of continuous employment, immediately preceding the visa application, in the alien's home country with the transferring employer. The applicant must also have intended to enter the U.S. only temporarily for the purpose of serving an affiliate or subsidiary of the transferring employer. Finally, the applicant must render services to his employer in a capacity that is managerial, executive, or involves specialized knowledge.[7]

B. Affiliation

The L-1 visa eligibility requirement, which is critical to the unitary tax question, is affiliation between the foreign and U.S. businesses.[8] For large multi-national corporations or enterprises, proof of affiliation is usually quite easy. In fact, the Immigration and Naturalization Service ("I.N.S.") has considered creating a one-time list for large U.S. firms frequently utilizing L-1 visas as presumptive proof of affiliation in their applications.[9]

Such a list will not affect persons using the L-1 visa as an immigration tool. In order to satisfy the I.N.S. that the L-1 visa applicant has a U.S. business to which he or she can be transferred, such persons may have to come to the U.S. to negotiate a lease for business premises. Although the U.S. business need not be in operation at the time of the visa application,[10] the applicant must demonstrate an intent to establish an affiliate, which usually amounts to evidence of a leasehold or real estate purchase.[11]

Affiliation means neither 100% ownership nor 100% control; it is a far more pragmatic and realistic concept. The applicant's U.S. employer must be the same employer as the applicant's foreign employer, or "a subsidiary or affiliate" of the foreign employer.[12] The I.N.S. has issued the following guidelines with respect to subsidiaries and affiliates of the foreign employer:

6. The Immigration and Nationality Act, *supra* note 1, specifically provides as one exception to the definition of an "immigrant" an L-1 visa applicant. 8 U.S.C. § 1101(a)(15)(L) (1970). *See also* 8 U.S.C. § 1201(a)(2) (1952).

7. 8 U.S.C. § 1101(a)(15)(L) (1970).

8. Specifically, an L-1 visa applicant must render services in the U.S. "to the same employer or a subsidiary or *affiliate* [of his previous foreign employer] . . . ." *Id.* (emphasis added).

9. *Nonimmigrant Business Visas Hearing*, *supra* note 3, at 18-19.

10. Matter of Colley, 18 I. & N. Dec. 117, 119 (1981) ("[A]n alien may be coming to the United States to establish an affiliate or subsidiary office and the affiliate or subsidiary need not be in existence or operation at the time of admission.")

11. 20 C.F.R. § 214.2(l)(1)(iii) (1973).

12. 8 U.S.C. § 1101(a)(15)(L) (1970).

> *Subsidiary relationships.* Stock ownership and a substantial degree of managerial control are the keys to measuring a subsidiary relationship. Control can be through less than majority stock ownership. Proxy votes of minor stockholders could give a larger stockholder a "majority." Also, as is the case with larger corporations, extremely diverse holdings of minor stockholders could vest control in a main, larger stockholder . . . .
>
> *Affiliate Relationships.* The most common affiliate relationship is analogous to the inter-relation of siblings through their common parent. Thus, two subsidiaries of a "parent" company would qualify as affiliates of each other. However, . . . many variations of the subsidiary/affiliate relationship exist. Each case must be judged on the merits of its corporate structure.[13]

Control is a key element in showing affiliation. The I.N.S. Appeals Board has held that an applicant need demonstrate only *de facto* control to show affiliation and, that such control may be present even when the affiliate is less than 50% owned by the parent, or when one company exists solely to sell the other's products.[14] For affiliate relationships, control may be held by one or more individual owners, not only corporate owners.[15] For subsidiary relationships, an applicant may be employed either by a foreign subsidiary of a U.S. parent company or by a U.S. subsidiary of a foreign parent company.[16]

C. Policy Analysis

The legislative history to the 1970 amendment to the Immigration and Nationality Act,[17] in which the L-1 visa was created, provides some of the policy justifications for the nonimmigration "track" offered by the L-1 visa. The primary objective of the L-1 visa was to relieve foreign executives, who were only being trans-

---

13. Memorandum of Acting Comm'r, David Crosland, *Consolidation of Policy on "L" Nonimmigrants*, 58 AM. COUNCIL FOR NATIONALITIES, SERVICE INTERPRETER RELEASES 194 b (1981).

14. *See, e.g.*, Matter of Hughes, 18 I. & N. Dec. 289, 293 (1982), in which the I.N.S. Appeals Board stated:

> Control may be *de jure* by reason of ownership of 51% of outstanding stocks of the other entity or it may be *de facto* by reason of control of voting shares through partial ownership and by possession of proxy votes. In some corporate structures, a relatively small concentration of ownership, perhaps 10%, in conjunction with dispersal of other stock among many minority investors may convey the right to appoint the board of directors. In examining control, the [I.N.S.] may take into consideration one company's ownership of patents, processes, copyrights, or other elements which are used by a related company. Because a structural or economic link is viewed as a characteristic of affiliation by authorities, the foregoing elements of control unaccompanied by significant ownership would not alone be considered as establishing affiliation.

15. Matter of Tessel, Inc., 17 I. & N. Dec. 631, 633 (1981).

16. Matter of Continental Grain Co., 14 I. & N. Dec. 140, 142 (1972).

17. *See supra* note 1.

ferred to the U.S. for a temporary tour of duty, from the delay resulting from the processing of immigration visa applications in situations where the ultimate grant of a visa was virtually certain.[18] Without an L-1 visa, international trade with the U.S. was being "crippled," especially with Canada.[19]

In addition, the L-1 visa was viewed as a mechanism which would enable international companies to bring to the U.S. foreigners with management, professional and specialist skills, and would thus enable American businesses to maintain and improve management effectiveness in their international operations. This would result in the expansion of U.S. exports and the improved competitiveness of U.S. companies in overseas markets. Conversely, foreign management would become familiar with American management techniques and, therefore, would be able to more effectively manage the affiliate operations of U.S. companies overseas. The cross-fertilization of ideas would benefit U.S. companies doing business abroad.[20]

Although the L-1 visa was never intended to be used as an immigration tool, it has become quite popular as such.[21] The major benefit of holding an L-1 visa is the relative ease in which the L-1 visa holder can "adjust" his status as a nonimmigrant to that of a permanent resident.[22] The L-1 visa holder may usually apply for permanent residence without having to undergo the usual labor certification process,[23] which normally requires a showing that there is no qualified American employee capable of doing the work to be performed by the applicant and that the applicant's employment will not adversely affect the wages and working conditions of American workers similarly employed.[24]

---

18. H. R. REP. NO. 851, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. CODE CONG. & AD. NEWS 2750. *See also* 110 CONG. REC. 5732 (1970) (for example, prior to enactment of the L-1 visa rules, a French national, who served as the president of an IBM subsidiary, had to apply for an immigrant visa even though he planned on staying in the U.S. for a temporary tour of duty).

19. Prior to enactment of the L-1 visa, qualified visa candidates from Canada had to wait approximately one year for a visa. H. R. REP. NO. 851, *supra* note 18, at 2754.

20. *Id.* at 2751-52.

21. Although no statistics are available on the extent to which L-1 visa applicants use the visa solely to obtain permanent residency, it is the author's belief that misuse of the L-1 occurs with great frequency.

22. *See supra* note 2.

23. A blanket labor certification is available to certain applicants defined in Schedule A of the Department of Labor Regulations covering labor certifications. The language in Schedule A corresponds closely to the L-1 visa requirements and is virtually identical for executive and managerial employees. *See* 20 C.F.R. § 656.10 (1980).

24. 8 U.S.C. § 1182(a)(14) (1952); 20 C.F.R. § 656.1(a) (1980).

II. THE UNITARY TAXING METHOD

A. Definition

The unitary taxing method developed as an alternative to the method of taxing a corporation with multi-jurisdictional operations on the corporation's actual income, determined by conventional accounting principles, from operations in the taxing state or nation. This method was often subject to abuse, as corporations could easily funnel income from high to low tax states by artificially manipulating the consideration conveyed in intra-company transactions such as sales of inventory, management contracts and lease arrangements.[25] Proponents of the unitary tax have argued that a taxing regime based on principles of separate accounting could only be enforced by an army of auditors whose impossible task would be to verify the "arms length" price for each intra-company transaction.[26] In response to these concerns, over twenty states have adopted the unitary tax method.[27]

The unitary tax method attempts to avoid such abuse by taxing the *value* contributed by the in-state operations to the overall income of the unitary business. Value, i.e., taxable income, allocable to business operations within the taxing state is typically calculated by using one of several objective formulas.[28]

Before going further, the following analogy will illustrate both the theory and practice of the unitary taxing method. Assume there is a fifty-unit apartment building, with each apartment of equal size, construction, and expense to its owner. The lower apartments and the apartments on the dark side of the building generate lower revenues than the penthouses and the apartments on the sunnier side of the building. If each state could only tax *one* apartment at the same rate, states taxing the lower apartments and the apartments on the dark side of the building would be able to levy less tax than the states taxing the penthouses and sunnier apartments. But according to the rationale behind the unitary taxing method, the entire apart-

---

25. *See, e.g.*, Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 164-65 (1983) ("One way of deriving locally taxable income is on the basis of formal geographical or transactional accounting. The problem with this method is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise."). *See also* Mobil Oil Corp. v. Comm'r of Taxes of Vt., 445 U.S. 425, 438 (1980); Tatarowicz, *State Judicial and Administrative Interpretations of U. S. Public Law 86-272*, 38 TAX LAW. 293, 303 (1985); Kerr, *Multiple Views on a Unitary Tax*, CAL. LAW., Mar. 1985, at 65, 66; Boren, *Separate Accounting in California and Uniformity in Apportioning Corporate Income*, 18 UCLA L. REV. 478, 490 (1971); S. REP. NO. 658, 86th Cong., 1st Sess., *reprinted in* 1959 U.S. CODE CONG. & AD. NEWS 2548, 2559.

26. Kerr, *supra* note 25, at 66.

27. *See supra* note 4.

28. *See infra* notes 50 to 59 and accompanying text.

ment house should be taxed as a single unit, with one-fiftieth of the total tax revenue being allocated to each apartment and, therefore, to each state. There would be no penthouses or sunny apartments without the lower apartments and the darker apartments as well. Each state's revenue would not depend on luck, coincidence or the device of the taxpayer in locating each apartment or each part of a unitary business. Hence, the overall revenue of the building should be allocated equally among the apartments, and each state should be entitled to levy the same amount.

B. Constitutionality

The power of unitary taxing states to impose a tax on formula-allocated income, whether for multi-state or multi-national enterprises, was upheld by the U.S. Supreme Court in *Container Corporation of America v. Franchise Tax Board*.[29] The Court interpreted the due process and commerce clauses to require the presence of three factors before a unitary tax can be imposed: some part of the unitary business must be conducted in the taxing state; some bond of ownership or control must exist which unites the affiliated operations of the unitary business; and some sharing or exchange of value incapable of precise identification or measurement must occur between the in-state operations and the other affiliates of the unitary business.[30] The Court also recognized that both vertically and horizontally integrated businesses linked by common management or operational resources will meet these requirements and hence be unitary.[31]

The *Container* Court stated that no particular formula is constitutionally required.[32] A formula must simply have "internal consistency," which means that the formula, if applied by every jurisdiction, will result in no more than all of the unitary business' income being taxed.[33] A formula must also have "external consistency," which requires that the factor or factors used in the apportionment formula actually reflect a reasonable sense of how income is generated.[34] The three-factor formula employed by California was expressly approved by the Supreme Court.[35]

C. Unities Test

The Supreme Court's definition of what constitutes a unitary

29. 463 U.S. 159 (1983).
30. *Id.* at 166.
31. *Id.*
32. *Id.* at 169-71.
33. *Id.* at 169.
34. *Id.*
35. *Id.* at 170; Butler Bros. v. McColgan, 315 U.S. 501 (1942) (California's "three-factor" formula of income apportionment does not violate the Fourteenth Amendment).

business is rather amorphous.[36] Fortunately, a more functional definition has been developed by the California courts, which have held that a taxpayer's business is unitary in the presence of unity of ownership, unity of operation, *and* unity of use.[37]

1. *Unity of Ownership.* Of all the requirements, this is the easiest to understand. In California, unity of ownership will most likely be found where more than 50% of the in-state operation is owned, directly or indirectly, by its out-of-state affiliates; 100% ownership is not required.[38] Although earlier California State Board of Equalization opinions equated direct and indirect ownership,[39] more recent decisions have insisted on actual, direct ownership, and not merely on control in an indirect sense.[40]

---

36. *See supra* note 30 and accompanying text.

37. *See, e.g.*, Butler Bros. v. McColgan, 17 Cal. 2d 664, 678, 111 P.2d 334, 341 (1941), *aff'd*, 315 U.S. 501 (1942); Chase Brass & Copper Co., Inc. v. Franchise Tax Bd., 10 Cal. App. 3d 496, 502, 95 Cal. Rptr. 805, 807 (1970), *aff'd on later appeal*, 70 Cal. App. 3d 457, 138 Cal. Rptr. 901 (1977), *appeal dismissed*, 434 U.S. 1029 (1978), *reh'g denied*, 435 U.S. 910 (1978); Anaconda Co. v. Franchise Tax Bd., 130 Cal. App. 3d 15, 25, 181 Cal. Rptr. 640, 646 (1982), *appeal dismissed*, 463 U.S. 1221 (1983).

California courts have also developed a "contribution and dependency test" to determine the existence of a unitary business. Although this test has been treated as a separate test (*see* Appeal of Williams Furnace Co., Cal. St. Bd. of Equalization ("S.B.E.") (8/7/69), ST. TAX REP. [Cal.] (CCH) ¶ 204-132), it is actually a generalized restatement of the unities test and will be treated as such for purposes of this article.

38. *See, e.g.*, Appeal of Revere Copper and Brass Inc., S.B.E. (7/5/77), ST. TAX REP. [Cal.] (CCH) ¶ 205-752 ("[g]enerally speaking, [the unity of] ownership can only be established by common ownership, directly or indirectly, of more than 50 percent of a corporation's voting stock"); Appeal of Westerhead Co., S.B.E. (4/24/67), ST. TAX REP. [Cal.] (CCH) ¶ 203-644 (unity of ownership found where 60% ownership was present); Appeal of Dohrmann Commercial Co., S.B.E. (2/29/56), ST. TAX REP. [Cal.] (CCH) ¶ 200-504 (75% ownership established the unity of ownership).

On the other hand, as long as direct or indirect ownership greater than 50% exists, even heavy regulation or intervention by foreign governments over out-of-state affiliates may not negate unity of ownership. *See* Anaconda Co., *supra* note 37, 130 Cal. App. 3d at 25 (foreign governmental intervention did not negate the unity of ownership where a foreign parent company owned 100% of the stock of its subsidiary which was doing business in California).

39. *See* Appeal of Revere Copper, *supra* note 38.

40. *See* Appeal of Douglas Furniture of California, Inc., S.B.E. (12/31/84), ST. TAX. REP. [Cal.] (CCH) ¶ 400-646, in which no unity of ownership was found where four family members each owned 25% of an Illinois corporation and 19.9% of a California corporation. The State Board of Equalization overruled case law which considered indirect ownership as "true" ownership for the unity of ownership test:

> The basic test to be met is that of *controlling ownership* over all parts of the business. In order to ensure that two or more corporations are appropriately treated as a single integrated enterprise, the controlling ownership must be held by one individual or entity. If no one individual or entity holds controlling ownership of all the corporations involved, there is no assurance that the corporations will be operated as a unit, and the requirement of controlling ownership over all parts of the business is not met.

Conversely, even if a majority shareholder is limited by a shareholder agreement (for

Consequently, ownership by family members or related entities may not be attributable to the individual or entity being tested for unity of ownership.

2. *Unity of Operation.* No single element controls the test of unity of operation.[41] Acts falling within the category of "operation" normally relate to staff functions[42] such as the sharing of personnel, accounting and recordkeeping facilities.[43] The sharing of services or facilities need not be total; periodic internal auditing or statistical analyses, occasional purchasing or order-filling by an affiliate, or retention of employee benefits by transferred employees may constitute substantial evidence of unity of operation.[44] So may internal loans, banking and financing, the sharing of advertising expenses, legal staff or legal fees, or the providing of technical assistance such as engineering and geological services or administrative and planning services.[45]

3. *Unity of Use.* Unity of use relates primarily to executive forces and operational systems.[46] Of principal importance here is the integration of major executive functions, such as the corporations' boards of directors or executive committees.[47] The overlap of high-level personnel and the existence of chains of approval may constitute substantial evidence of unity of use.[48] Unity of use may also be demonstrated by affiliated businesses employing identical operational procedures.[49]

Some of the circumstances which tend to establish the unities of ownership, operation and use are necessarily vague. This grants courts flexibility in evaluating unusual forms of business operations. Nonetheless, several standard forms of businesses will most likely be classified as unitary. First, there is the vertically integrated

example, he must obtain the approval of minority shareholders for all actions), the California State Board of Equalization will probably find that the unity of ownership exists.

41. Anaconda Co., *supra* note 37, 130 Cal. App. 3d at 25.

42. Chase Brass, *supra* note 37, 10 Cal. App. 3d at 502.

43. RKO Teleradio Pictures, Inc. v. Franchise Tax Bd., 246 Cal. App. 2d 812, 817, 55 Cal. Rptr. 299, 303 (1966).

44. Anaconda Co., *supra* note 37, 130 Cal. App. 3d at 26; Chase Brass, *supra* note 37, 10 Cal. App. 3d at 503.

45. *See* Anaconda Co., *supra* note 37; Chase Brass, *supra* note 37. Unity of operation has also been found where the money available for lending by the branches of an equity lender had been borrowed initially by the parent company. *See* Household Finance Corp. v. Franchise Tax Bd., 230 Cal. App. 2d 926, 929-30, 41 Cal. Rptr. 565, 567-68 (1964).

46. Chase Brass, *supra* note 37, 10 Cal. App. 3d at 504.

47. *Id.*; Anaconda Co., *supra* note 37, 130 Cal. App. 3d at 27.

48. *Id.*

49. RKO Teleradio, *supra* note 43, 246 Cal. App. 2d at 817; Standard Register Co. v. Franchise Tax Bd., 259 Cal. App. 2d 125, 135-37, 66 Cal. Rptr. 803, 809-11 (1968).

enterprise, where affiliates are not engaged in the same types of activities, but each is necessary to the overall success of the enterprise. A typical example is where raw materials are extracted in one part of the world, manufactured into a product in another part of the world, and distributed in a third part of the world. The second typical unitary business is the horizontally integrated enterprise, where each affiliate is engaged in the same types of activities but relies on the others for shared facilities, advertising, financial support, etc. A typical example would be a chain of retail stores selling the same type of merchandise. In either event, an L-1 visa applicant, who must establish an affiliation between the foreign and the U.S. businesses, will run a great risk that both businesses will be considered unitary, resulting in the in-state operation being taxed on the basis of the three-factor (or comparable) unitary tax formula.

4. *Formulas.* A typical formula utilized by unitary taxing states to allocate income to the in-state operations of a unitary business is based on quantitative measures of the operations as they relate to the production of income. The California formula, known as the "three-factor formula", is based, in equal parts, on the proportion of a unitary business' total payroll, property, and sales that are paid, located or occur in the taxing state.[50] The three-factor formula, derived from a uniform act drafted in the 1950's,[51] is the most popular formula among the unitary taxing states.[52] Analogous variables are used for businesses for which these factors are not meaningful.[53]

It must be remembered that the unitary taxing method is a double-edged sword. The taxing state cannot suddenly abandon its formula-allocated income when the reported income of the local business turns out to be higher than the formula figure.[54]

---

50. *See* CAL. REV. & TAX. CODE §§ 25128-25136 (1966).

51. *See* UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT, 7A U.L.A. 331 (1957) (the model act, which was intended to eliminate the incidents of multiple taxation of the same income, was approved by the American Bar Association and the National Conference of Commissioners on Uniform State Laws in 1957, and was then endorsed by the Multistate Tax Commission in 1966) [hereinafter cited as *UDITPA*]. *UDITPA* sought to eliminate the incidents of multiple taxation of the same income. *See generally* Corrigan, *Toward Uniformity in Interstate Taxation*, 11 TAX NOTES 507, 509 (1980).

52. The unitary tax methods enacted by most states, *supra* note 4 closely correspond to the provisions of *UDITPA*, *supra* note 51.

53. Household Finance, *supra* note 45, 230 Cal. App. 2d at 930 (outstanding loans, interest collected, and payroll used as factors for an institutional lender).

54. CAL. REV. & TAX. CODE § 25101 (1955). *See, e.g.*, Honolulu Oil Corp. v. Franchise Tax Bd., 60 Cal. 2d 417, 425, 386 P.2d 40, 44-45, 34 Cal. Rptr. 552, 556-57 (1963) (use of the allocation formula in determining corporate franchise tax payable in California is not restricted to cases where it is impossible to make a separate accounting); Superior Oil Co. v. Franchise Tax Bd., 60 Cal. 2d 406, 416, 386 P.2d 33, 39, 34 Cal. Rptr. 545, 551 (1963) (though reported income of local operations was higher than

The application of California's three-factor formula is quite straightforward, although sometimes difficult to determine for large unitary businesses. A ratio is calculated for each factor between the in-state operations and the unitary business as a whole.[55] The three ratios are averaged, with the resulting ratio then multiplied by the income of the entire unitary business. This computation yields the income allocable to the California operations.

California recently added a novel twist to its unitary tax regime by allowing certain foreign-based, multinational corporations to elect to have the three-factor formula apply to either its business operations worldwide or its operations solely within the United States.[56] The latter alternative, commonly known as the "water's edge" method of unitary taxation, comes at the expense of a .03% election fee, which is based on the corporation's payroll, property and sales in California and is due each taxable year.[57] As a compromise, certain domestic-based multinationals will be allowed to exclude from unitary tax consideration up to 75% of foreign-source dividends received from affiliated corporations.[58] The amendments were made in response to claims by foreign multinationals that the present unitary tax method discourages job-producing investment in California.[59]

III. INTERACTION OF THE L-1 VISA AND THE UNITARY TAX

A. Discussion

The nature of the relationship between an entity's in-state operations and its foreign business will determine whether its executives will be eligible for an L-1 visa and whether it will be subject to the unitary tax. The L-1 visa requires a subsidiary or affiliate relation-

the formula figure, local operations were not sufficiently separate from out-of-state operations to justify taxation on a non-unitary basis).

55. For instance, the payroll expended by the California operations of a unitary business will be divided by the payroll expended by the entire unitary business. *See* CAL. REV. & TAX. CODE § 25132 (1966).

56. S. BILL NO. 85, 1985-86 Leg., Reg. Sess., § 6, CAL. REV. & TAX. CODE §§ 25110-25115 (1986). Although Senate Bill 85 was signed into law by Governor Deukmejian on September 5, 1986, its provisions apply to taxable years beginning on or after January 1, 1988. S. BILL NO. 85, *supra* § 15.

57. CAL. REV. & TAX. CODE § 25115 (1986). In this regard, the sum of the payroll, property and sales in California can be reduced by investment made in new plants or facilities in California after January 1, 1988, as well as the amount expended for new employees in California. *Id.* § 25115(b)(3) (1986).

58. *Id.* § 24411 (1986). To qualify under section 24411, the affiliated corporation's average of the payroll, property and sales factors within the United States must be less than 20%. *Id.* § 2411(a)(1) (1986). An affiliated corporation is one in which the taxpayer owns greater than 50% of the total combined voting power of all classes of stock entitled to vote. *Id.* § 24411(a)(2) (1986).

59. L.A. Daily J., August 22, 1986, at 2.

ship between the two entities which is met primarily by a showing of *de facto* control. The unitary taxing method requires that the relationship pass the unities test. Where an L-1 visa applicant owns, controls and manages all the shares of a foreign parent company, as well as all the shares of, for example, a California affiliate, and the two entities actively deal with each other in the same type of business, the California affiliate will most likely be subject to the California unitary tax.

The objective of the unitary method of taxation is laudable; it prevents artificial losses or artificially lower profits from being reported by the in-state operations in a unitary taxing state.[60] The purpose behind the L-1 visa is likewise meritorious; it allows executives or those with specialized knowledge from foreign countries who plan on working in the U.S. for a temporary tour of duty an expedited route to obtaining a work visa.[61]

Given the objectives behind, and practical results of, both the L-1 visa and the unitary tax method, how should the two bodies of law interact? Should, as a matter of policy, every L-1 visa holder whose employer satisfies the unities test be subject to imposition of the unitary tax? A corporation, whose principal objective is making an investment in a certain state, will incorporate the financial impact of the unitary tax into their investment decision. These corporations need L-1 visas solely to manage their investment. Consequently, there is no reason to carve out an exception to the unitary method of taxation for these companies. The cost of the unitary tax is simply a cost of doing business in the taxing state, not unlike any other expense incurred in the pursuit of income.

Individuals, whose primary objective is obtaining permanent residence in the United States (through the use of L-1 visas), will probably only consider where they wish to live and work. These individuals almost never intend to create artificially lower profits in the unitary taxing state and, therefore, the objective of the unitary tax method would not be thwarted if their in-state operations were taxed as a separate entity. If subjected to the unitary tax method, these individuals would be forced to report income from all worldwide sources that satisfy the unities test, which may result in the assessment of tax, due to the allocation formula, even if economic and accounting losses are suffered because of high start-up costs.[62]

Although these individuals may be unintended subjects of the

---

60. *See supra* notes 25 to 28 and accompanying text.

61. *See supra* notes 17 to 20 and accompanying text.

62. Severe financial losses experienced by the in-state operations, whether caused by high start-up costs, mismanagement, or government regulation, and apparent imbalances caused by the use of payroll in the three-factor formula when labor is cheaper in many foreign countries, are of no avail to the taxpayer under the unitary taxing method. *See, e.g.*, John Deere Plow Co. v. Franchise Tax Bd., 38 Cal. 2d 214, 222-27, 238 P.2d

unitary tax method, in reality they are unintended beneficiaries of the L-1 visa rules. The original purpose of the L-1 visa was not for it to be used as a means of obtaining permanent residence.[63] Nonetheless, that is exactly how it is used in countless cases.

In weighing the equities, then, it might seem fair that L-1 visa applicants taking advantage of this immigration loophole be subjected to the unitary method of taxation. But although this may achieve a rough sense of justice, the "punishment", in some instances, may not fit the "crime." A less offensive and more efficient approach would be for Congress to stiffen the L-1 visa requirements in order to eliminate or restrict the use of the L-1 visa as an immigration tool. For example, the L-1 employer might be required to make a "substantial" investment in the United States, as is required for an "E-2" visa.[64]

B. Recommendations

It should be noted that the preceding outline of the unitary tax method is extracted primarily from California case law. In other states the specific rules may vary. Nonetheless, in most unitary taxing states, including California, a business will be deemed unitary only if each of the requisite unities of ownership, operation, and use is established. As a result, one may structure his U.S. business in such a way so as to avoid establishing one of the three unities, while perhaps conceding the existence of the others.

It may be possible to avoid the unity of ownership, because the L-1 visa only requires that the applicant establish *de facto* control,[65] whereas the unitary taxing method usually requires *de jure* control (direct ownership of more than 50%).[66] For example, an applicant could own less than 50% of the U.S. business directly, but maintain effective control through the use of proxies, preferred stock, directors, or other means. The same result could be achieved by having the non-voting common stock of the in-state operations owned by several members of the L-1 visa applicant's family, while having all

---

569, 573-76 (1951), *appeal dismissed*, 343 U.S. 939 (1952); Anaconda Co., *supra* note 37, 130 Cal. App. 3d at 30-33.

63. *See supra* notes 21 to 24 and accompanying text.

64. An "E-2" visa applies to those nonimmigrant aliens who enter the U.S. under a treaty of commerce and navigation between the U.S. and the foreign state of which he is a national. 8 U.S.C. § 1101(a)(15)(E) (1952). The purpose of the visa is to enable an alien to develop and direct an enterprise in which he has invested, or is actively in the process of investing, a "substantial" amount of capital. *Id.* The requirements of an E-2 visa are that the alien intend to depart the U.S. upon termination of his status, has invested or is actively in the process of investing a substantial amount of capital in a bona fide enterprise, and is employed by a person or organization owned by a person or persons having the same nationality as the treaty country. 22 C.F.R. § 41.41(a) (1959).

65. *See supra* note 14 and accompanying text.

66. *See supra* note 40 and accompanying text.

of the preferred stock (which could be made voting stock) held by the applicant.

Even more flexibility is available in structuring the in-state operations to avoid the unity of operation. The applicant, once relocated in the United States, may relinquish control of his foreign business to associates, hired employees or family, and avoid the sharing of his management skills. The in-state operations could also be designed to employ separate advertising, financial, or technical resources.[67] As can be imagined, the actions one might undertake to avoid the unity of operation are limited only by the ingenuity of counsel.

The same cannot be said of avoiding the unity of use, because the most important factor in establishing affiliation for purposes of the L-1 visa is the integration of executive functions, which is normally established through centralized management.[68] Consequently, it may be difficult for the L-1 visa applicant to disprove the existence of centralized management and avoid establishing the unity of use.

In situations where the three unities are clearly established and the business operations cannot be structured to avoid imposition of the unitary tax, there are ways to minimize its impact. By reducing the property, payroll and sales in California, for example, the amount of income allocated to California is or will be correspondingly reduced. Although such recommendations are not within the scope of this article, one can imagine, for example, storing inventory in Nevada (a non-unitary taxing state), and shipping to customers directly from Nevada on orders received in California. This may reduce both property and sales in California.

Finally, it is necessary to mention those devices or circumstances which will *not* avoid the unitary tax. One device which might be considered, but should be rejected, is some sort of dividend arrangement by which the entire income of either the U.S. business or foreign business is paid out as a dividend either to the L-1 visa holder directly or, if a corporate form is used, to a corporation, so as to reduce the income allocated to the unitary taxing state. The payment of cash dividends does not affect the sales, property and payroll factors and, therefore, has no impact on the income tax assessed under the unitary taxing method.[69] The payment of for-

67. This is particularly possible when the U.S. business produces a product or performs a service unrelated to the foreign business.

68. *See supra* notes 46 to 49 and accompanying text.

69. For example, California excludes the receipt of intercompany dividends in determining the income of the recipient company of the unitary business. CAL. REV. & TAX. CODE §§ 24402 (1955), 25106 (1967). In addition, the payment of the dividend cannot be deducted from the income of the taxpayer paying the dividend. CAL. REV. & TAX. CODE § 24402 (1955).

eign taxes is also not deductible from the income of a unitary business.[70] Finally, the form of the taxpayer is not important. Although a state "may" recognize the corporate form and not find a business to be unitary if it is separated by a corporate shell,[71] no states actually do so.

IV. CONCLUSION

The L-1 visa process has become very popular as an immigration tool because it provides a simple means of obtaining a labor certification and, ultimately, permanent residency. However, the price that an L-1 visa holder often must pay for his nonimmigraton visa is the imposition of the unitary taxing method on his employer. L-1 visa applicants should be aware that when proving affiliation for L-1 visa purposes, they should try to avoid inadvertently proving the existence of a unitary business in those states using the unitary method. This can possibly be accomplished by employing the recommendations made in this article.

To avoid manipulation and misuse of both the L-1 visa and the unitary taxing method, legislators should consider modifying the visa application rules and the definitions of the three unities. The L-1 visa requirements could be stiffened so as to prevent L-1 visa applicants from avoiding the normally difficult labor certification process. The unitary taxing states could also consider phasing in the allocation of income for new in-state businesses which genuinely face losses or low profits in the first few years of operations. These states could also consider redefining the unity of ownership test to include indirect or constructive ownership. This would render the unity of ownership test at par with the L-1 visa's affiliation test and, as a result, legislate away one of the tax and immigration lawyer's most instrumental tools. These suggestions, among others, would serve to restrict the availability of L-1 visas and expand the imposition of the unitary tax in a manner entirely consistent with the objectives behind each of these bodies of law.

---

70. CAL. REV. & TAX. CODE § 24345(a)(2) (1955). However, a credit for all or a portion of foreign taxes paid may be allowed against the federal income tax liability of the L-1 visa holder or his U.S. employer. *See generally* I.R.C. §§ 27, 901-908.

71. Container Corp., *supra* note 25, 463 U.S. at 167-68.