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The Constitutionality of the Multistate Tax Compact

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NOTE

The Constitutionality of the Multistate Tax Compact

I. INTRODUCTION

It is now firmly established that states have the constitutional power to tax multistate businesses on net income reasonably attributable to activity within the taxing state.[1] Within this legal framework, limited only by Public Law 86-272,[2] the states have fashioned separate and diverse rules for the taxation of multistate corporations.[3]

The recently formed Multistate Tax Compact provides an efficient alternative to both the present disarray of state statutes and possible federal regulation of interstate taxation.[4] The principal purposes of the Compact are to establish uniform rules for determining state tax liabilities of multistate taxpayers, to eliminate ineffective tax administration and the attendant problems of taxpayer noncompliance, and to eliminate double taxation.[5]

Notwithstanding the success of the Multistate Tax Compact where it is in effect, its constitutionality currently is being challenged by multistate corporations subject to its administrative procedures. Although the Supreme Court of Washington recently upheld the constitutionality of the Compact's interstate joint audit provisions in *Kinnear v. Hertz Corp.*,[6] the constitutionality of the

1. *See* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959). For a discussion of decisions subsequently extending the state's power to tax corporate income, see Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 VAND. L. REV. 21, 41-43 (1959).

2. 15 U.S.C. §§ 381-84 (1970). Public Law 86-272 exempts out-of-state corporations from state taxation if their only activity within the state is mere "solicitation" of orders for the sale of tangible personal property that are sent out of the state for approval or rejection and are filled by shipment from a point outside the state. *See* Hartman, *"Solicitation" and "Delivery" Under Public Law 86-272: An Uncharted Course*, 29 VAND. L. REV. 353 (1976).

3. *See* Hartman, *supra* note 1, at 49.

4. *See* Corrigan, *Interstate Corporate Taxation—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423 (1976).

5. The stated purposes of the Compact are to: (1) facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; (2) promote uniformity in significant components of tax systems; (3) facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) avoid duplicative taxation. P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 6310.

6. 545 P.2d 1186 (Wash. 1976).

Compact in its entirety is still open to question. Not only may the *Hertz* decision be appealed,[7] but litigation pending before a three-judge federal district court in *United States Steel Corp. v. Multistate Tax Commission*[8] could result in a United States Supreme Court ruling on the constitutionality of the entire Compact since the litigants in *United States Steel* appear determined to appeal to the Supreme Court.[9] The cases are significant both because of their potential impact on state taxation of multistate businesses and because of the opportunity presented for judicial re-examination of the constitutionality of interstate compacts generally in light of their contemporary application. This Note will examine the constitutional law dealing with interstate compacts and then will discuss whether the Multistate Tax Compact satisfies these constitutional requirements.

II. Constitutional Basis of Interstate Compacts

A. *Constitutional Framework*

Interstate compacts normally are treated as statutes of the adopting states, and in cases of conflict, supersede existing state statutes.[10] These agreements are subject to the compact clause of the Constitution, article I, section 10, clause three, which provides:

> No State shall, without the consent of Congress . . . enter into any Agreement or Compact with another State or with a foreign power . . . .[11]

The meanings the framers intended the terms "agreement" and "compact" to have are unclear since there is no mention of these terms in the records of the constitutional convention.[12] *The Federalist* states only that the transfer, in slightly altered form, of the analogous Article VI of the Articles of Confederation to the

7. Review may be obtained by appeal under 28 U.S.C. § 1257(2) (1970). Note also that review could be obtained by petition of certiorari under 28 U.S.C. § 1257(3) (1970).

8. 72 Civ. 3438 (S.D.N.Y. filed Sept. 17, 1972). Arguments were heard before the 3-judge court in the Southern District of New York, February 3, 1976. A decision in the case may be withheld until an appeal is heard in *Kinnear v. Hertz Corp.*, or the time for appeal expires. Telephone interview with William D. Dexter, General Counsel, Multistate Tax Comm'n, Mar. 5, 1976.

9. *Id.*

10. Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823). *See also* Note, *Some Legal and Practical Problems of the Interstate Compact*, 45 YALE L.J. 324, 328-29 & n.27 (1935). Compacts also are treated as "contracts of quasi-international status" the terms of which are properly to be construed according to contract law. *Id.* at 328 & n.21.

11. U.S. CONST. art. I, § 10, cl. 3.

12. *See* Engdahl, *Characterization of Interstate Arrangements: When is a Compact Not a Compact?*, 64 MICH. L. REV. 63, 75 (1965).

compact clause of the Constitution "needs no explanation"[13] and that interpretations of these terms are "either so obvious, or so fully developed, that they may be passed over without remark."[14]

Two opposing theories of the meaning of "agreement or compact" were advanced at an early date. The first, by Vattel, the most widely recognized legal theorist during the period immediately preceding the drafting of the Constitution,[15] designated as "treaties" international arrangements calling for specified acts each time an occasion specified in the arrangement arises.[16] Vattel called these arrangements "nondispositive" because they do not permanently dispose of a single dispute or issue, but rather establish an ongoing agreement to settle future problems. In contrast, Vattel placed "dispositive" arrangements, such as permanent boundary settlements, within the class "agreement or compact." The second theory was advanced by Mr. Justice Joseph Story in his *Commentaries on the Constitution of the United States*.[17] His was a more encompassing interpretation of the compact clause, and theorized that "agreements or compacts" under the compact clause pertain to "private rights of sovereignty" such as boundary disputes and disputes over land within the territory of one state.[18] According to Justice Story, every "agreement or compact" required congressional consent.[19] Subsequent writers and courts have chosen between these two theories and, as a result, have developed different interpretations of the terms "agreement or compact."[20] Consequently, the meanings of these terms have become clouded with time.

B. Judicial Interpretation of the Compact Clause

The compact clause on its face seems to provide that any "agreement or compact" requires the consent of Congress in order to be valid. In *Holmes v. Jennison*,[21] the first definitive Supreme Court interpretation of the compact clause, the Court held that an extradition agreement between the governor of Vermont and a Ca-

13. THE FEDERALIST No. 44, at 193 (Beard ed. 1948) (J. Madison).

14. *Id.* at 195.

15. *See* Engdahl, *supra* note 12, at 75-84 & n.62.

16. *Id.* at 76-77. An agreement that calls for support each time an ally is threatened is such an example.

17. 3 STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1403 (2d ed. 1851).

18. *See* Engdahl, *supra* note 12, at 81-84.

19. *See* STORY, *supra* note 17, at § 1403.

20. *See* Engdahl, *supra* note 12, at 81-84.

21. 39 U.S. (14 Pet.) 540 (1840). *See* P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 6600 and cases cited therein.

nadian official violated the compact clause because it was entered into without congressional consent. Chief Justice Taney broadly construed the terms "treaty," "compact," and "agreement" to include every mutual understanding of the parties—written, verbal, formal, informal, express, or implied.[22] This case, however, concerned an international agreement and therefore arguably left open the possibility of differing judicial interpretations of "agreements or compacts" among sister states.

Some state courts subsequently sought to avoid the sweeping *Holmes* rule in cases involving interstate agreements,[23] and the next United States Supreme Court case to construe the compact clause refused to apply to an interstate agreement the broad criteria Justice Taney applied to the international agreement at issue in *Holmes*. That decision, *Virginia v. Tennessee*,[24] is now the leading case interpreting the compact clause. The issue involved a claim by Virginia that a prior boundary settlement, approved by the legislatures of both states and subsequently honored by both states for eighty-five years, was invalid because the original agreement had not received approval of the United States Congress. Justice Field, writing for the majority, held that congressional acts subsequent to the boundary agreement, such as apportionment of congressional seats and division of federal judicial districts with reference to the boundary lines established in the agreement, constituted implied congressional approval of the agreement.[25] While the Court based its decision on this finding of implied congressional approval, it nevertheless addressed the compact clause issue. The Court stated:

> Looking at the clause in which the terms "compact" or "agreement" appear, it is evident that the prohibition is directed to the formation of *any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States.*[26]

One year later, in *Wharton v. Wise*,[27] the Court applied this

22. 39 U.S. (14 Pet.) at 572.

23. One court, for example, held that the arrangements involved were not "agreements or compacts" within the meaning of the compact clause and thus did not require congressional approval. Fisher v. Steele, 39 La. Ann. 447, 1 So. 882 (1887). Other courts held that no agreement which deals with matters falling within the police power of the state requires congressional approval, Union Branch R.R. v. East Tenn. & Ga. R.R., 14 Ga. 327 (1853), and that no mutual understanding underlay two separate, conveniently complementary state acts, Dover v. Portsmouth Bridge, 17 N.H. 200 (1845).

24. 148 U.S. 503 (1893).

25. *Id.* at 525.

26. *Id.* at 519 (emphasis added). Justice Field cited both Story and Vattel as supporting this rule. *Id.* at 519-23.

27. 153 U.S. 155 (1894).

same interpretation to a similar clause in the Articles of Confederation,[28] which governed the dispute in that case. Although the Maryland-Virginia agreement at issue in *Wharton* regulated navigation of public waters, the Court found no requirement for congressional consent, apparently holding that the agreement did not interfere with the power of Congress to regulate interstate commerce. Importantly, the Court applied the *Virginia v. Tennessee* interpretation of the compact clause of the Constitution to the question of what arrangements required congressional consent under the Articles of Confederation.[29] The Court's reliance on this interpretation in deciding *Wharton* arguably established the language quoted above from *Virginia v. Tennessee* as a rule of law rather than as dictum.

The most recent Supreme Court decision to construe the compact clause, *Bode v. Barrett*,[30] involved a reciprocal agreement between two states mutually to exempt drivers from the other state from certain vehicle taxes. The Supreme Court of Illinois, quoting from *Virginia v. Tennessee*, rejected plaintiff's contention that the agreement was invalid under the compact clause for want of congressional consent, and stated that the compact clause does not prohibit "purely fiscal interstate agreements that facilitate interstate commerce and aid in execution of internal revenue policies."[31] The United States Supreme Court affirmed, noting that such reciprocal arrangements between states have never been thought to violate the compact clause.[32] A host of state court decisions also have followed the rule of *Virginia v. Tennessee*.[33] Indeed, according to one commentator:

> . . . in every case since *Virginia v. Tennessee* in which an interstate arrangement has been challenged for lack of congressional consent, it has been held exempt from the consent requirement . . . .[34]

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28. Article VI of the Articles of Confederation had provided that 2 or more states could not enter into any treaty, confederation, or alliance without the consent of Congress.

29. 153 U.S. at 170.

30. 344 U.S. 583 (1953), *aff'g* 412 Ill. 204, 106 N.E.2d 521 (1952).

31. 412 Ill. at 233, 106 N.E.2d at 536.

32. 344 U.S. at 586.

33. State v. Doe, 149 Conn. 216, 178 A.2d 271 (1962); Duncan v. Smith, 262 S.W.2d 373 (Ky. 1953); Dixie Wholesale Grocery, Inc. v. Martin, 278 Ky. 705, 129 S.W.2d 181, *cert. denied*, 308 U.S. 609 (1939); Roberts Tobacco Co. v. Department of Revenue, 322 Mich. 519, 34 N.W.2d 54 (1948); Ham v. Maine-N.H. Interstate Bridge Auth., 92 N.H. 268, 30 A.2d 1 (1943); Landes v. Landes, 1 N.Y.2d 358, 135 N.E.2d 562, 153 N.Y.S.2d 14 (1956); McHenry County v. Brady, 37 N.D. 59, 163 N.W. 540 (1917); Town of Searsburg v. Town of Woodford, 76 Vt. 370, 57 A. 961 (1904).

34. *See* Engdahl, *supra* note 12, at 69.

Notwithstanding the weight of authority that has embraced the rule of *Virginia v. Tennessee*, the decision is subject to criticism as having misconstrued the constitutional framers' intent.[35] From the elliptical remarks noted above in the *Federalist* and the popularity of Vattel's works during the time the Constitution was being drafted, it seems plausible to suppose that the framers' understanding of the term "agreement or compact" coincided with the construction placed upon it by Vattel. Since, according to Vattel, the term "agreement or compact" embraced only interstate, *dispositive* arrangements, the compact clause arguably covers only those interstate arrangements that conclusively determine a dispute such as a boundary dispute between sister states. Indeed, the examples set forth in the *Virginia v. Tennessee* opinion[36] appear to indicate that the Court itself limited its contemplation of "agreement or compact" to interstate arrangements of a dispositive nature.[37] Secondly, the Court seems to have misinterpreted Story in citing him as authority for its characterization of a compact quoted above.[38] Although Justice Story distinguished between arrangements of a political character (prohibited "treaties") and those of a private character ("agreements or compacts" requiring consent), he contended that all "agreements or compacts" require congressional consent.[39] His failure to dissent from Justice Taney's opinion in *Holmes*[40] further supports this view. The Court in *Virginia v. Tennessee*, however, seems to have seized upon the "political character" language that Justice Story used in reference to "treaty" arrangements absolutely prohibited by clause one and grafted it onto an entirely different classification of arrangements in clause three—"agreements or compacts"—as the test for whether such arrangements require congressional consent. In this way, the Court formulated a rule that seems directly to contradict Justice Story's construction of the compact clause.

Whatever interpretation is placed upon the compact clause, it is clear that neither the framers of the Constitution nor the Court in *Virginia v. Tennessee* contemplated the nondispositive interstate

35. *See, e.g.*, Dunbar, *Interstate Compacts and Congressional Consent*, 36 VA. L. REV. 753 (1950); Engdahl, *supra* note 12.

36. For example, according to the Court, an agreement between two states to transport an item to the Chicago world's fair by passing through one state would not require congressional consent.

37. 148 U.S. 503, 518 (1893).

38. *See* text accompanying note 17 *supra*.

39. *See* STORY, *supra* note 17, at § 1403.

40. *See* text accompanying notes 21-22 *supra*.

compacts that increasingly have been used by the states in recent years.[41] Modern "compacts" often are little more than cooperative arrangements establishing independent commissions or joint agencies to advise the participating states on specified matters or to regulate matters delegated by the states.[42] In effect, these cooperative arrangements create suprastate bodies for interstate government that continually perform *nondispositive* functions for the party states. Under Vattel's analysis, these cooperative arrangements do not fall within the class of dispositive "agreements or compacts" and thus do not require congressional consent under the compact clause.

Moreover, even if the *Virginia v. Tennessee* rule accurately represents the perception of the framers of the Constitution of why compacts require congressional consent, clause three of the compact clause makes clear that Congress, and not the judiciary, is the proper body to determine whether a compact in fact impermissably encroaches on its area of activity.[43] To say that an arrangement is an "agreement or compact" only if it tends to encroach upon federal activity, as the Court has held, in effect begs the question because it interposes the judiciary between a disputed arrangement and Congress. For example, if a court determines that a disputed arrangement does not encroach on federal activity, then presumably the compact need not be submitted for congressional review. Conversely, if the court determines that a compact interferes with federal activity, then presumably Congress could not responsibly approve such a compact. Thus, only if Congress disagreed with a judicial determination of whether the disputed arrangement encroached upon federal activity would congressional approval be of any consequence. Further, such disagreement between Congress and the courts could raise the additional issue of the separation of powers. Moreover, one commentator has suggested that different tests have been applied to determine whether a given interstate compact encroaches upon federal activity; the courts have applied a test of *actual* encroachment, while state legislatures and compact proponents have asked whether the compact *may* encroach upon federal activity.[44]

41. For a discussion of one of these compacts in operation, see Goldstein, *An Authority in Action—An Account of the Port of New York Authority and Its Recent Activities*, 26 LAW & CONTEMP. PROB. 715 (1961).

42. For a complete history of the development of the modern interstate compact up to 1925, see Frankfurter & Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustment*, 34 YALE L.J. 685 (1925).

43. *Id.*

44. *See* F. ZIMMERMANN & M. WENDELL, THE LAW AND USE OF INTERSTATE COMPACTS 90

This analysis leads to the conclusion that the courts should defer to a congressional determination in the first instance of whether an interstate arrangement encroaches upon federal activity. It has been argued, however, that Congress has neither the time nor the interest to handle the large volume of compacts that might be submitted for approval, especially if the compacts present no arguable conflict with a federal interest. This problem could be alleviated somewhat, however, if consent were inferred from the failure of Congress to act on an arrangement within a reasonable period of time after it had been submitted.[45] Some compact proponents, on the other hand, argue that in the absence of congressional approval, such an arrangement would constitute a "voidable" compact, meaning one that Congress might later reject.[46] Concern over the voidability of a compact not acted upon by Congress seems misplaced, however, because no legal impediment prevents Congress from shifting its position on any compact, even after approval. In this sense, all compacts are voidable.[47] If the concern over voidability focuses on the inconvenience of establishing a cooperative organization only to be required later to disassemble that organization because of Congress' delayed disapproval, then a possible solution might be to establish a congressional screening committee for interstate compacts from which a compact proponent could receive at least an initial sounding before the compact was placed in effect.

Although the extent of the supervisory power of Congress over an interstate compact involving both state and traditionally federal functions never has been judicially determined,[48] the existence of

(1961); Engdahl, *supra* note 12, at 68-69.

45. As early as Green v. Biddle, 21 U.S. (8 Wheat.) 1 (1823), and later in *Virginia v. Tennessee*, the Court has held that consent may be inferred from a "positive act" by Congress. 21 U.S. (8 Wheat.) at 86. This construction of "consent" could be extended to allow an inference of consent.

46. *See, e.g.*, Washington Attorney General Opinion No. 22 (1968), prepared by Assistant Attorney General Timothy R. Malone, reported in P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 6600.

47. As discussed previously, notes 10 & 11 *supra* and accompanying text, compact law at most has the force of the signatory states' statutes and if Congress were to enact legislation within its constitutional powers, such state law would necessarily be preempted in accordance with the supremacy clause.

48. Frankfurter & Landis, *supra* note 42. The authors note that:

> [T]he Constitution plainly had two very practical objectives in view in conditioning agreement by States upon consent of Congress. For only Congress is the appropriate organ for determining what arrangements between States fall within the prohibited class of "Treaty, Alliance, or Confederation," and what arrangements come within the permissive class of "Agreement or Compact." But even the permissive agreements may affect the interests of States other than those parties to the agreement: the national, and not merely regional, interest may be involved. Therefore, Congress must exercise na-

such congressional supervisory power clearly has been recognized in some areas of activity.[49] Congress has taken the position that when the operation of a compact touches upon the federal realm, Congress may exert its supervisory power over the entire compact, including those operations that take place wholly within the traditional sphere of state activity.[50] Congress can supervise a given compact by conditioning its consent on the provision by the states of periodic reports, by requiring approval of any changes in compact operation, or by making periodic investigations.[51] Although recognizing Congress' preemptive power in the federal domain, states have objected to its supervision of state matters and consequently, have been increasingly reluctant to submit proposed compacts to Congress for approval.[52] In light of the express dictates of the compact clause, however, the states arguably must obtain a judicial ruling that Congress may exert control over only the federal facets of compact operation, insofar as the federal portions reasonably may be separated from the state portions, if the states wish to avoid overall congressional supervision.

C. *Constitutionality of the Multistate Tax Compact*

Bills seeking congressional approval of the Multistate Tax Compact have been submitted in previous terms of Congress[53] and will be reintroduced during the current term. Congress has not acted upon any of the bills, however; thus the Compact presently is operating without congressional approval. Presumably Congress has taken no action because of the continuing political controversy over whether federal legislation should be enacted to regulate interstate taxation of multistate businesses.[54] The question, therefore, is

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tional supervision through its power to grant or withhold consent, or to grant it under appropriate conditions.

Id. at 694-95.

49. *See, e.g.*, Tohin v. United States, 306 F.2d 270 (D.C. Cir.), *cert. denied*, 371 U.S. 902 (1962).

50. *See generally* Engdahl, *supra* note 12, at 72-73.

51. *See generally* Note, *Congressional Supervision of Interstate Compacts*, 75 YALE L.J. 1416 (1966).

52. *See* Engdahl, *supra* note 12, at 72-73.

53. *See* S. 3333, 92d Cong., 2d Sess. (1972); S. 1883, 92d Cong., 1st Sess. (1971); H.R. 6160, 92d Cong., 1st Sess. (1971); S. 1198, 91st Cong., 1st Sess. (1969); H.R. 9873, 91st Cong., 1st Sess. (1969); H.R. 6246, 91st Cong., 1st Sess. (1969); S. 1551, 90th Cong., 1st Sess. (1967); S. 883, 90th Cong., 1st Sess. (1967); H.R. 13,682, 90th Cong., 1st Sess. (1967); H.R. 9476, 90th Cong., 1st Sess. (1967); S. 3892, 89th Cong., 2d Sess. (1966).

54. *See* Corrigan, *supra* note 4, at 426-27, which suggests that part of this congressional debate may be attributed to the strong lobhying efforts of the Committee on State Taxes of the Council of State Chambers of Commerce (COST).

whether the Commission may continue to operate under the compact clause absent congressional approval.

The Multistate Tax Compact, which establishes ongoing, nondispositive relationships among the party states, may unquestionably be classified as a cooperative arrangement outside Vattel's class of dispositive "agreements or compacts" that require congressional approval. Moreover, this Compact probably is of a nature beyond the contemplation of both the framers of the Constitution and the Supreme Court in *Virginia v. Tennessee*. Thus, the compact clause arguably does not require congressional consent in order to validate the Multistate Tax Compact. Nonetheless, strong policy considerations favor affording Congress the opportunity to review this Compact, including Congress' interest in supervising interstate compacts that touch upon federal activity.[55]

In the area of state taxation of multistate and multinational business, this interest is especially acute. It arguably may be a burden on interstate commerce to subject such business to diverse and conflicting state tax laws, although double taxation has been dismissed as a constitutional challenge to state tax laws.[56] Further, some multistate businesses may be taxed by several states on income derived from a single activity, placing them at a competitive disadvantage with a local business in a particular state.[57] Conversely, a corporate business, by carefully designing its intracorporate structure may escape taxation by any state of a portion of its income.[58] These problems demonstrate the need for uniformity in state taxation and emphasize a legitimate federal interest in ensuring this uniformity when it affects areas of federal concern.[59]

III. Recent Application of Constitutional Requirements to the Multistate Tax Compact

A. *Application of Constitutional Requirements to Joint Audit Provisions of the Compact*

The Supreme Court of Washington, in *Kinnear v. Hertz Corp.*,[60] recently considered the application of the rule of *Virginia*

55. *See* note 48 *supra* and accompanying text.

56. *See* Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 VAND. L. REV. 401 (1976).

57. *See* Hartman, *supra* note 2, at 387.

58. *See* Corrigan, *supra* note 4, at 435-36.

59. *See* Hartman, *supra* note 2, at 357-59.

60. 545 P.2d 1186 (Wash. 1976). Defendant Hertz Corp. had refused to provide the Multistate Tax Comm'n with records necessary for the determination of its sales and use tax liability in several member states.

v. Tennessee to the Multistate Tax Compact. The court thus was faced with the question whether the subject matter of the Compact tends to increase the political power of the states and thereby encroach upon or interfere with the just supremacy of the United States.[61] The court was able to sever from the Compact the joint audit provisions found in article VIII, and unanimously held them to be constitutional.[62] Adhering to the rule developed in *Virginia v. Tennessee*, the *Hertz* court held that the joint audit provisions do not increase the political power of the signatory states since the Multistate Tax Commission exercises no greater power than an individual state in conducting an audit.[63] Secondly, the court found that the provisions do not "encroach upon or interfere with the just supremacy of the United States"[64] since Congress has failed to regulate in the area of audits of interstate business. The court concluded, therefore, that the challenged provisions did not constitute the type of interstate agreement or compact subject to congressional approval under the compact clause.

The *Hertz* court also rejected defendant's arguments based on the commerce and equal protection clauses of the Constitution. Defendant Hertz Corporation alleged that the Multistate Tax Compact violates the commerce clause[65] since regulation of interstate taxation and audits requires a uniform national policy in an area in which Congress has attempted to regulate. The *Hertz* court rejected this contention, however, on two grounds: first, that in the absence of legislation, Congress had not preempted the area of interstate audits;[66] and secondly, that there was no need for a uniform national policy with respect to auditing multistate businesses for purposes of state taxation.[67] Indeed, the court found that because of the diversity of state taxation schemes, a uniform national auditing policy would be "very undesirable."[68] The court concluded that there was no improper regulation of commerce because the audit provisions

61. *See* note 26 *supra* and accompanying text.

62. 545 P.2d at 1189; *see* text accompanying notes 74-75 *infra*. Article VIII of the Multistate Tax Compact is reprinted in full in the Appendix to this Note.

63. 545 P.2d at 1190. Arguably this is an exercise by the Commission of political power. *See* notes 80-81 *infra* and accompanying text.

64. 545 P.2d at 1190, quoting from Virginia v. Tennessee, 148 U.S. 503, 519. *See* notes 65-69 *infra* and accompanying text.

65. U.S. CONST. art. I, § 8, cl. 3.

66. 545 P.2d at 1190, citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 139 (1973).

67. 545 P.2d at 1190.

68. *Id.* at 1191.

"constitute no more of a regulation of commerce than the state taxes they are designed to enforce."[69]

Hertz further contended that the Compact's lack of criminal penalties for disclosure of audit information, equivalent to those under state law, results in discrimination between interstate and intrastate taxpayers in violation of the equal protection clause.[70] Rejecting this argument, the court concluded that there was no unequal treatment of taxpayers because the Compact provides interstate taxpayers with the same rights of confidentiality as exist for intrastate taxpayers.[71] The court also rejected defendant's argument that discrimination resulted from the Commission's power to appoint auditors "[i]rrespective of the civil service, personnel or other merit system laws of any party state . . . ."[72] The court observed that *intrastate* taxpayers also are subject to audits by appointed agents; hence, no discriminatory treatment was present.[73]

Although the *Hertz* case is significant because it upholds the audit provisions of the Multistate Tax Compact, its precedential value is diminished by the narrow issue decided by the court.[74] Rather than decide the crucial issue of whether states may enter into a multistate tax compact without congressional consent, the *Hertz* court was able to avoid this determination by severing the audit provisions from the Compact itself and thereby limit its ruling to Article VIII.[75] Thus, conclusive determination of the constitutionality of the entire Multistate Tax Compact must await a subsequent decision. *United States Steel Corp. v. Multistate Tax Commission*[76] presents an opportunity for such a decision, for it squarely addresses the issue of the entire Compact's validity absent congressional con-

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69. *Id.*

70. *Id.*

71. *Id.* The court noted that article VIII, § 6 of the Multistate Tax Compact provides:

> Availability of information shall be in accordance with the laws of the states or subdivisions on whose account the commission performs the audit, and only through the appropriate agencies or officers of such states or subdivisions.

The court observed in dictum that this provision "may be broad enough to include even the state penalty statutes that [Hertz] asserts are lacking." *Id.*; *see* Appendix *infra*.

72. *Id.* citing Multistate Tax Compact, art. VI, § 1(g); *see* Appendix *infra*.

73. The court further rejected defendant Hertz Corporation's due process and fourth amendment claims. The court found that Hertz Corp. was not denied due process and that because the Commission is a validly constituted body, its audits do not violate defendant's fourth amendment right to be free from unreasonable searches and seizures. *Id.* at 1192.

74. The issue before the court was whether the Commission had the power and authority to conduct a sales and use tax audit of Hertz Corp. pursuant to article VIII of the Compact. *Id.* at 1188.

75. *Id* at 1189.

76. 72 Civ. 3438 (S.D.N.Y. filed Sept. 17, 1972).

sent under the compact clause.[77] The following section of this note discusses the issues that face the *United States Steel* court and, ultimately, the United States Supreme Court.

B. *Application of Constitutional Requirements to the Entire Compact*

(1) Political Power

The compact clause requires congressional approval of interstate agreements that increase the political power of the states and thereby encroach upon federal supremacy.[78] Arguably, the Commission's power to subpoena any person beyond the borders of a member state requesting such a subpoena[79] and its power to apply for enforcement or compulsory process orders in aid of joint audits reflect an increase in the political power of the siguatory states.[80] The Commission's subpoena power may be exercised, however, only in member states in which an audit is being conducted or in which the subpoenaed person resides. Similarly, the Commission's power to seek orders for compulsory process or enforcement extends to courts located either in a member state requesting such an order or in a member state in which the object of the order is located.[81] These powers of the Commission clearly exceed those of any member acting alone.[82] Nevertheless, the powers resulting from the Compact are not substantial as "political" powers and are no greater than those resulting from the adoption by several states of a uniform act or

77. Plaintiffs' amended complaint at 8-10, United States Steel Corp. v. Multistate Tax Comm'n, 72 Civ. 3438 (S.D.N.Y. Sept. 17, 1972) characterizes the secondary issues substantially as follows: (1) Does the Compact encroach upon the exclusive federal supremacy in the area of interstate commerce as provided for in the commerce clause; (2) Does the Compact unconstitutionally discriminate against multistate businesses engaged in interstate commerce under the commerce clause; (3) Do separate standards in the area of interstate commerce deny the plaintiffs any constitutional rights protected by the commerce clause; (4) Do Compact standards regarding the qualification of auditors, the confidentiality of audit information, remedies with respect to breach of confidentiality requirements and the scope of the subpoena powers and their enforcement given the Commission unconstitutionally discriminate against interstate taxpayers as compared to intrastate taxpayers in violation of the due process and equal protection clauses of the fourteenth amendment; and (5) Does the Compact violate plaintiffs' right to be protected from unreasonable searches and seizures under the fourth amendment?

Arguably, these issues were all answered in the negative by the court in *Hertz*. *See* notes 60-75 *supra* and accompanying text.

78. Virginia v. Tennessee, 148 U.S. 503 (1893). *See* note 26 *supra*.

79. Multistate Tax Compact art. VIII(3); *see* Appendix *infra*.

80. If the power to subpoena is viewed as a power in aid of enforcement of state taxes, and taxation is viewed as a political power, this argument has validity.

81. Multistate Tax Compact art. VIII(4); *see* Appendix *infra*.

82. *See* text accompanying note 63 *supra*.

reciprocal agreement, which have not been subjected to the constraints of the compact clause.[83] Thus, the Multistate Tax Compact could be interpreted as merely a cooperative agreement not subject to congressional approval under the compact clause. Furthermore, it should be emphasized that the Commission's powers are neither mandatory nor binding, but are available for the member states to accept or decline.[84] Consequently, the individual states, not the Commission, ultimately exercise the power that may affect an individual's rights.

(2) Encroaching upon Interstate Commerce

Even assuming that the Commission's powers tend to increase the political power of the member states, congressional consent for the Compact apparently is not required under the rule of *Virginia v. Tennessee* unless this increased political power encroaches upon or interferes with federal supremacy.[85] The question, therefore, is whether this interstate arrangement for more uniform state tax administration encroaches upon federal supremacy in the area of interstate commerce.

The broad power of Congress to regulate commerce among the states has been recognized since Chief Justice Marshall's interpretation of the commerce clause in *Gibbons v. Ogden*.[86] Should Congress choose to legislate in the field of state taxation and that legislation is found to be constitutional, state action that conflicts with such legislation must yield under the supremacy clause.[87] This has been demonstrated by the enactment of Public Law 86-272[88] and subsequent cases upholding its constitutionality.[89] Thus, any provision of the Multistate Tax Compact, a form of "state action," that conflicts

83. For example, 44 states have entered into reciprocal agreements for the enforcement of the respective states' tax laws. *See* Leflar, *Out-Of-State Collection of State and Local Taxes*, 29 VAND. L. REV. 443 (1976). Furthermore, 29 states have adopted the Uniform Division of Income for Tax Purposes Act (UDITPA). *See* Corrigan, *supra* note 4, at 436-37.

84. The Commission does not determine a state's power or jurisdiction to impose a tax on a multistate taxpayer; it does not determine conclusively the proper division of a multistate taxpayer's income for tax purposes; and acts only in an advisory capacity to assist in auditing multistate taxpayers, in educating state tax administrators and in recommending improvements for fairly characterizing a taxpayer's enterprise structure for tax purposes.

85. *See* note 26 *supra*.

86. 22 U.S. (9 Wheat.) 1 (1824).

87. U.S. CONST. art. 6, § 2.

88. 13 U.S.C. §§ 381-84 (1970). *See* Hartman, *supra* note 2.

89. International Shoe Co. v. Cochreham, 246 La. 244, 164 So. 2d 314, *cert. denied, sub. nom.* Mouton v. International Shoe Co., 379 U.S. 902 (1964); State *ex rel.* CIBA Pharmaceutical Prod. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964); Smith Kline & French Laboratories, Inc. v. State Tax Comm'n, 241 Ore. 50, 403 P.2d 375 (1965).

with Public Law 86-272 must fail.[90] In the absence of federal legislation, however, the provisions of the Compact may fall within an area of commerce left to the exclusive control of the states and do not constitute an unconstitutional regulation of commerce under Supreme Court decisions construing the commerce clause.[91] Indeed, the Supreme Court has expressly held that state taxation of a multistate business, consistent with constitutional limitations, is not a regulation of interstate commerce.[92]

In the absence of federal legislation, the courts have tested challenged state statutes by balancing competing state and federal interests. If the subject of commerce affected by the state statute requires uniform treatment throughout the nation, then the power of Congress is exclusive. Conversely, in the absence of federal legislation, if the subject affected can best be accomodated by local regulation, the state may legislate concurrently with Congress.[93] Except for Public Law 86-272 Congress has not enacted legislation designed to regulate state taxation of interstate business. Thus, the preemption doctrine does not invalidate the Compact.

The policy considerations favoring federal activity in this area have been reviewed above.[94] These considerations suggest a need for uniformity among all the states. On the other hand, as the *Hertz* court noted,[95] a persuasive argument can be made that the diversity of state taxation schemes makes a uniform federal policy undesirable, at least with respect to auditing multistate businesses for purposes of state taxation. The resolution of these difficult policy conflicts remains for the courts in *United States Steel.*

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90. *See* Hartman, *supra* note 2, at 397.

91. Northwestern States Portland Cement Co. v. Minnesota, consolidated on appeal with Williams v. Stockham Valves & Fittings, Inc., 358 U.S. 450 (1959). State statutes in the field of interstate taxation that do not "unduly burden interstate commerce," consistently have been held constitutional. *See, e.g.*, International Harvester Co. v. Department of Treasury, 322 U.S. 340, 358 (1944). The Supreme Court has sustained a number of diverse and conflicting state tax apportionment and allocation laws against challenges of impermissible infringement upon interstate commerce. *See, e.g.*, General Motors Corp. v. District of Columbia, 380 U.S. 553 (1965); International Harvester v. Evatt, 329 U.S. 416 (1947); Ford Motor Co. v. Beauchamp, 308 U.S. 331 (1939); Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920). As recently as 1972, the Court dismissed for failure to raise a substantial federal question a multistate taxpayer's complaint alleging inconsistent apportionment and allocation of its net income by two states. Kennecott Copper Corp. v. State Tax Comm'n, 409 U.S. 973, *dismissing* 27 Utah 2d 119, 493 P.2d 632 (1972).

92. *See, e.g.*, Southern Pacific Co. v. Arizona, 325 U.S. 761 (1945).

93. Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1851).

94. *See* notes 55-59 *supra* and accompanying text.

95. *See* notes 67-68 *supra* and accompanying text.

(3) Fourteenth Amendment Rights

The United States Supreme Court has ruled that the equal protection clause "imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation,"[96] and that a classification resting upon "some reasonable difference or policy . . . [results in] no denial of the equal protection of the law."[97] The Court has further held that a state may adapt its tax system to different characteristics of corporate taxpayers to provide for administrative convenience in the collection and verification of taxes of a particular business without violating either the equal protection or due process clauses.[98] An important question, therefore, is whether action by the Multistate Tax Commission, particularly in its joint audits, impermissibly discriminates against multistate corporate taxpayers doing business in the member states.

A rational basis may be found for the differences in the auditing provisions applicable to multistate taxpayers and those applicable to intrastate taxpayers. The problems involved in auditing multistate taxpayers are substantially different from those involved in intrastate audits.[99] Whereas audits of multistate taxpayers involve problems of apportionment and allocation of income and application of sales and use taxes to interstate sales, audits of intrastate taxpayers principally involve expense and revenue determinations. The different nature of the taxpayers involved also may justify standards for the qualification and selection of multistate auditors differing from those standards as applied to intrastate auditor's[100] Compact provisions granting the Commission interstate subpoena power[101] and the power to apply for compulsory process and enforcement orders likewise may be sustained on these distinctions. Thus, one reasonably may conclude that the differing treatment described above is based on some distinction having a fair and substantial relation to the object of the legislation.[102]

96. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 22, 26 (1959).

97. Brown-Forman Co. v. Kentucky, 217 U.S. 563, 573 (1910). *See also* Maxwell v. Bugbee, 250 U.S. 525 (1919).

98. Lehnhausen v. Lake Shore Auto Parts, 410 U.S. 356, *rehearing denied*, 411 U.S. 910 (1973).

99. *See* Corrigan, *supra* note 4, at 430-33.

100. *See* notes 72-73 *supra* and accompanying text.

101. Multistate Tax Compact art. VIII(3); *see* Appendix *infra*.

102. *See* F.S. Royster Guano Co. v. Virginia, 253 U.S. 412, 415 (1920).

IV. CONCLUSION

Analytically, good reasons can be presented for sustaining the constitutionality of the Multistate Tax Compact, at least until Congress enacts preemptive legislation. The Compact and its multistate audits are within the power of the signatory states and do not encroach upon federal supremacy. Indeed, both the states and the federal government retain the same powers under the Compact as they would have without the Compact. On the other hand, perhaps policy considerations discussed above suggest a need for uniformity in state taxation of multistate business that the Multistate Tax Compact has not provided. Indeed because the states have exhibited some reluctance to join the Compact as full members,[103] the Compact may not provide a uniform solution in the near future. Nevertheless, whatever uniformity can be achieved by the Compact is preferable to the void that has been left by Congress. Thus, the substance of the policy arguments favoring federal action sublimates in the vacuum of congressional inaction. With policy considerations under the commerce clause at least neutral and preemption not a factor, a strict analysis under the compact clause becomes the key to the constitutionality of the Multistate Tax Compact. Since the powers exercised by the Multistate Tax Commission realistically do not amount to political power that encroaches upon federal supremacy, the Compact must stand.

ROBERT M. WHITE*

103. Twenty-one, and soon 22, states are full members in the Multistate Tax Compact. P-H STATE & LOCAL TAXES, ALL STATES UNIT ¶ 5150; *see* Corrigan, *supra* note 4 at 441, n. 44.

* George M. Kryder, III updated and revised this Note.

APPENDIX

MULTISTATE TAX COMPACT

ARTICLE I. PURPOSES

The purposes of this compact are to: (1) Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes; (2) Promote uniformity or compatibility in significant components of tax systems; (3) Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; (4) Avoid duplicative taxation.

ARTICLE II. DEFINITIONS

As used in this compact:

1. "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any Territory or Possession of the United States.

2. "Division" means any governmental unit or special district of a State.

3. "Taxpayer" means any corporation, partnership, firm, association, governmental unit or agency or person acting as a business entity in more than one State.

4. "Income Tax" means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

5. "Capital stock tax" means a tax measured in any way by the capital of a corporation considered in its entirety.

6. "Gross receipts tax" means a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax.

7. "Sales tax" means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by State or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax

imposed exclusively on the sale of a specifically identified commodity or articles or class of commodities or articles.

8. "Use tax" means a nonrecurring tax, other than a sales tax, which (a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property and (b) is complementary to a sales tax.

9. "Tax" means an income tax, capital stock tax, gross receipts tax, sales tax, use tax, and any other tax which has a multistate impact, except that the provisions of Articles III, IV and V of this compact shall apply only to the taxes specifically designated therein and the provisions of Article IX of this Compact shall apply only in respect to determinations pursuant to Article IV.

ARTICLE III. ELEMENTS OF INCOME TAX LAWS

Taxpayer option, state and local taxes.—1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such State or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV. This election for any tax year may be made in all party States or subdivisions thereof or in any one or more of the party States or subdivisions thereof without reference to the election made in the others. For the purposes of this paragraph, taxes imposed by subdivisions shall be considered separately from State taxes and the apportionment and allocation also may be applied to the entire tax base. In no instance wherein Article IV is employed for all subdivisions of a State may the sum of all apportionments and allocations to subdivisions within a State be greater than the apportionment and allocation that would be assignable to that State if the apportionment or allocation were being made with respect to a State income tax.

Taxpayer option, short form.—2. Each party State or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return, whose only activities within the taxing jurisdiction consist of sales and do not include owning or renting real estate or tangible personal property, and whose dollar volume of gross sales made during the tax year within

the State or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax due on the basis of a percentage of such volume and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The Multistate Tax Commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the Commission, shall replace the $100,000 figure specifically provided herein. Each party State and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph.

Coverage.—3. Nothing in this Article relates to the reporting or payment of any tax other than an income tax.

Article IV. Division of Income

Definitions.—1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commerical domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipe line, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or ap-

proved by a Federal, State or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) "This State" means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayer's commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in

a State is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental [or] royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown as unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this state.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

7. Interest and dividends are allocable to this State if the taxpayer's commercial domicile is in this state.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to the extent that a patented product is produced in the State. If the basis of receipts from patent royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this State by

multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this state if:

(a) the individual's service is performed entirely within the State;

(b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this state.

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this State during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of

the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this State if:

(a) the income-producing activity is performed in this State; or

(b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article V. Elements of Sales and Use Tax Laws

Tax credit.—1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another State and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the State, and any unused portion of the credit shall then be applied against the amount of any use tax due a subdivision.

Exemption certificates, vendors may rely.—2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate State or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

ARTICLE VI. THE COMMISSION

Organization and management.—1. (a) The Multistate Tax Commission is hereby established. It shall be composed of one "member" from each party State who shall be the head of the State agency charged with the administration of the types of taxes to which this compact applies. If there is more than one such agency the State shall provide by law for the selection of the Commission member from the heads of the relevant agencies. State law may provide that a member of the Commission be represented by an alternate but only if there is on file with the Commission written notification of the designation and identity of the alternate. The Attorney General of each party State or his designee, or other counsel if the laws of the party State specifically provide, shall be entitled to attend the meetings of the Commission, but shall not vote. Such Attorneys General, designees, or other counsel shall receive all notices of meetings required under paragraph 1(e) of this Article.

(b) Each party State shall provide by law for the selection of representatives from its subdivisions affected by this compact to consult with the Commission member from that State.

(c) Each member shall be entitled to one vote. The Commission shall not act unless a majority of the members are present, and no action shall be binding unless approved by a majority of the total number of members.

(d) The Commission shall adopt an official seal to be used as it may provide.

(e) The Commission shall hold an annual meeting and such other regular meetings as its bylaws may provide and such special meetings as its Executive Committee may determine. The Commission bylaws shall specify the dates of the annual and any other regular meetings, and shall provide for the giving of notice of annual, regular and special meetings. Notices of special meetings shall include the reasons therefor and an agenda of the items to be considered.

(f) The Commission shall elect annually, from among its members, a Chairman, a Vice Chairman and a Treasurer. The Commission shall appoint an Executive Director who shall serve at its pleasure, and it shall fix his duties and compensation. The Executive Director shall be Secretary of the Commission. The Commission shall make provision for the bonding of such of its officers and employees as it may deem appropriate.

(g) Irrespective of the civil service, personnel or other merit system laws of any party state, the Executive Director shall appoint

or discharge such personnel as may be necessary for the performance of the functions of the Commission and shall fix their duties and compensation. The Commission bylaws shall provide for personnel policies and programs.

(h) The Commission may borrow, accept or contract for the services of personnel from any State, the United States, or any other governmental entity.

(i) The Commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

(j) The Commission may establish one or more offices for the transacting of its business.

(k) The Commission shall adopt bylaws for the conduct of its business. The Commission shall publish its bylaws in convenient form, and shall file a copy of the bylaws and any amendments thereto with the appropriate agency or officer in each of the party States.

(l) The Commission annually shall make to the Governor and legislature of each party State a report covering its activities for the preceding year. Any donation or grant accepted by the Commission or services borrowed shall be reported in the annual report of the Commission, and shall include the nature, amount and conditions, if any, of the donation, gift, grant or services borrowed and the identity of the donor or lender. The Commission may make additional reports as it may deem desirable.

Committees.—2. (a) To assist in the conduct of its business when the full Commission is not meeting, the Commission shall have an Executive Committee of seven members, including the Chairman, Vice Chairman, Treasurer and four other members elected annually by the Commission. The Executive Committee, subject to the provisions of this compact and consistent with the policies of the Commission, shall function as provided in the bylaws of the Commission.

(b) The Commission may establish advisory and technical committees, membership on which may include private persons and public officials, in furthering any of its activities. Such committees may consider any matter of concern to the Commission, including problems of special interest to any party State and problems dealing with particular types of taxes.

(c) The Commission may establish such additional committees as its bylaws may provide.

Powers.—3. In addition to powers conferred elsewhere in this compact, the Commission shall have power to: (a) Study State and local tax systems and particular types of State and local taxes; (b) Develop and recommend proposals or an increase in uniformity or compatibility of State and local tax laws with a view toward encouraging the simplification and improvement of State and local tax law and administration; (c) Compile and publish information as in its judgment would assist the party States in implementation of the compact and taxpayers in complying with State and local tax laws; (d) Do all things necessary and incidental to the administration of its functions pursuant to this compact.

4. (a) The Commission shall submit to the Governor or designated officer or officers of each party State a budget of its estimated expenditures for such period as may be required by the laws of that State for presentation to the legislature thereof.

(b) Each of the Commission's budgets of estimated expenditures shall contain specific recommendations of the amounts to be appropriated by each of the party States. The total amount of appropriations requested under any such budget shall be apportioned among the party States as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each party State and its subdivisions from income taxes, capital stock taxes, gross receipts taxes, sales and use taxes. In determining such amounts, the Commission shall employ such available public sources of information as, in its judgment, present the most equitable and accurate comparisons among the party States. Each of the Commission's budgets of estimated expenditures and requests for appropriations shall indicate the sources used in obtaining information employed in applying the formula contained in this paragraph.

(c) The Commission shall not pledge the credit of any party State. The Commission may meet any of its obligations in whole or in part with funds available to it under paragraph (1)(i) of this Article: provided that the Commission takes specific action setting aside such funds prior to incurring any obligation to be met in whole or in part in such manner. Except where the Commission makes use of funds available to it under paragraph (1)(i), the Commission shall not incur any obligation prior to the allotment of funds by the party States adequate to meet the same.

(d) The Commission shall keep accurate accounts of all receipts and disbursements. The receipts and disbursements of the Commission shall be subject to the audit and accounting procedures established under its bylaws. All receipts and disbursements of

funds handled by the Commission shall be audited yearly by a certified or licensed public accountant and the report of the audit shall be included in and become part of the annual report of the Commission.

(e) The accounts of the Commission shall be open at any reasonable time for inspection by duly constituted officers of the party States and by any persons authorized by the Commission.

(f) Nothing contained in this Article shall be construed to prevent Commission compliance with laws relating to audit or inspection of accounts by or on behalf of any government contributing to the support of the Commission.

ARTICLE VII. UNIFORM REGULATIONS AND FORMS

1. Whenever any two or more party States, or subdivisions of party States, have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, sales or use tax, the Commission may adopt uniform regulations for any phase of the administration of such law, including assertion of jurisdiction to tax, or prescribing uniform tax forms. The Commission may also act with respect to the provisions of Article IV of this compact.

2. Prior to the adoption of any regulation, the Commission shall:

(a) As provided in its bylaws, hold at least one public hearing on due notice to all affected party States and subdivisions thereof and to all taxpayers and other persons who have made timely request of the Commission for advance notice of its regulation-making proceedings.

(b) Afford all affected party States and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be considered fully by the Commission.

3. The Commission shall submit any regulations adopted by it to the appropriate officials of all party States and subdivisions to which they might apply. Each such State and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures.

ARTICLE VIII. INTERSTATE AUDITS

1. This article shall be in force only in those party States that specifically provide therefor by statute.

2. Any party State or subdivision thereof desiring to make or participate in an audit of any accounts, books, papers, records or other documents may request the Commission to perform the audit

on its behalf. In responding to the request, the Commission shall have access to and may examine, at any reasonable time, such accounts, books, papers, records, and other documents and any relevant property or stock of merchandise. The Commission may enter into agreements with party States or their subdivisions for assistance in performance of the audit. The Commission shall make charges, to be paid by the State or local government or governments for which it performs the service, for any audits performed by it in order to reimburse itself for the actual costs incurred in making the audit.

3. The Commission may require the attendance of any person within the State where it is conducting an audit or part thereof at a time and place fixed by it within such State for the purpose of giving testimony with respect to any account, book, paper, document, other record, property or stock of merchandise being examined in connection with the audit. If the person is not within the jurisdiction, he may be required to attend for such purpose at any time and place fixed by the Commission within the State of which he is a resident: provided that such State has adopted this Article.

4. The Commission may apply to any court having power to issue compulsory process for orders in aid of its powers and responsibilities pursuant to this Article and any and all such courts shall have jurisdiction to issue such orders. Failure of any person to obey any such order shall be punishable as contempt of the issuing court. If the party or subject matter on account of which the Commission seeks an order is within the jurisdiction of the court to which application is made, such application may be to a court in the State or subdivision on behalf of which the audit is being made or a court in the State in which the object of the order being sought is situated. The provisions of this paragraph apply only to courts in a State that has adopted this Article.

5. The Commission may decline to perform any audit requested if it finds that its available personnel or other resources are insufficient for the purpose or that, in the terms requested, the audit is impracticable of satisfactory performance. If the Commission, on the basis of its experience, has reason to believe that an audit of a particular taxpayer, either at a particular time or on a particular schedule, would be of interest to a number of party States or their subdivisions, it may offer to make the audit or audits, the offer to be contingent on sufficient participation therein as determined by the Commission.

6. Information obtained by any audit pursuant to this Article

shall be confidential and available only for tax purposes to party States, their subdivisions or the United States. Availability of information shall be in accordance with the laws of the States or subdivisions on whose account the Commission performs the audit, and only through the appropriate agencies or officers of such States or subdivisions. Nothing in this Article shall be construed to require any taxpayer to keep records for any period not otherwise required by law.

7. Other arrangements made or authorized pursuant to law for cooperative audit by or on behalf of the party States or any of their subdivisions are not superseded or invalidated by this Article.

8. In no event shall the Commission make any charge against a taxpayer for an audit.

9. As used in this Article, "tax," in addition to the meaning ascribed to it in Article II, means any tax or license fee imposed in whole or in part for revenue purposes.

ARTICLE IX. ARBITRATION

1. Whenever the Commission finds a need for settling disputes concerning apportionments and allocations by arbitration, it may adopt a regulation placing this Article in effect, notwithstanding the provisions of Article VII.

2. The Commission shall select and maintain an Arbitration Panel composed of officers and employees of State and local governments and private persons who shall be knowledgeable and experienced in matters of tax law and administration.

3. Whenever a taxpayer who has elected to employ Article IV, or whenever the laws of the party State or subdivision thereof are substantially identical with the relevant provisions of Article IV, the taxpayer, by written notice to the Commission and to each party State or subdivision thereof that would be affected, may secure arbitration of an apportionment or allocation, if he is dissatisfied with the final administrative determination of the tax agency of the State or subdivision with respect thereto on the ground that it would subject him to double or multiple taxation by two or more party States or subdivisions thereof. Each party State and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

4. The Arbitration Board shall be composed of one person selected by the taxpayer, one by the agency or agencies involved, and one member of the Commission's Arbitration Panel. If the agencies involved are unable to agree on the person to be selected by

them, such person shall be selected by lot from the total membership of the Arbitration Panel. The two persons selected for the Board in the manner provided by the foregoing provisions of this paragraph shall jointly select the third member of the Board. If they are unable to agree on the selection, the third member shall be selected by lot from among the total membership of the Arbitration Panel. No member of a Board selected by lot shall be qualified to serve if he is an officer or employee or is otherwise affiliated with any party to the arbitration proceeding. Residence within the jurisdiction of a party to the arbitration proceeding shall not constitute affiliation within the meaning of this paragraph.

5. The Board may sit in any State or subdivision party to the proceeding, in the State of the taxpayer's incorporation, residence or domicile, in any State where the taxpayer does business, or in any place that it finds most appropriate for gaining access to evidence relevant to the matter before it.

6. The Board shall give due notice of the times and places of its hearings. The parties shall be entitled to be heard, to present evidence, and to examine and cross-examine witnesses. The Board shall act by majority vote.

7. The Board shall have power to administer oaths, take testimony, subpoena and require the attendance of witnesses and the production of accounts, books, papers, records, and other documents, and issue commissions to take testimony. Subpoenas may be signed by any member of the Board. In case of failure to obey a subpoena, and upon application by the Board, any judge of a court of competent jurisdiction of the State in which the Board is sitting or in which the person to whom the subpoena is directed may be found may make an order requiring compliance with the subpoena, and the court may punish failure to obey the order as a contempt. The provisions of this paragraph apply only in States that have adopted this Article.

8. Unless the parties otherwise agree the expenses and other costs of the arbitration shall be assessed and allocated among the parties by the Board in such manner as it may determine. The Commission shall fix a schedule of compensation for members of Arbitration Boards and of other allowable expenses and costs. No officer or employee of a State or local government who serves as a member of a Board shall be entitled to compensation therefor unless he is required on account of his service to forego the regular compensation attaching to his public employment, but any such Board member shall be entitled to expenses.

9. The Board shall determine the disputed apportionment or allocation and any matters necessary thereto. The determinations of the Board shall be final for purposes of making the apportionment or allocation, but for no other purpose.

10. The Board shall file with the Commission and with each tax agency represented in the proceeding: the determination of the Board; the Board's written statement of its reasons therefor; the record of the Board's proceedings; and any other documents required by the arbitration rules of the Commission to be filed.

11. The Commission shall publish the determinations of Boards together with the statements of the reasons therefor.

12. The Commission shall adopt and publish rules of procedure and practice and shall file a copy of such rules and of any amendment thereto with the appropriate agency or officer in each of the party States.

13. Nothing contained herein shall prevent at any time a written compromise of any matter or matters in dispute, if otherwise lawful, by the parties to the arbitration proceedings.

ARTICLE X. ENTRY INTO FORCE AND WITHDRAWAL

1. This compact shall enter into force when enacted into law by any seven States. Thereafter, this compact shall become effective as to any other State upon its enactment thereof. The Commission shall arrange for notification of all party States whenever there is a new enactment of the compact.

2. Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

3. No proceeding commenced before an Arbitration Board prior to the withdrawal of a State and to which the withdrawing State or any subdivision thereof is a party shall be discontinued or terminated by the withdrawal, nor shall the Board thereby lose jurisdiction over any of the parties to the proceeding necessary to make a binding determination therein.

ARTICLE XI. EFFECT ON OTHER LAWS AND JURISDICTION

Nothing in this compact shall be construed to: (a) Affect the power of any State or subdivision thereof to fix rates of taxation, except that a party State shall be obligated to implement Article III (2) of this compact; (b) Apply to any tax or fixed fee imposed for the registration of a motor vehicle or any tax on motor fuel,

other than a sales tax, provided that the definition of "tax" in Article VIII (9) may apply for the purposes of that Article and the Commission's powers of study and recommendation pursuant to Article VI (3) may apply; (c) Withdrawal [sic] or limit the jurisdiction of any State or local court or administrative officer or body with respect to any person, corporation or other entity or subject matter, except to the extent that such jurisdiction is expressly conferred by or pursuant to this compact upon another agency or body; (d) Supersede or limit the jurisdiction of any court of the United States.

ARTICLE XII. CONSTRUCTION AND SEVERABILITY

This compact shall be liberally construed so as to effectuate the purposes thereof. The provisions of this compact shall be severable and if any phrase, clause, sentence or provision of this compact is declared to be contrary to the constitution of any State or of the United States or the applicability thereof to any government, agency, person or circumstance is held invalid, the validity of the remainder of this compact and the applicability thereof to any government, agency, person or circumstance shall not be affected thereby. If this compact shall be held contrary to the constitution of any State participating therein, the compact shall remain in full force and effect as to the remaining party States and in full force and effect as to the State affected as to all severable matters.