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State Taxation of Interstate Business-Looking Toward Federal-State Cooperation

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NOTES

State Taxation of Interstate Business—Looking Toward Federal-State Cooperation

The growth of multistate businesses, the increased mobility of the population, and the rise of mass advertising have changed the complexion of the American marketplace. Markets that were formerly local have become regional and national. Radio and television advertising has attracted customers from a multistate area. Nevertheless, while modern business has tended toward multi-jurisdictional operations, the trend in state taxation has been toward pushing the state's jurisdiction to tax to its constitutional limits. Moreover, due to the complexity of state tax laws, even a small business often incurs tax liability in several different states. Many of these taxes result in expenditures of time and money disproportionate to the amount of taxes actually owed.

Congress, the states, and the business community are aware of the discrimination against interstate operations created by multistate business taxation. They disagree, however, on the nature of the problem, on what should be done, and on who should do it. Some see the basic problem as a lack of jurisdictional certainty, which could be resolved through federal legislation. To others, the problem is lack of uniformity in taxing multistate businesses and the solution is a multistate tax compact.

This note will review the historical setting of state taxation of interstate commerce and examine the problems created by the diversity of state tax laws. It will further discuss the two different approaches toward solving these problems, investigate the constitutional issues involved in the proposed solutions, analyze their inadequacy, and recommend a federal-state cooperative approach.

I. Development of the Conflict Between State and Federal Interests

Under the Articles of Confederation, Congress lacked authority to regulate interstate commerce. As a result, legislation in this field was left entirely to the individual states.[1] Continuing disputes erupted because

1. *See* B. Schwartz, A Commentary on the Constitution of the United States, pt. I, at 178-79 (1963); J. Story, Commentaries on the Constitution of the United States § 126 (abr. ed. 1833).

each state exercised its taxing power over interstate commerce without regard to the interests of the adjoining states or of the nation as a whole,[2] and the states' unrestrained power to tax interstate commerce became the power to destroy any opportunity for the growth of a vital national economy.[3] To remedy the lack of enforceable mutual concessions regarding interstate commerce, the framers of the Constitution of 1787 included the commerce clause in the new compact of government.[4] In keeping with the remedial nature of the commerce clause, the United States Supreme Court early held that the clause had force in the absence of congressional action and that where Congress had not spoken, the Court would protect the national interest.[5]

For the next 170 years Congress was content to leave most of the regulation of state taxation of interstate commerce in the hands of the Supreme Court.[6] At the outset, relatively little regulation was required for two main reasons. First, the states did not press their power to tax interstate commerce. Secondly, the major tax until the Civil War was the relatively simple property tax. In the late 1800's the Supreme Court's role increased as a result of the states' growing need for revenue, which resulted in the development of the capital stock, gross receipts, net income, and sales and use taxes.[7] Each of these taxes created its own problems for multistate businesses. Moreover, in the absence of a congressional policy, the Supreme Court had to act as a quasi-legislative body in balancing the demands of the states for tax revenue and the national need for a smooth flow of interstate commerce. The tests devised by the Court in resolving these competing demands shifted with the composition and attitude of the Court.[8]

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2. *See* B. SCHWARTZ, *supra* note 1, at 238-40.

3. *Cf. In re* Rahrer, 140 U.S. 545 (1891); P. HARTMAN, STATE TAXATION OF INTERSTATE COMMERCE 2 (1953).

4. *See* E. DUMBAULD, THE CONSTITUTION OF THE UNITED STATES 112-39 (1964); A. KELLEY & W. HARBISON, THE AMERICAN CONSTITUTION 293 (3d ed. 1963).

5. *See* Freeman v. Hewit, 329 U.S. 249, 263 (1946) (Rutledge, J., concurring); Brown v. Maryland, 25 U.S. (12 Wheat.) 419 (1827).

6. W. BEAMAN, PAYING TAXES TO OTHER STATES, ch. 1, at 10 & ch. 2, at 2 (1963). One instance of congressional action, however, was the McCarran Act in which Congress provided that the states could regulate and tax insurance companies even though the Supreme Court had declared insurance to be interstate commerce and not subject to state regulation. 15 U.S.C. §§ 1011-15 (1964). For congressional comments on the McCarran Act see 1945 U.S. CODE CONG. SERV. 670-73.

7. *Cf.* Melder, *Interstate Tax Barriers*, in NATIONAL TAX ASSOCIATION, 1958 PROCEEDINGS OF THE FIFTY-FIRST ANNUAL CONFERENCE ON TAXATION 280, 281 (1959).

8. In the early 1900's, Mr. Justice Holmes established the rule that a tax levied directly on interstate commerce was invalid. This approach tended to favor free trade over state power to tax. In the 1930's, Mr. Justice Stone established the "cumulative burdens" test which invalidated a state

As multistate businesses began to increase in number and as the states imposed more complex taxes on interstate businesses, members of the Supreme Court began to call on Congress to take over the burden of adjusting the competing interests.[9] Congress, however, showed little interest in the matter until 1959, the year the Court decided *Northwestern States Portland Cement Co. v. Minnesota.*[10] In that case the Court held that "net income from the interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state. . . ."[11] The business community, fearing that the decision would encourage the states to extend their tax jurisdiction even further, rushed to Congress for relief.[12] Pressed by business demands, Congress "reacted with astonishing speed and for the first time in its history adopted an act [Public Law 86-272] restricting the power of the States to tax interstate businesses."[13]

Public Law 86-272,[14] passed within seven months of the decision in *Northwestern,* established a minimum nexus requirement for a state net income tax on multistate businesses selling tangible personal property. The Act also authorized a comprehensive study of state net income taxation of these businesses, which was later broadened to include all matters pertaining to the taxation of interstate commerce by the states.[15]

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tax if it threatened to subject interstate commerce to the burden of multiple taxation. This approach tended to favor the states' power to tax. In the 1940's a modified Holmes approach was in vogue which allowed a state to impose an "indirect" tax on interstate commerce and yet to measure it by an incident of interstate commerce. For a more complete treatment of the Court's attempt to adjust the competing state and national interests in this area see P. HARTMAN, *supra* note 3, at 5-13.

9. *E.g.,* Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 470-77 (1959) (Frankfurter, J., dissenting); McCarroll v. Dixie Greyhound Lines, Inc., 309 U.S. 176, 188-89 (1940) (Black, Douglas, & Frankfurter, JJ., dissenting). *See* note 37 *infra* and accompanying text.

10. 358 U.S. 450 (1959).

11. *Id.* at 452. The business activities were exclusively in furtherance of interstate commerce.

12. HOUSE COMM. ON THE JUDICIARY, SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE, STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. NO. 1480, 88th Cong. 2d Sess., vol. 1, at 7 (1964) [hereinafter cited as REPORT]. According to a less neutral view, "certain well known propagandists . . . launched upon a campaign of propaganda, through their affiliated trade associations, to pressure Congress into the enactment of some federal law which would exaggerate the confusion which had previously existed in this area." Cox, *The Impact of Recent Supreme Court Decisions on State Taxation of Interstate Commerce,* in NATIONAL TAX ASSOCIATION, 1959 PROCEEDINGS OF THE FIFTY-SECOND ANNUAL CONFERENCE ON TAXATION 441 (1960).

13. *See* J. HELLERSTEIN, STATE AND LOCAL TAXATION 259 (3d ed. 1969).

14. 15 U.S.C. § 381 (1964).

15. Act of April 7, 1961, Pub. L. No. 87-17, 75 Stat. 41 (1961), *amending* 15 U.S.C. § 381 (1958). This was the result of reaction to Scripto, Inc. v. Carson, 362 U.S. 207 (1960), in which the Supreme Court held that an out-of-state business could be required to collect a use tax on sales

Shortly after the Willis Subcommittee study was completed in 1965,[16] a bill, H.R. 11798, was introduced to implement the Subcommittee's recommendations. This bill would have limited state power to tax interstate commerce, imposed a mandatory two-factor apportionment formula for net income and capital stock taxes, and provided for direct federal administration and adjudication of tax disputes.[17] After numerous objections were raised during hearings on the bill,[18] the Subcommittee introduced a new bill, which eliminated provisions for direct federal administration and adjudication and made the mandatory two-factor formula optional.[19] Since no action was taken before the 89th Congress adjourned, the bill died,[20] but a new bill incorporating most of these proposals has since been introduced.

The states, by this time, had become concerned over the threatened "encroachment" on their traditional power to tax. Although the simple solution seemed to be a tax compact,[21] the barriers to such interstate

made within the taxing state even though it maintained no facilities in the state and its sales were made through independent contractors. The business community was disturbed by this decision and feared that it would lead to a similar ruling on mail order catalogue sales. The pressure on Congress for a federal statute was relieved somewhat when the Supreme Court decided National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), which held that a state could not impose the duty of use tax collection and payment upon a seller whose only connection with customers in the state is by mail or common carrier. *See* Taylor, *Multistate Tax Compact*, 31 TEXAS B.J. 773, 822 (1967).

16. Volumes 1 and 2, H.R. REP. No. 1480, 89th Cong., 1st Sess. (1965), dealing with state income taxes, were submitted to the Speaker of the House on June 15, 1964; volume 3, H.R. REP. No. 565, 89th Cong., 1st Sess. (1965), dealing with state sales and use taxes, capital stock taxes, and gross receipts taxes, was submitted on June 30, 1965; volume 4, H.R. REP. No. 952, 89th Cong., 1st Sess. (1965), containing the Subcommittee's recommendations, was submitted on September 2, 1965.

17. *See* text of H.R. 11798, 89th Cong., 2d Sess. (1966), printed in *Hearings on H.R. 11798 & Companion Bills Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary, Appendix I*, 89th Cong., 2d Sess., ser. 14, vol. 2, at 1447-512 (1966); 19 ABA TAXATION SECTION 111-12 (1965).

18. Representatives of both the states and the business community expressed opposition. *Hearings on H.R. 11798 & Companion Bills Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, 89th Cong., 2d Sess., ser. 14 (1966).

19. H.R. 16491, 89th Cong., 2d Sess. (1966); *see* Celler, *The Development of a Congressional Program Dealing with State Taxation of Interstate Commerce*, 36 FORDHAM L. REV. 385, 391 (1968).

20. Celler, *supra* note 19, at 390. Representative Edwin Willis (D-La.) reintroduced the bill as H.R. 2158, 90th Cong., 1st Sess. (1967), which passed the House, 284 to 89, and then died for lack of Senate action at the end of the 90th Congress. Representative Peter W. Rodino, Jr., (D-N.J.) later introduced the bill as H.R. 7906, 91st Cong., 1st Sess. (1969), which was passed by the House, 311 to 89, on June 25, 1969, but has not yet been enacted by the Senate.

21. *See* C. PENNIMAN & W. HELLER, STATE INCOME TAX ADMINISTRATION 243 (1959); Ratliff, *State Taxation of Interstate Commerce: The Case for Federal Control*, in NATIONAL TAX ASSOCIATION, 1962 PROCEEDINGS OF THE FIFTY-FIFTH ANNUAL CONFERENCE ON TAXATION 513, 519 (1963); *cf.* NEW YORK JOINT LEGISLATIVE COMMITTEE, REPORT ON INTERSTATE COOPERATION 271-75 (1961) [hereinafter cited as NEW YORK REPORT].

cooperation were immense. "It would take time to draft a workable, reasonable compact, and years to present it to all the legislatures and to Congress. . . ."[22] Furthermore, the states would have to overcome the "inertia, neglect, provincialism, and inadequate appropriations to tax administrators" that had made the states' record for cooperation with one another in taxation so unimpressive.[23] By 1966, however, a Multistate Tax Compact had been drafted, and it became effective in 1967 as the seventh state adopted it.[24] A conflict between the two competing approaches to state tax regulation was thus framed with a federal interstate tax bill[25] pending in Congress and a Multistate Tax Compact in existence and gaining support.[26]

II. THE PROBLEMS

A. Problems in Defining the "Common Market"

Except for the provisions of Public Law 86-272, enacted in 1959, the Supreme Court has had to rely on constitutional limitations alone in adjusting disputes involving multistate taxpayers challenging the authority of states to impose certain taxes. The primary constitutional provisions relied upon by the Court have been the vague "due process" and "commerce" clauses. The purpose of the due process clause of the fourteenth amendment, which governs the relationship between the state and, in this context, the taxpayer, is to insure fairness by protecting the

22. *See* 20 ABA TAXATION SECTION 151, 163 (Jan. 1967) (remarks of Arthur B. Barber).

23. *See* C. PENNIMAN & W. HELLER, *supra* note 21, at 242; *Report of the Committee on Interstate Allocation of Business Income* in NATIONAL TAX ASSOCIATION, 1958 PROCEEDINGS OF THE FIFTY-FIRST ANNUAL CONFERENCE ON TAXATION 372, 373 (1959). *But cf.* NEW YORK JOINT LEGISLATIVE COMMITTEE, COMPACT ON TAXATION OF MOTOR FUELS CONSUMED BY INTERSTATE BUSES 92-97 (1968).

24. On January 12-13, 1966, the National Association of State Tax Administrators held a special meeting in Chicago, where there was support for a multistate tax compact. Later a drafting committee was formed, and on December 20, 1966, the final draft of the Multistate Tax Compact was published. It was to become effective when it was adopted by 7 states.

25. H.R. 7906, 91st Cong., 1st Sess. (1969).

26. *See, e.g.*, ABA Committee on State and Local Taxes, *Recommendation*, in 22 TAX LAW. 1041 (1969) (recommendation that Congress enact an interstate taxation act and appropriate legislation relating to the Multistate Tax Compact). The American Bar Association House of Delegates approved legislation consenting to the Compact in its 1970 meeting at St. Louis, Missouri. Report of ABA Annual Meeting, 39 U.S.L.W. 2110, 2113 (Oct. 25, 1970). As of January 13, 1970, 19 states had adopted the Compact. These include Arkansas, Colorado, Florida, Hawaii, Idaho, Illinois, Kansas, Michigan, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, Texas, Utah, Washington, and Wyoming. In addition, Alabama has adopted the Compact subject to congressional consent. The following states are associate members (possessing no right to vote or to hold office) of the Compact: Alabama, Alaska, Arizona, California, Indiana, Louisiana, Massachusetts, New York, Pennsylvania, South Dakota, Tennessee, Virginia, and West Virginia. P-H STATE TAX GUIDE ¶ ¶ 742-W, 743 (All States ed. 1970).

taxpayer from unreasonable or extraterritorial state action. The courts are generally competent to determine, as a matter of essential fairness, when a state has a sufficient justification to warrant exercise of its power over persons or corporations.[27] On the other hand, the commerce clause,[28] primarily concerned with relations between the nation and the states, was written into the Constitution "to rescue [commerce] from the embarrassing and destructive consequences, resulting from the legislation of so many different States, and to place it under the protection of a uniform law."[29] Thus, the commerce cause was not grounded on common law principles or on any principle of ultimate fairness, but rather on political and economic expediency—the need for a "common market" area that would benefit all the states.[30]

The commerce clause has two aspects. First, it is the express source of power in the national government to regulate commerce among the states. Secondly, it is a source of implied restraint on the power of the states, even in the absence of federal legislation.[31] The Supreme Court's problem has arisen from its attempt to use this second, negative aspect of the commerce clause to formulate an affirmative policy whereby the national interest in having a common market is not jeopardized by the same state rivalries and provincial interests that made the commerce clause necessary in the first place. The Court has had difficulty in using the commerce clause in this manner as demonstrated by the various approaches it has taken in adjusting the competing national and state interests. Many of the decisions are a composite of due process and commerce clause ideas;[32] several rely on conclusions obscuring the basis

27. *Cf.* International Shoe Co. v. Washington, 326 U.S. 310 (1945); F. JAMES, CIVIL PROCEDURE 644-49 (1965); Conlon, *The Report of the Special Subcommittee: A Preliminary Appraisal*, in NATIONAL TAX ASSOCIATION, 1964 PROCEEDINGS OF THE FIFTY-SEVENTH ANNUAL CONFERENCE ON TAXATION 529, 536 (1965). This does not mean, however, that the judicial task is an easy one, especially with regard to the taxing power. *See* V. WOOD, DUE PROCESS OF LAW 1932-1942, at 340-400 (1951).

28. "Unlike the due-process clause, which focuses attention on the inconvenience to the defendant for his own protection, the commerce clause limitation is concerned with the imposition on the defendant's business insofar as it serves to impair the public interest in an open economy in our federal system." Note, *Developments in the Law—State-Court Jurisdiction*, 73 HARV. L. REV. 909, 985 (1960). For a discussion of the interrelationship of these two clauses see W. BEAMAN, *supra* note 6, ch. 1, at 7, and Barrett, *State Taxation of Interstate Commerce—"Direct Burdens," "Multiple Burdens," or What Have You?*, 4 VAND. L. REV. 496 (1951).

29. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 11 (1824). *See also* notes 1-4 *supra* and accompanying text.

30. *See* B. SCHWARTZ, *supra* note 1, at 178.

31. *See, e.g.*, Freeman v. Hewit, 329 U.S. 249, 263 (1946) (Rutledge, J., concurring).

32. *See, e.g.*, International Harvester Co. v. Department of Treas., 322 U.S. 340, 355 (1944) (Rutledge, J., concurring and dissenting). Justice Rutledge's opinion, covering 3 cases, is an

of the decision;[33] and others are based on considerations having no economic significance.[34] Since the Court has failed to give substance to the commerce clause as the source of an affirmative policy, it is difficult to predict which tax will be found to "unduly burden interstate commerce."[35]

Lacking any guidelines from the express words of the Constitution, from common law experience, or from congressional legislation, the Supreme Court has no special competence to accommodate the conflicting interests of state and nation in defining the proper boundaries of the common market that the commerce clause was to create and was intended to protect.[36] The Court cannot make " a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life, neither can [it] devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsible to the subtleties of the interrelated economies of Nation and State . . . ."[37] The commerce clause, based on economic realities and not common law principles, raises questions of a political nature more appropriately decided by a political rather than a judicial body.[38] The appropriate political body to establish the national interstate commerce policy, according to the Constitution, is Congress. Using the negative implications of the commerce clause, the Court can only attempt to restrain the states from destroying the common market goal of that clause while waiting for Congress to define its boundaries and establish a method for protecting it.

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excellent discussion of the Court's difficulty in dealing with the due process and commerce clauses in relation to state taxation of interstate commerce.

33. As an example, for many years the Court struck down "direct" taxes and upheld "indirect" taxes. The test applied to invalidate a tax on this basis has been subject to considerable criticism: "It gave very little help to the legislator, the lower courts, or the taxpaying businessman in predicting whether a particular tax would be valid. The alleged test simply . . . described a result reached, not the reasons for that result." P. HARTMAN, *supra* note 3, at 32.

34. *See, e.g.*, P. HARTMAN, *supra* note 3, at 264; Barrett, *"Substance" vs. "Form" in the Application of the Commerce Clause to State Taxation*, 101 U. PA. L. REV. 740 (1953). States can frequently avoid the effect of these decisions and extract the same amount of tax from the same multistate taxpayer merely by rewording their tax statutes. *See* Hartman, *State Taxation of Income from a Multistate Business*, in SELECTED PROBLEMS IN THE LAW OF CORPORATE PRACTICE 36 (T. Roady & W. Andersen eds. 1960); Powell, *Contemporary Commerce Clause Controversies over State Taxation*, 76 U. PA. L. REV. 773, 774 (1928).

35. *See* International Harvester Co. v. Department of Treas., 322 U.S. 340, 358 (1944) (Rutledge, J., concurring).

36. *See* H. ABRAHAM, THE JUDICIARY 42 (2d ed. 1969).

37. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 475 (1959) (Frankfurter, J., dissenting).

38. *See, e.g.*, H. ABRAHAM, *supra* note 36, at 42; P. HARTMAN, *supra* note 3, at 276.

B. *Problems Described by Legal Writers*

While one major constitutional problem—what the common market policy inherent in the commerce clause should be—has been the source of the Supreme Court's difficulties, legal writers have identified and analyzed several additional problems in interstate tax relations. One of the problems recognized as faced by multistate businesses is the great degree of uncertainty about what the states will be allowed to tax.[39] Another major problem is the diversity of tax laws among the states, which leads to high administrative costs among taxpayers complying with the laws.[40] A third identified problem, stemming from the diversity of tax laws, is the inequity among multistate taxpayers created by a system that produces overtaxation or undertaxation.[41] Not every state utilizes the same apportionment formula, taxes the same transactions, or defines terms the same as other states do. This causes some businesses to be overtaxed by doing business in states that seek more than their share, while other businesses are undertaxed as a result of doing business in states with lax tax laws.

C. *Problems Found by Congressional Study*

Prior to the study of state taxation conducted by the Willis Subcommittee in the early 1960's,[42] there was no reliable empirical data by which to evaluate the many problems believed to exist in interstate tax relations.[43] As a result of its study, the Willis Subcommittee concluded that there were four major defects[44] in the present state

39. *See* W. BEAMAN, *supra* note 6, ch. 4, at 6: "The judicial prescription of taxable *nexus* . . . consists of a few inconclusive interpretations of the Due Process Clause and the unpredictable rule which treats exclusively interstate commerce as exempt from 'direct' state taxation."

40. *See* C. PENNIMAN & W. HELLER, *supra* note 21, at 242-43. Diversity also results from variations in interpretation and application of the tax laws. *Id.*

41. *See* W. BEAMAN, *supra* note 6, ch. 4, at 9; C. PENNIMAN & W. HELLER, *supra* note 21, at 243.

42. *See* note 16 *supra.*

43. Hellerstein, *An Academician's View of State Taxation of Interstate Commerce,* in NATIONAL TAX ASSOCIATION, 1960 PROCEEDINGS OF THE FIFTY-THIRD ANNUAL CONFERENCE ON TAXATION 201, 217 (1961).

44. *See* REPORT, *supra* note 12, vol. 4, at 1127-28. Jurisdiction, while not considered to be one of the major defects, was considered to be a problem: "In determining tax liability, the threshold question for every business which crosses State lines is that of jurisdiction. . . . The jurisdictional provision of most State tax laws do very little to help . . . ." REPORT, *supra* note 12, vol. 12, at 594. Another problem faced by the multistate taxpayer is that of liability to political subdivisions within a state. Although the taxpayer may have done the same thing in 2 cities of the same state, one city may consider him liable for the tax and the other not. "But most bewildering of all, the State . . . may consider him not liable on the basis of an activity within its borders while one of its political subdivisions . . . may consider the same activity within its borders sufficient to create liability for the local tax. Thus within each state a whole new world of confusion breeds." *Id.*

taxation system: (1) the system was marked by a tendency toward overtaxation and undertaxation; (2) local business was often favored over interstate business; (3) there was widespread noncompliance with state tax laws as a result of the burden of excessive compliance costs; and (4) the system had generated an unhealthy attitude among taxpayers concerning compliance with state tax laws. For the most part, the Subcommittee simply verified the conclusions of the prior legal writers.[45]

III. THE PROPOSED SOLUTIONS

A. The Federal Approach

One of the first federal attempts to resolve the problems of multistate business taxation was the Harrison Bill of 1934,[46] which would have allowed states to tax interstate transactions subject to three limitations. First, a state could levy a tax upon, or measured by, sales of tangible personal property only in the same manner and to the same extent as taxes were levied on like property not in interstate commerce. Secondly, a state could not tax items transported for the purpose of resale by consignees. Thirdly, political subdivisions of states could not levy a tax upon, or measure it by, a sale of tangible personal property in interstate commerce.[47] The bill was passed by the Senate but was not enacted into law.[48]

Most writers, nevertheless, have continued to believe that congressional action is necessary.[49] Some have argued that the Constitution imposes a duty on Congress to remove all state impediments to the free flow of commerce between the states.[50] Others have insisted that the states cannot realistically be expected to agree on

45. *See* Cox, *Taxation of Interstate Business*, in NEW YORK JOINT LEGISLATIVE COMMITTEE, REPORT ON INTERSTATE COOPERATION 115, 116-18 (1965). For a critical evaluation of the Subcommittee's study see 19 ABA TAXATION SECTION 111, 117-21 (July 1966).

46. S. 2897, 73d Cong., 2d Sess. (1934). Probably the first federal attempts to eliminate difficulties in allocation of taxes of multistate businesses were S. 3074, 72d Cong., 1st Sess. (1931) and H.R. 9692 & H.R.11950, 72d Cong., 1st Sess. (1931). Essentially the bills provided that interstate business could be taxed in the same manner and to the same extent as intrastate business provided the taxes were not discriminatory and the business or property was not subject to double taxation. J. KALLENBACH, FEDERAL COOPERATION WITH THE STATES UNDER THE COMMERCE CLAUSE 187 n.119 (1968). *See generally* Perkins, *The Sales Tax and Transactions in Interstate Commerce*, 12 N.C. L. REV. 99 (1934).

47. S. 2897, 73d Cong., 2d Sess. (1934).

48. 78 CONG. REC. 4598 (1934).

49. For comments prior to 1959 see Dowling, *Introduction: State Taxation of Multistate Business*, 18 OHIO ST. L.J. 3 (1957). For comments after 1959 see Hellerstein, *State Taxation of Interstate Business: Reflections on Legislative Directions*, in TAX INSTITUTE OF AMERICA, FEDERAL-STATE-LOCAL FISCAL RELATIONSHIPS 257, 263 (1968).

50. *See* 20 ABA TAXATION SECTION 151, 162 (Jan. 1967) (remarks of Arthur B. Barber).

the substance and scope of uniform rules and to set aside local interests in favor of national ones,[51] especially since multistate business taxpayers are being taxed without representation in states where they have no business location. Finally, writers have suggested that Congress is the only political body having sufficient authority to deal with the problem in an adequate manner.[52]

1. *The Recommendations.*—In response to the congressional interest created by the Supreme Court's holding in *Northwestern* and the congressional enactment of Public Law 86-272, the Willis Subcommittee recommended that formula apportionment be used as the sole method of dividing the tax base among the states.[53] Specific allocation and separate accounting were to be eliminated. A two-factor apportionment formula, based on property and payroll, was recommended instead of the much used three-factor formula based on property, payroll, and sales.[54] The recommended rule for jurisdiction to tax allowed a state to assert net income tax jurisdiction over a multistate business that had either property or payroll in the taxing state.[55] The starting point for computing state taxes was to be the federal tax base.[56] The Subcommittee also suggested that capital stock and gross receipt taxes be subject to the same apportionment formula and jurisdictional standard applicable to income taxes. It recommended, with respect to sales and use taxes, that states either adopt a uniform sales and use tax act, included in the recommendations, or retain their own tax system and be subject to federal jurisdictional requirements.[57] Furthermore, the Willis Subcommittee urged that the United States Treasury Department be given administrative responsibility for issuing rules regarding the uniform division of income, power to modify the apportionment formula

51. *Id.* at 164 (remarks of Stephen C. Nemeth, Jr.).

52. *Id.* at 151 (remarks of Jess N. Rosenberg).

53. *See* REPORT, *supra* note 12, vol. 4, at 1144.

54. This method of dividing income was recommended because it would reduce complexity, thus lowering compliance costs, resulting in a higher level of compliance. *Id.* at 1144-45.

55. This recommendation was designed to eliminate complexity by relating jurisdiction to the apportionment formula, both being based on property and payroll ("business location"). The result was to be elimination of tax returns showing only small liabilities. *Id.* at 1156.

56. A closer conformity between state and federal definitions was to facilitate taxpayer compliance, allow for more efficient tax administration, and reduce favoritism in the tax base. *Id.* at 1158.

57. Sellers in states electing the uniform act would be required to collect sales or use taxes for any sale within the state. Sellers of tangible personal property making only prepaid mail order sales with no other contact in the state, except advertising, would be exempt from collecting either tax. *Id.* at 1181. States not electing the uniform act could only require sellers to collect the sales and use tax if the sellers had real property, full time employees, or made regular household deliveries in the taxing state. *Id.* at 1180.

when inequity would result in a particular case, and power to resolve multistate tax disputes. Under the bill, the Department also would be authorized to study the interstate tax problems of businesses not otherwise covered by the proposed federal legislation.

2. *The Proposed Legislation.*—Shortly after publication of the Willis Subcommittee Report, a congressional bill[58] was introduced to implement the Subcommittee's recommendations. In the hearings on this bill,[59] there was such widespread opposition to its provisions, from business and states alike, that the bill was rewritten and reintroduced in modified form,[60] eliminating provisions recommending direct federal administration, federal adjudication of tax disputes, use of the federal tax base as a starting point for computation purposes, and the uniform sales and use tax act. The remnants of the original recommendations—the uniform jurisdictional standard based on a business location test for income, capital stock, and gross receipts taxes—are the basis of a bill presently pending Senate action.[61] In this current bill a state may require collection of sales and use taxes if the business meets the business location test or regularly makes household deliveries in the state. The two-factor apportionment formula based on property and payroll is available to taxable businesses as an option to the state's method of determining the tax base for a net income or capital stock tax. Moreover, the state may not impose a tax under its formula greater than the maximum using the optional federal formula. Businesses having average annual net incomes in excess of one million dollars and certain other businesses engaged in designated activities are excluded from the coverage of the bill.

B. The State Approach

Another approach to solving the taxation problems, this time through state action, came in 1957 with the drafting of the Uniform Division of Income for Tax Purpose Act,[62] which provided for an

58. H.R. 11798, 89th Cong., 1st Sess. (1965).

59. *Hearings on H.R. 11798 and Companion Bills Before the Special Subcomm. on State Taxation of Interstate Commerce of the House Comm. on the Judiciary*, 89th Cong., 2d Sess., ser. 14 (1966) [hereinafter cited as *Hearings*].

60. H.R. 16491, 89th Cong., 2d Sess. (1966). For a discussion of the major provisions of H.R. 16491 see Glander, *State Taxation of Interstate Commerce—A Review*, in NATIONAL TAX ASSOCIATION, 1966 PROCEEDINGS OF THE FIFTY-NINTH ANNUAL CONFERENCE ON TAXATION 286, 293 (1967).

61. H.R. 7906, 91st Cong., 1st Sess. (1969); *see* note 20 *supra*.

62. *See* Lynn, *The Uniform Division of Income for Tax Purposes Act Re-Examined*, 46 VA. L. REV. 1257, 1258 (1960); Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 TAXES 747 (1957); Wilkie, *Uniform Division of Income for Tax Purposes*, 37 TAXES 65 (1959).

equitable division of the tax base of multistate businesses by the use of a three-factor apportionment formula based on sales, property, and payroll. It was hoped that the Act would be adopted in every state, thus assuring that every multistate business would be taxed only on its entire net income.[63] This state action approach had several major flaws. First, the Act assumed state jurisdiction to levy the tax in the first place. Secondly, it did not establish a uniform definition of terms. Thirdly, it did not provide that every state would have a net income tax and it did not establish what the rates would be. Fourthly, it applied only to corporate net income taxes and did not attempt to resolve the problems of the gross receipts, capital stock, or sales and use taxes. Finally, since it was not adopted by a substantial number of states, the desired uniformity was not achieved.[64]

Despite these flaws, state action has still been the choice of many writers. The case for allowing the states to resolve the problem, however, seems to have been based as much on opposition to federal "intervention" as it has been on concern for the problems of the multistate business.[65] Many opponents of federal legislation have felt that it would be an "unwarranted, unnecessary and undesirable intrusion into the tax and fiscal jurisdiction to the states and their local governments," and have opposed such legislation "because it would be destructive of the principles of federalism."[66] The attack on federal legislation has been frequently directed against the Willis Subcommittee study. Objections have been that the Subcommittee lacked any special competence to evaluate the problems of state and local taxation and that its conclusions were based on data gathered during the turbulent years following the *Northwestern* decision and the enactment of Public Law

63. *See* Hartman, *State Taxation of Corporate Income from a Multistate Business,* 13 VAND. L. REV. 21, 76 (1959).

64. *See* W. BEAMAN, *supra* note 6, ch. 4, at 11. In 1965 only Alaska, Arkansas and Kansas, of 38 states imposing corporate income taxes, had enacted the uniform act. Hellerstein, *Allocation and Nexus in State Taxation of Interstate Businesses,* in TAX INSTITUTE OF AMERICA, STATE AND LOCAL TAXES ON BUSINESS 67, 75 (1965). By 1968 the number of states adopting the uniform act had risen to 11, with the addition of California, Hawaii, Idaho, New Mexico, North Dakota, Oregon, South Carolina (in part) and Utah (in part). NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS HANDBOOK 370 (1968).

65. *See, e.g.,* Dexter, *The Case Against Federal Intervention,* in TAX INSTITUTE OF AMERICA, STATE AND LOCAL TAXES ON BUSINESS 98 (1964); 20 ABA TAXATION SECTION 152, 168 (Jan. 1967) (remarks of T.W. DeLooze).

66. Statement by John W. Lynch, President, National Association of Tax Administrators, on January 27, 1966, quoted in Bishop & Taylor, *H.R. 11798, Reform or Ruin?,* 29 TEXAS B.J. 247 (1966). *See also* Sparks, *Taxation of Interstate Commerce: The Case for State Control,* in NATIONAL TAX ASSOCIATION, 1962 PROCEEDINGS OF THE FIFTY-FIFTH ANNUAL CONFERENCE ON TAXATION 505, 510-11 (1963).

86-272.[67] Furthermore, the report has been said to overemphasize compliance costs and to disregard the equity of the present state tax system considered as a whole.[68] Some opponents have placed the burden on Congress to prove that interstate taxpayers suffer an undue tax burden and have claimed that since the Willis Subcommittee failed to sustain the burden, Congress is without power to interfere.[69] Moreover, opponents to federal action have believed that the existing system, even with its faults, would be better than some federal system likely to cause as many problems as it would solve.[70] The most persuasive argument by those in favor of state action has been that the states are in a better position to determine state taxing requirements and to adjust a new system of multistate taxation to the existing structure of state tax administration.

Based on one or more of the above arguments, the approach favored by many states is that of interstate cooperation—more specifically, the Multistate Tax Compact.[71] The Compact allows any multistate business to use the Uniform Division of Income for Tax Purposes Act, rather than a particular state's tax laws, in determining liability for net income taxes.[72] Small businesses are given the option to pay a tax on gross sales in lieu of paying a net income tax.[73] The Compact further provides for credit to be given by the taxing state for sales and use taxes previously paid to another state. Similarly, interstate sellers are relieved from collection of sales or use taxes of the taxing state upon good faith acceptance of a tax exemption certificate from that state. A Multistate Tax Commission has been created to implement the purposes of the Compact and to administer the program, conduct studies, and make recommendations concerning problems as they arise. Single audits of a multistate taxpayer are available on a multistate basis in states choosing to become parties to a cooperative audit provision. The Compact also establishes an optional arbitration procedure for settling disputes concerning apportionments and allocations.

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67. *See* Lock, *A Moderate's Viewpoint on State Taxation of Interstate Commerce*, 17 TAX EXEC. 321, 322-23 (1965).

68. *See* Bishop & Taylor, *supra* note 66, at 308; Lock, *supra* note 67, at 323-24.

69. *See* 19 ABA TAXATION SECTION 117 (July 1966).

70. *See* Dexter, *supra* note 65, at 98-99.

71. *Cf.* Taylor, *Multistate Tax Compact*, 30 TEXAS B.J. 773 (1967).

72. Multistate Tax Compact, art. I, § 3, *reported in* 27 COUNCIL OF STATE GOVERNMENTS, SUGGESTED STATE LEGISLATION C-9 (1968) [hereinafter cited as Multistate Tax Compact].

73. Multistate Tax Compact, art. III, § 2.

IV. CONSTITUTIONAL ISSUES INVOLVING THE PROPOSED SOLUTIONS

A. Constitutionality of Congressional Legislation

The states greeted the enactment of Public Law 86-272 with attacks on its constitutionality.[74] The attacks have failed for the simple reason that the plenary power of Congress to regulate interstate commerce embraces congressional action to limit, displace, or override state taxation that might be permissible in the absence of federal action.[75] Although the states maintain that the courts have not considered all the possible grounds of attack on the statute, it seems apparent that the states are fighting an uphill constitutional battle.[76] The Supreme Court can be expected to uphold the constitutionality of Public Law 86-272, as well as the proposed legislation, if it should be enacted into law.

B. Constitutionality of the Multistate Tax Compact

It seems rather anomalous that the states should attack the constitutional power of Congress to regulate state taxation of interstate commerce and yet join in a Multistate Tax Compact in the face of the express constitutional prohibition of the compact clause.[77] The Supreme Court, however, has held that not all compacts among the states are prohibited. As early as 1893, in *Virginia v. Tennessee*,[78] the Court said that the prohibition of the compact clause "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."[79] As a consequence of this and similar decisions,

74. *See, e.g.*, International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314, *cert. denied*, 379 U.S. 902 (1964) (amici curiae briefs filed by 19 states); State *ex rel.* Ciba Pharmaceutical Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964); Smith Kline & French Labs. v. State Tax Comm'n, 241 Ore. 50, 403 P.2d 375 (1965). *See also* Roland, *Public Law 86-272: Regulation or Raid?*, 46 VA. L. REV. 1172 (1960).

75. *See* cases cited note 74 *supra*. For a survey of case law on the scope of congressional power see Hartman & Sanders, *The Power of Congress to Prohibit Discrimination in the Assessment of Property of Interstate Carriers for State Ad Valorem Taxes*, 33 ICC PRAC. J. 654 (1966).

76. *See* Bishop & Taylor, *The Proposed Interstate Taxation Act*, 29 TEXAS B.J. 247, 309 (1966).

77. "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . . ." U.S. CONST. art. I, § 10, cl. 3.

78. 148 U.S. 503 (1893). For a discussion of the early federal history of the interstate compact see Frankfurter & Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments*, 34 YALE L.J. 685 (1925). For later developments see F. ZIMMERMAN & M. WENDELL, THE INTERSTATE COMPACT SINCE 1925 (1951); F. ZIMMERMAN & M. WENDALL, THE LAW AND USE OF INTERSTATE COMPACTS (1961).

79. 148 U.S. at 519.

only political compacts are now viewed as requiring congressional consent.[80]

1. *Definition of Political Compact.*—What constitutes a "political" compact? The test seems to be dependent upon the degree to which an interstate agreement may conflict with federal law or federal interests.[81] A compact should be considered void, in the absence of congressional consent, when it has the tendency to disrupt national interests and to encroach upon the responsibility of Congress to decide questions of national concern.[82] Generally, if the interstate compact simply seeks uniformity of state services, state administration, or state law within the normal realm of state responsibility, the compact is not of a political nature.

One test advanced to determine whether a compact is political sounds deceptively simple: "[I]f the states can seek uniformity of law by statute without consent of the federal government, there is no reason why the same words in an interstate compact require consent."[83] The real question is, however, not whether the states would have authority to regulate the subject matter when acting independently of a compact, but whether the federal government would have the ultimate responsibility and power to act upon the disputed matter even if traditionally subject to state regulation. If a compact concerns a matter of national interest and responsibility, such as interstate commerce, Congress should decide whether the states *collectively* are more competent to regulate the subject matter than the national government, and whether the states should be allowed to unite into a political entity to regulate the subject matter. In other words, if the states are unable to resolve a problem of national magnitude through uniform laws, but instead must create a new entity for complete and adequate action, then direct congressional action may be more appropriate than collective state action.[84]

2. *Congressional Consent.*—The problem of deciding which

80. *See, e.g.*, Dunbar, *Interstate Compacts and Congressional Consent*, 36 VA. L. REV. 753, 756 (1950).

81. *See* F. ZIMMERMAN & M. WENDELL, THE LAW AND USE OF INTERSTATE COMPACTS 23 (1961). *See also* 94 CONG. REC. 5677 (1948) (remarks of Senator Pepper): "Probably it [the political compact] depends upon the degree of involvement in the compact, the number of agreements entered into, the relative importance of the agreements, the scope of them, and the general range of activity which is contemplated."

82. *Cf.* F. ZIMMERMAN & M. WENDELL, *supra* note 81, at 23.

83. F. ZIMMERMAN & M. WENDELL, *supra* note 81, at 24.

84. *Cf.* F. ZIMMERMAN & M. WENDELL, *supra* note 81, at 23: "The real test of the need for Congressional consent in the present day is the degree to which an interstate agreement may conflict with *federal law or federal interests*. If it runs any danger of conflict with federal law or the doctrine of pre-emption, then the need for congressional consent is clearly indicated." (emphasis added).

compacts are political can be ameliorated by looking first for some sign of congressional consent. Although the Constitution does not specify when or how the consent of Congress shall be signified, the Supreme Court has held that consent may precede the compact or be given subsequent to its existence,[85] and further, that consent may be inferred from the circumstances[86] and may be granted conditionally.[87] Since Congress has never voided an already effective compact,[88] and since the Court can be expected to infer consent where there is no reason to suppose that Congress is opposed to a compact,[89] it seems fair to say that Congress impliedly consents to the existence of any compact of which it has knowledge and has not negated by legislation.[90]

3. *Constitutional Analysis of the Multistate Tax Compact.*—It is submitted that the Multistate Tax Compact is political in nature and is prohibited by the compact clause—in the absence of congressional consent.[91] One reason for this conclusion is that the primary purpose of the Compact is to lessen the necessity for federal action.[92] Also, the Compact seeks, in effect, to relieve Congress of its responsibility to decide the proper scope of the common market intended by the commerce clause.[93] Furthermore, the whole area of state taxation of interstate commerce was a source of federal-state sensitivity long before the Multistate Tax Compact was promulgated.[94] Present congressional concern in this area can be demonstrated by the enactment of Public Law 86-272, by the lengthy congressional study of such taxation, and by a bill designed to limit state power to tax interstate commerce which has been passed by the House and is pending Senate action.[95] A final reason for this conclusion is that the individual states were unable to resolve the

85. *See* Virginia v. Tennessee, 148 U.S. 503 (1893). Congress has passed consent acts in advance in several fields, including forest protection, crime control, and flood control. F. ZIMMERMAN & M. WENDELL, THE INTERSTATE COMPACT SINCE 1925, at 57 (1951).

86. *See* Virginia v. West Virginia, 78 U.S. (11 Wall.) 39 (1870).

87. *See* James v. Dravo Contracting Co., 302 U.S. 134 (1937).

88. *See* F. ZIMMERMAN & M. WENDELL, *supra* note 85, at 40 n.171.

89. *Cf. id.*

90. *See id.*

91. *Cf.* ALA. CODE tit. 51, § 919, Note (Supp. 1967): "This act shall become effective . . . upon the passage and approval by the congress [*sic*] of an act authorizing the various states to enter into such Multistate Tax Compact."

92. *See, e.g.*, Taylor, *Multistate Tax Compact*, 30 TEXAS B.J. 773-74 (1967): "The principal cause of the battle has been such threatening federal legislation now pending in Congress as H.R. 2158 . . . which is designed to curtail existing state and local taxing power . . . ."

93. *See* F. ZIMMERMAN & M. WENDELL, *supra* note 81, at 22.

94. *See* notes 1-9 *supra*, and accompanying text.

95. H.R. 7906, 91st Cong., 1st Sess. (1969). *See* notes 13-20, 58-61 *supra* and accompanying text.

problems and had to join together into a multistate entity that can be fully effective only if *all* of the states become parties.[96]

Assuming that the Multistate Tax Compact is political in nature and requires congressional consent to be effective, the next question is whether consent has been given. As yet there has been no express consent, but there are good grounds for finding implied consent. Congress clearly knows that the Compact is in existence, as evidenced by the Compact consent bills[97] pending in both houses of Congress. Even though the consent bills have not been enacted, there appears to be no reason to suppose that Congress is opposed to the compact,[98] especially since it has failed to negate it.[99] So long as Congress tolerates the existence of the Compact there is no apparent reason for the judiciary to strike it down as violating the compact clause. The courts should not readily invalidate a cooperative experiment that could prove beneficial in resolving a problem of almost two centuries' duration. Moreover, little harm could be done in allowing the Compact to continue, at least until it is certain that Congress disapproves of its existence. The mere finding of an implied congressional consent, however, does not imply a relinquishment or restriction of congressional power, including the power to negate the Compact at any time by appropriate legislation or the power to regulate interstate commerce and thus preempt contrary state action.[100]

V. ADEQUACY OF PROPOSED SOLUTIONS

A. Present Situation

Has the multistate business taxpayer benefited from the proposed efforts to simplify the state tax laws? Presently, a multistate business must consult Public Law 86-272 to determine the jurisdictional standard for state net income taxes. If a business is within the state's jurisdictional reach for net income taxes, it must refer to state and local law in matters of apportionment, administration, and interpretation of the tax laws. In addition, it still must examine state and local law to determine jurisdiction and liability for all other taxes. Businesses operating within

96. *Cf.* notes 62-73 *supra* and accompanying text.

97. *E.g.*, S. 2804, 91st Cong., 1st Sess. (1969); H.R. 6246 & H.R. 9873, 91st Cong., 1st Sess. (1969).

98. *Cf.* Hogan, *H.R. 2158 vs. The Multistate Tax Compact: Are They Mutually Exclusive?*, 20 TAX EXEC. 93, 96 (1968).

99. Failure to negate an existing compact within a reasonable length of time should be sufficient to imply consent. *See* F. ZIMMERMAN & M. WENDELL, *supra* note 81, at 22.

100. *See* Pennsylvania v. Wheeling & Belmont Bridge Co., 59 U.S. (18 How.) 421, 433 (1856).

states that are members of the Multistate Tax Compact must also determine whether to use the optional apportionment formula of the Uniform Act and whether any other provisions of the Compact may benefit them as taxpayers. The task of the multistate taxpayer, therefore, has not necessarily been simplified by the federal "jurisdictional" approach of Public Law 86-272 or by the multistate "uniformity" approach. Furthermore, neither of the present approaches addresses itself to the underlying policy of the commerce clause. The Supreme Court is in no better position to determine whether the uniform provisions of the Multistate Tax Compact are compatible with the commerce clause than it was to determine whether the state tax in *Northwestern* was compatible with that clause.

B. Possible Future Situations

Assuming that the pending bill is enacted into law and that the Multistate Tax Compact continues in existence,[101] the multistate taxpayer is likely to find determination of his tax liability even more difficult. The pending bill applies only to "small" businesses, creating a source of litigation to determine which companies are excluded. Public Law 86-272 would still apply to some of the excluded businesses. Not only would the taxpayer have the option to choose either the state's apportionment formula or the Compact's formula, both based on a three-factor formula and each with its own interpretative gloss, he would also have the option to choose the federal two-factor formula.[102] Even if the taxpayer did not choose the federal formula, it would impose an upper limit on his tax liability. Thus, the taxpayer could determine his maximum tax liability with the federal formula and then experiment with all three formulas—state, Compact, or federal—to ascertain which one would yield the lowest tax. This same process would have to be repeated in each state in which the business operates and for each type of tax, since the pending bill and, to some extent, the Multistate Tax Compact, also cover the other major taxes imposed by the states. Therefore, if the additional federal legislation is enacted and the Compact is left intact, the multistate taxpayer will be faced with three sets of laws by which to determine his state tax liability.[103] Prior to the

101. "As a practical matter it is hard to see how both could remain operative for very long." Hogan, *supra* note 98, at 96.

102. "Consider the dilemma of a taxpayer in a 'Compact' state, electing to adopt the three-factor formula of the Compact where H.R. 2158 may only have entitled him to the optional two-factor formula. The fact remains, the interstate tax problem continues to exist and should be capable of a fair and equitable solution." *Id.*

103. *See* Glander, *State Taxation of Interstate Commerce—A Review*, in NATIONAL TAX

recent search for "solutions," he was simply confronted with a variety of state laws.

Assuming that the pending bill is enacted into law and that the Multistate Tax Compact ceases to exist, for whatever reason, the multistate taxpayer would only be confronted with two federal laws in addition to the variety of state laws. Although this situation would have the advantage of a greater degree of simplicity, all future problems would have to be resolved through federal or state legislation since there would be no agency to administer a cooperative program.

VI. COOPERATIVE COMPACT APPROACH

The enactment of a Compact consent bill could alleviate many of the inadequacies in separate solutions by federal and state governments. In addition to authorizing the Multistate Tax Compact, such a bill could impose federal standards similar to those of the Compact, on states not joining the Compact.[104] The Compact consent bill could also contain a congressional statement of the commerce clause policy to be applied by the Supreme Court in situations not expressly covered by either the Compact or the federal standards.

A. The Necessity for Cooperation

When a traditionally "state" problem begins to have adverse effects on national interests, there are essentially three alternatives: (1) leave the solution of the problem to the states, acting individually or collectively; (2) solve the problem by federal legislation; or (3) resolve the problem through federal-state cooperation. The present struggle between the state and federal governments over control of state taxation of interstate commerce tacitly recognizes only the first two of these alternatives, both of which have become increasingly unsatisfactory.[105] Neither state nor federal action alone is likely to bring about an effective

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ASSOCIATION, 1966 PROCEEDINGS OF THE FIFTY-NINTH ANNUAL CONFERENCE ON TAXATION 286, 292 (1966): "Taxpayers could actually have greater recordkeeping headaches than at present, and filing requirements would increase for many more companies . . . great care must be taken to draft and enact a measure which, in fact, will ease the burdens . . . rather than merely substitute a new set of problems . . . ."

104. *Cf.* S. 2804, 91st Cong., 1st Sess. (1969), which would give congressional consent to a multistate tax compact and would provide optional allocation and apportionment provisions, similar to the Compact provisions, to taxpayers in states that have not adopted the Compact by July 1, 1971. Other provisions include tax limitations on political subdivisions and authorization to impose, or require collection of, a sales or use tax on sales to a consumer within a taxing jurisdiction where the seller regularly makes household deliveries.

105. *See* pp. 1325-29 *supra;* Frankfurter & Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments,* 34 YALE L.J. 685, 688 (1925).

coordination of taxes so long as there is a federal system of government.[106] Mere interstate cooperation, in the form of compacts or uniform laws, cannot substitute for federal action on a problem affecting a national interest.[107] On the other hand, federal action alone is not likely to increase harmony in federal-state relations where the states' revenue source is at stake. The nation and the states must be treated as mutually supplementing agencies of government, not as jealous rivals for power.[108]

B. *Federal-State Compact*

The only alternative to further conflict in the area of state taxation of interstate commerce is joint federal-state action. It is submitted that the most appropriate type of joint action would be a federal-state tax compact. The use of federal-state compacts to resolve problems involving federal and state interests has been urged for several years.[109] The propriety of federal participation in a multistate compact seems clear when a national interest such as interstate commerce is an important facet of the compact.[110] Moreover, the federal government has already played a limited role in several regional interstate compacts.[111] Recently it became a fully participating member of such a regional compact, agreeing to substantially the same terms as the states.[112] If governmental participation is proper and desirable in these regional compacts, it would seem that such participation would be even more appropriate in a multistate compact seeking to resolve a national problem.

Congress and the states agree, in principle, on many of the goals of

106. *Cf.* Hartman, *State Taxation of Corporate Income from a Multistate Business*, 13 VAND. L. REV. 21 (1959). Federal-state cooperation in taxation is not a recent development.

107. *See* Bunn, *Production, Prices, Incomes, and the Constitution*, 11 WIS. L. REV. 313, 320-21 (1936); *cf.* Macmahon, *Introduction of Part III*, in FEDERALISM, MATURE AND EMERGENT 267, 269 (A. Macmahon ed. 1955).

108. Corwin, *National-State Cooperation—Its Present Possibilities*, 46 YALE L.J. 599, 601 (1937).

109. *See* J. CLARK, THE RISE OF A NEW FEDERALISM 72 (1938); E. ZIMMERMAN & M. WENDELL, THE INTERSTATE COMPACT SINCE 1925, at 60 (1951); Robertson, *Recent Developments in Federal-State Cooperation*, in NATIONAL TAX ASSOCIATION, 1958 PROCEEDINGS OF THE FIFTY-FIRST ANNUAL CONFERENCE ON TAXATION 483, 484-85 (1959).

110. *Cf.* Grad, *Federal-State Compact: A New Experiment in Co-operative Federalism*, 63 COLUM. L. REV. 825 (1963). "Where matters of national interest are involved in a compact, the federal government is concerned with the operation of the compact." CONFERENCE OF INTERSTATE AGENCIES, SUMMARY OF PROCEEDINGS, *printed in* NEW YORK JOINT LEGISLATIVE COMMITTEE, REPORT OF INTERSTATE COOPERATION 393, 394-95 (1961).

111. *See, e.g.*, The Ohio River Valley Water Sanitation Compact, ch. 581, 54 Stat. 752 (1940) (3 members of the compact commission appointed by the President). *See also* West Virginia *ex rel.* Dyer v. Sims, 341 U.S. 22, 27-28 (1951).

112. *See* Grad, *supra* note 110.

a national interstate commerce tax policy.[113] The main difficulty arises in the choice of methods to be used and in the scope of the solution. Although the states disapprove of federal intervention in the area of state taxation, it is time for Congress to take action on the problems facing the multistate taxpayer.[114] Congress, however, can and should fashion its solution to give the states added incentive to work constructively toward a multistate tax program compatible with the national interest. In the event the states are unable or unwilling to cooperate, a solely federal solution should be available.

C. *Proposed Legislative Approach*

The following discussion is intended to outline a legislative program that could resolve many of the problems now facing the Supreme Court in interpreting the commerce clause, encourage constructive state action in resolving the problems faced by the multistate taxpayer while preserving state responsibility for state tax policies, and guarantee a large degree of uniformity. Although specific legislation is not recommended, it is submitted that Congress should pass legislation encompassing the following three general attributes.

First, Congress should define the proper boundaries of the common market that the commerce clause was designed to create and protect.[115] As previously discussed, this is the question that has given the Supreme Court difficulty in resolving the conflicting interests between state tax policy and national commerce policy. A common market policy could be stated in general or detailed terms and could be in the form of an anti-discrimination provision, allowing non-discriminatory state taxation, or in the form of a jurisdictional standard, establishing a "tax free" zone.[116]

113. *See, e.g.*, Hellerstein, *State Taxation of Interstate Business: Reflections on Legislative Directions*, in TAX INSTITUTE OF AMERICA, FEDERAL-STATE-LOCAL FISCAL RELATIONSHIPS 257 (1968); Hogan, *supra* note 98, at 95.

114. *See* Glander, *State Taxation of Interstate Commerce—A Review*, in NATIONAL TAX ASSOCIATION, 1966 PROCEEDINGS OF THE FIFTY-NINTH ANNUAL CONFERENCE ON TAXATION 286, 293 (1967).

115. *See* Harriss, *State-Local Taxation of Interstate Commerce: Progress and Problems*, in NATIONAL TAX ASSOCIATION, 1966 PROCEEDINGS OF THE FIFTY-NINTH ANNUAL CONFERENCE ON TAXATION 294, 299 (1967). Congress needs "to establish a concept of some transcendent national interest as a benchmark from which to work out the detail." Johnson, *State Taxation of Interstate Commerce: Looking Toward Federal Legislation*, in NATIONAL TAX ASSOCIATION, 1961 PROCEEDINGS OF THE FIFTY-FOURTH ANNUAL CONFERENCE ON TAXATION 333, 334-35 (1962).

116. An anti-discrimination policy would seem preferable. The jurisdictional approach can solve the compliance difficulties of small businesses, but it does not help the financial problems of the states or the tax problems of the local business that must compete with interstate commerce and yet pay the tax that its competitors escape. *See* Sparks, note 66 *supra*, at 512. "A true federalism suggests that interstate commerce and intrastate commerce be treated alike with no segment of this

An anti-discrimination policy would emphasize the responsibility of interstate commerce to pay its own way. On the other hand, the jurisdictional approach would encourage business expansion and eliminate compliance costs and tax liability completely for some businesses.[117]

Secondly, Congress should authorize the existence of a multistate tax compact. With federal recognition and participation in the existing Compact, its framework for further tax uniformity could be continued without the necessity for establishing a new agency or beginning with completely new legislation.[118] Such participation would give both federal and state representatives the opportunity to consider all factors prior to the establishment of any tax policy. The degree of federal participation and the scope of authority of the federal representatives should be limited, however, to encourage voluntary state action.

Thirdly, Congress should provide for an interstate taxation act that would be applicable to non-member states.[119] The purpose of this federal alternative would be to encourage all states to join the Compact for a more uniform approach to tax problems.[120] An interstate tax act, such as H.R. 7906, would freeze state tax law into what is believed to be a workable solution at the time the legislation passes. Most states would

national commerce enjoying any competitive advantage over the other." Johnson, *supra* note 115, at 336. "The goal . . . should be to place interstate and local commerce, so far as possible, upon a plane of tax equality." B. SCHWARTZ, *supra* note 1, at 291.

117. *Cf.* Sparks, *supra* note 66, at 506.

118. Retention of the machinery of the present Multistate Tax Compact has been recently urged by an ad hoc committee of state tax administrators and business representatives who met to work out a compromise solution to the state and federal approaches. In a proposal submitted to the Multistate Tax Commission at its meeting in Chicago on June 4, 1970, the Ad Hoc Committee recommended a merger of the 2 approaches that would combine federal substantive provisions with Multistate Tax Compact administration. Specifics of the proposal are discussed in 31 CCH STATE TAX REV. NO. 24, at 2 (June 16, 1970). The Commission passed a resolution approving in principle the basic objective embodied in the proposal and the scope of its substantive provisions.

119. The federal provision should utilize as many as possible of the features of the Compact. Any federal legislation should adopt the 3-factor apportionment formula which will provide equitable results if applied uniformly. Most of the income tax states use the 3-factor formula which business is accustomed to, and the 2-factor formula simply adds confusion to an already complicated area. For a discussion of states electing the uniform act see note 64 *supra* and accompanying text.

120. This purpose can be compared with the use of federal funds to encourage state acceptance of federal requirements in welfare legislation. In Massachusetts v. Mellon, 262 U.S. 447 (1923), the Supreme Court held that, since a state was not forced to accept the offer of federal funds, state sovereignty was not infringed. In the present context, federal action is being used somewhat as a "big stick" instead of as a "carrot" to encourage states voluntarily to resolve many of the problems with a minimum of federal intervention. A comparison also can be made with the original federal recommendation for federal restrictions on sales and use taxes unless the states enacted the uniform sales and use tax act. *See* note 57, *supra* and accompanying text.

probably be encouraged to seek membership in the Compact to take advantage of the opportunity to help fashion their own multistate tax policy instead of being tied to the more restrictive federal alternative. Thus hopefully no state would choose to operate under the federal alternative.

In summary, the proposed system would establish an express commerce clause policy applicable to all states and businesses regardless of whether the state chose to operate under the compact or the federal alternative. It would guarantee uniformity because each state would be subject to either the compact or the alternative interstate tax act. The competition between federal and state governments over the control of state taxation of interstate commerce would be lessened, if not eliminated, since both would be participating. Finally, if "the protection of the political balance of the federal system is the main purpose of the compact clause, and if the protection of this political balance is adequately safeguarded . . . merely by congressional consent, then it is protected even more assuredly by a compact when there is not only congressional consent, but actual and continuous participation by the federal government."[121]

VII. CONCLUSION

One of the primary "needs" in federal-state relations is a congressional statement of the scope of the common market protection from state taxation given by the commerce clause. Such a statement would solve the Supreme Court's present dilemma of trying to adjust conflicting national and state interests without guidelines from Congress. Action by the states, alone or collectively, neither can nor should establish this policy. Only Congress, through direct federal legislation or through federal participation in interstate cooperation, can satisfy the dictate of the Constitution that "Congress shall have the power to regulate commerce among the States." Direct federal legislation is unpopular among the states primarily because of the influence it would have on state taxing policy. Cooperative federal-state action is preferable because the states should have a voice in a matter of such vital concern as taxation.

The federal-state compact approach avoids the problems of having the states, the Multistate Tax Compact, and the federal government simultaneously trying to regulate and simplify state tax laws. In any one state, business would be faeed with either state law and the compact,[122]

121. Grad, *supra* note 110, at 846.

122. This proposition is based on the assumption that the state chose to join the compact.

or with state law and federal law.[123] Furthermore, if the federal-state compact did not work or ceased to exist, there would be an existing federal law to implement as a solely federal solution. If the federal-state compact functioned successfully, the states would not be saddled with a federally mandated solution. There would be no jurisdictional standards with their inherent tax preferences. Also, the states would have had a major voice in shaping their tax policies to conform with national interests. Finally, there would be a compact commission continuously at work to stay abreast of current problems and to conduct studies and make recommendations designed to achieve further simplicity and tax equity.[124]

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123. This statement assumes that the state chose not to join the compact.
124. This statement is premised on the provision of the current Multistate Tax Compaet.