Vanderbilt Law Review

Volume 19
Issue 2 *Issue 2 - March 1966*

Article 8

3-1966

Legislation

Law Review Staff

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Recommended Citation
Law Review Staff, Legislation, 19 *Vanderbilt Law Review* 523 (1966)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol19/iss2/8

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LEGISLATION

An Analysis of the Net Income Tax Provisions of the Interstate Taxation Act (H.R. 11798)

I. Introduction

An examination of the current status of state net income taxation on interstate business logically begins with the decision in *Northwestern Portland Cement Co. v. Minnesota* and its companion case *Williams v. Stockham Valves & Fitting, Inc.*[1] There the United States Supreme Court held that an apportioned, nondiscriminatory excise tax imposed by a state on the net income of a foreign corporation does not violate either the due process clause or the commerce clause of the federal constitution, even though the income is derived solely from interstate commerce.[2] Mr. Justice Frankfurter, dissenting, warned that increased burdens of bookkeeping necessary to ascertain the tax due under the diverse state formulas would far outweigh the various local interests.

> To subject these . . . [relatively small or moderate size] corporations to a separate income tax in each of these States means that they will have to keep books, make returns, store records, and engage legal counsel, all to meet the divers and variegated tax laws of forty-nine states, with their different times for filing returns, different tax structures, different modes for determining 'net income,' and different, often conflicting, formulas of apportionment. . . . The cost of such a far-flung scheme for complying with the taxing requirements of the different States may well exceed the burden of the taxes themselves . . . .[3]

1. 358 U.S. 450 (1959). In *Northwestern*, Minnesota levied an income tax for the years 1933-1948 against an Iowa corporation engaged in the manufacturing and sale of cement at its plant in Iowa. The corporation maintained an office in Minnesota, staffed by three employees whose activities consisted of a regular and systematic course of solicitation of orders for the sale of its product, each order being subject to acceptance, filling, and delivery at the Iowa plant. Minnesota used a three-factor apportionment formula of sales, property and payroll to determine the portion of net income taxable under its law. The Supreme Court of the United States upheld the tax. In *Stockham*, a Delaware corporation with its principal office in Alabama maintained an office in Georgia which employed two people. The corporation sold valves and pipe fittings through established local wholesalers and jobbers who handled products other than those of the corporation. The salesmen in Georgia carried on the usual sales activities, including regular solicitation, receipt and forwarding of orders to the Birmingham office and promotion of the business. All orders were accepted and filled outside the state. Other than office equipment, the corporation had no property in Georgia. The state of Georgia levied a net income tax on the foreign corporation based on a three-factor apportionment formula consisting of inventory, wages and gross receipts. The Supreme Court of the United States upheld the tax.

2. Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal*, 46 VA. L. REV. 1051 (1960).

3. 358 U.S. at 474.

Northwestern-Stockham, together with three subsequent decisions,[4] provided the necessary impetus for legislative action. Less than seven months after the case was decided, Congress, in response to the protests of the business community,[5] passed Public Law 86-272.[6] This act prohibits the imposition of state *net* income taxes on a foreign corporation if its only business activity in the state is the solicitation of orders for the sale of tangible personal property.[7] Two

4. Within a week after the *Northwestern-Stockham* decision, the Court in a per curiam decision affirmed a judgment of the North Carolina Supreme Court which upheld a state tax as applied to the net income of an interstate freight motor carrier company, whose income was derived exclusively from interstate commerce. ET & WNC Transportation Co. v. Currie, 248 N.C. 560, 104 S.E.2d 403, *aff'd per curiam,* 359 U.S. 28 (1959). At the same term, the Court granted the motion to dismiss the appeal and refused certiorari in Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So. 2d 70 (1958), *appeal dismissed and cert. denied,* 359 U.S. 28 (1959). The Louisiana Supreme Court had held the imposition of the apportioned state net income tax upon a Kentucky distiller constitutional although the taxpayer maintained neither a warehouse, nor a stock of goods in Louisiana; and the taxpayer's activities in the taxing state were limited to the presence of "missionary men" who called upon wholesale dealers and, occasionally, assisted in displaying the taxpayer's merchandise at business establishments of retailers. On May 4, 1959, the Court denied *certiorari* in the ease of International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640, *cert. denied;* 359 U.S. 984 (1959), which also involved a foreign corporation engaged exclusively in interstate operations. Over commerce clause and due process clause objections, the Louisiana Supreme Court had held the imposition of her apportioned net income tax valid. See Hartman, *supra* note 2, at 41-45.

5. The multistate business operators relied heavily on Mr. Justice Frankfurter's dissenting opinion. "Not only were multistate businesses apprehensive over increased taxation by additional states, but also over the inescapable fact that they would incur substantial expenditures in complying with the diverse tax laws of almost every state in which they made a sale or to which they shipped goods." Hartman, *State Taxation of Corporate Income From a Multistate Business,* 13 VAND. L. REV. 21, 44 (1959).

6. 73 Stat. 555 (1959), 15 U.S.C. § 381 (1964). See also *Hearings Before Senate Committee on Small Business on State Taxation of Interstate Commerce,* 86th Cong. 1st Sess. (1959); *Hearings on State Taxation on Interstate Commerce Before the Senate Select Committee on Small Business,* 86th Cong., 1st Sess., pts. 1, 2 & 3 (1959); S. Rep. No. 658, 86th Cong., 1st Sess. (1959); H.R. Rep. No. 453, 86th Cong., 1st Sess. (1959); H.R. Rep. No. 936, 86th Cong., 1st Sess. (1959); Mickey & Mickum, *Congressional Regulation of State Taxation of Interstate Commerce,* 38 N.C.L. REV. 119, 124-29 (1959).

7. The pertinent sections of Public Law 86-272 are:

§ 101. Imposition of Net Income Tax–Minimum Standards

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such state by any person from interstate commerce if the only business activities within such state by or on behalf of such person during taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such

points should be noted: First, Public Law 86-272 applies only to the sale of tangible personal property and to net income taxes, or taxes measured by net income. Second, Congress has left to the courts the problem of defining "solicitation," "tangible personal property" and "sale."[8]

Public Law 86-272, however, was not intended as a final solution to the problem. "Both Houses [of Congress] . . . viewed this provision as a temporary measure designed to hold the line pending the completion of a thorough study which was considered necessary to achieve a permanent solution."[9] Title II of the act authorized such a study to be made by the Committee on the Judiciary of the House of Representatives[10] for the purpose of recommending legislation to provide uniform standards. A Special Subcommittee on State Taxation of Interstate Commerce was established to conduct the study. It dealt with net income tax, capital stock tax, sales and use tax, and gross receipts tax,[11] but limited its investigations solely to manufacturing

person, if orders by such customer to such person, enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1). 73 Stat. 555 (1959), 15 U.S.C. § 381 (1964).

8. For a comprehensive discussion of the inherent problems resulting from this failure to define terms, see Dane, *Small Business Looks at Public Law 86-272 in the Perspective of its Alternatives*, 46 VA. L. REV. 1190 (1960); Hartman, *supra* note 2, at 23-48; Note, 46 VA. L. REV. 297, 313-22 (1960).

9. Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, *State Taxation of Interstate Commerce*, H.R. REP. No. 1480, 88th Cong., 2d Sess. 8 (1964) [hereinafter cited as *Report*]. "Public Law 86-272 was enacted as a stopgap legislation to forestall what was viewed as a possible expansion of the taxing jurisdiction of the States." *Id.* at 438.

10. A similar study was to be conducted by the Senate Committee on Finance, but this Committee left the study to the House Committee on the Judiciary.

11. The Subcommittee prepared two questionnaires. The first was designed to determine whether the respondent companies were engaged in interstate commerce in a sense meaningful for the purposes of the study, whether they paid taxes in more than one state, and their size in terms of the number of paid employees. See *Report*, appendix C. This questionnaire was mailed to 30,894 corporations selected as a sample of the most comprehensive list obtainable of manufacturing and mercantile companies in the United States.

The second questionnaire was mailed to two samples of companies drawn from the group which had indicated in the first questionnaire that they were engaged in interstate commerce. Respondents were asked, among other things, to furnish the volume of sales made during the 1959 fiscal year into each state in which they sold goods, to provide information about the nature of the business activities which they conducted in each state, and to indicate which of the studied taxes they paid in 1959. See *Report*, appendix D. For a description of the mailing lists, as well as a discussion of other factors which should be considered in deriving generalized conclusions from the information obtained through the business questionnaires, see *Report*, appendix H, at A197-A225.

In addition the Subcommittee undertook an elaborate study of the compliance costs of 100 mercantile and manufacturing corporations. The study was designed to provide detailed information on the variety and extent of compliance costs, reasons for incurring them, and the means of compliance employed by the taxpayers. See *Report* at 35. "The 100 companies participating in the Cost Study were selected from among those

and mercantile businesses. The Subcommittee considered four basic questions: (1) Does the lack of uniformity in the apportionment formulas of the states involve greater compliance costs to the small businesses? (2) To what extent do these businesses actually comply with these taxes? (3) To what extent would a limitation of the apportionment formulas to uniform standards reduce state revenues? (4) What factors should be included in the apportionment formula and how should each factor be defined?

On June 15, 1964, after four years of extensive investigation, compilation and evaluation, the first Subcommittee report was completed.[12] Although its detailed statistical analysis is too comprehensive to set forth at length, the Subcommittee's conclusions should be noted.[13] First, the present system of state taxation of interstate businesses is characterized by diversity and complexity, and often results in substantial inequities. This is due to the inconsistency in state apportionment formulas, the different definitions of specific factors such as payroll, property and sales, and the inharmonious jurisdictional requirements set up by the different states to reach interstate corporations. Second, there is a widespread noncompliance with present state and local tax provisions. Third, the judicial process is unable to resolve these existing problems. Fourth, while Public Law 86-272 has achieved some degree of success as a "stopgap" measure,[14] more comprehensive and permanent congressional action is necessary.

II. PROPOSED LEGISLATION

On June 30, 1965, the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary released its final report. Volume four included a recommendation for the "enact-

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who indicated in their responses to Business Questionnaire I that they paid some form of tax in more than one State." *Ibid.*

A further source of information was through extensive Congressional hearings. *Id.* at 26-30.

12. *Supra* note 9.

13. See Note, 19 Sw. L.J. 170, 175 (1965).

14. The few cases which have construed Public Law 86-272 have held it constitutional. In International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314 (1964), *cert. denied sub nom.*, Mouten v. International Shoe Co., 379 U.S. 902 (1965), the Supreme Court of Louisiana upheld the constitutionality of the statute as a regulation of interstate commerce. A similar conclusion was reached by the Supreme Court of Missouri in Ciba Pharmaceutical Prod. v. State Tax Commission, 382 S.W.2d 645 (Mo. 1964). The Supreme Court of Oregon recently reversed the Oregon Tax Court which had held that Public Law 86-272 constituted an invalid exercise by Congress of its powers under the commerce clause. It upheld the validity of the statute over the contention that the law violated due process, the doctrine of separation of powers, and exceeded the power of Congress to regulate interstate commerce. Smith, Kline & French, Laboratories v. State Tax Commission, CCH STATE TAX CAS. REP. ¶ 250-116 (Ore. April 1964), *rev'd*, 403 P.2d 375 (Ore. 1965). In Ownbey v. Butler, 211 Tenn. 366, 365 S.W.2d 33 (1963), the Supreme Court of Tennessee treated

ment of legislation providing a workable method of State income taxation of multistate business under uniform rules governing division of income, jurisdiction to tax, and the basic definition of taxable income."[15] Three months later, on October 22, 1965, H.R. 11798, The Interstate Taxation Act, was introduced in Congress. It is designed to "regulate and foster commerce among the states by providing a system for the taxation of interstate commerce."[16] The bill contains provisions regulating state net income, sales, use, capital stock, and gross receipts taxes on interstate corporations; however, the discussion here will be confined exclusively to those provisions directly concerning the state net income tax. H.R. 11798 provides that "no State or political subdivision thereof shall have power—(1) to impose a net income tax . . . on a corporation other than an excluded corporation unless the corporation has a business location in the State during the taxable year."[17] The corporate income tax on interstate firms is to be based upon taxable income as defined in the Internal Revenue Code of 1954, as amended; all corporate income is to be apportioned according to a two-factor formula dependent upon the locations of its property and payroll; and jurisdiction to tax will depend upon whether the corporation owns or leases realty in the state or has an employee located in the state. Absent these two prerequisites, a state may still have jurisdiction to impose a net income tax if "the principal place from which a corporation's trade or business is conducted is located" in that state, or if the corporation's "legal domicile" is in that state.[18]

the statute as an apportionment statute and held the taxpayer's entire income taxable in Tennessee because Public Law 86-272 prevented taxation of any part of it by any other state.

15. Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, *State Taxation of Interstate Commerce,* H.R. REP. No. 952, 88th Cong., 2d Sess. 1143 (1965) [hereinafter cited as *Recommendations*]. Voluntary state action to achieve these results has been painfully slow. Some forty years ago the National Tax Association first prepared uniform acts for adoption by the states in an effort to achieve uniformity in the allocation and apportionment of income. In 1957, the National Conference of Commissioners on Uniform State Laws finally adopted the Uniform Division of Income for Tax Purposes Act. See Wilkie, *The Uniform Division of Income for Tax Purposes,* 37 TAXES 65 (1959); Lynn, *The Uniform Division of Income for Tax Purposes Act Re-Examined,* 46 VA. L. REV. 1257 (1960). In 1958, the American Bar Association approved this provision, but at present, only Alaska, Arkansas and Kansas have substantially enacted the model act. Conflicting economic interests, multiplicity of provincial pressures, and the difficulty of arousing interest in technical problems of taxation have contributed to the failure to achieve any marked degree of acceptance of uniformity of tax base or division of income rules. The "conclusion is inescapable that the voluntary adoption by the states of any kind of uniform system is a slow and halting process, if not a virtual impossibility." *Report* 123; see Hellerstein, *Allocation and Nexus in State Taxation of Interstate Businesses,* 20 TAX L. REV. 259, 265 (1965).

16. H.R. 11798, 89th Cong., 2d Sess. (1966). See appendix A *infra.*

17. H.R. 11798, 89th Cong., 2d Sess. § 101 (1966).

18. H.R. 11798, 89th Cong., 2d Sess. § 612(b) (1966). This section provides: (b) BUSINESS LOCATION IN SPECIAL CASES—If a person does not own or lease

Consolidation of the income tax returns of any group of corporations affiliated through fifty per cent common ownership could be required by a state and would have to be permitted if the taxpayers so requested.[19] All administrative functions are to be delegated to the Secretary of the Treasury who shall be authorized "to prescribe such rules, regulations and forms as may be necessary to carry out this Act and for its uniform application . . . ."[20] Interstate apportionment disputes may be submitted to an Apportionment Board, with appeal to the United States Tax Court. The findings of fact of the Apportionment Board, if supported by substantial evidence, are to be conclusive on the Tax Court. The United States Courts of Appeal, however, shall have jurisdiction to review de novo any issues relating to an interstate apportionment dispute, with its decision being subject to review by the Supreme Court of the United States. In regard to local income taxes, the bill merely provides that "The amount of net income . . . of a corporation attributed to a political subdivision for tax purposes shall be determined . . . in the same manner as though the political subdivision were a State . . . ."[21]

The provisions of the Interstate Taxation Act, however, will not apply to income taxes on any of the following types of corporations: transportation companies, utilities, insurance companies, financial institutions, investment companies, and holding companies.[22] Nor are

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real property within any State or have an employee located in any State . . . that person shall be considered to have a business location—

(1) in the State in which the principal place from which its trade or business is conducted is located, or

(2) if the principal place from which its trade or business is conducted is not located in any State, in the State of its legal domicile.

19. H.R. 11798, 89th Cong., 2d Sess. § 205 (1966). Consolidation is prohibited with respect to any income which is exempt from Federal taxation as the result of being derived from sources outside the United States. This section is designed to clarify when the income of a multicorporate enterprise should be treated as a whole. It will supplant the vague and often unevenly administered state "unitary business" rules which are designed to treat the income of affiliated corporations in the same manner as though earned by a single business.

20. H.R. 11798, 89th Cong., 2d Sess. § 511 (1966).

21. H.R. 11798, 89th Cong., 2d Sess. § 207 (1966).

22. H.R. 11798, 89th Cong. 2d Sess. § 607 (1966). The pertinent parts of this section read as follows:

(a) In General.—An "excluded corporation" is any corporation—

(1) which derives more than 50 percent of its ordinary gross income for the taxable year from regularly carrying on any one or more of the following business activities:

(A) the transportation for hire of property or passengers, including the rendering by the transporter of services incidental to such transportation;

(B) the furnishing of telephone service or the sale of electrical energy, gas, or water;

(C) the issuing of insurance or annuity contracts or reinsurance; or

(D) banking, the lending of money, or the extending of credit;

they applicable to personal income taxes or income taxes on unincorporated businesses. With respect to these, the bill provides that a study be conducted by the Secretary of the Treasury, who "within two years after the date of the enactment of this Act, shall report to the Congress his findings and recommendations, including recommendations for appropriate legislation if he finds that such a need does exist."[23]

Hearings on H.R. 11798 are scheduled to be held early in the second session of the eighty-ninth Congress. Since the bill is based exclusively upon the recommendations of the Special Subcommittee,[24] and received an unprecedented unanimous approval by the parent House Judiciary Committee, passage in some form in both the House and the Senate appears probable. While it is not the purpose here to explore the constitutionality of H.R. 11798, there seems to be little doubt that under its commerce powers, Congress has ample authority to regulate state taxation of interstate businesses.[25]

The following pages will take a closer look at this bill, insofar as it regulates state net income taxes on interstate corporations, in an attempt to assess its ultimate effect upon existing state and local tax structures.[26]

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(2) which is a "personal holding company" as defined in section 542 of the Internal Revenue Code of 1954 or a "foreign personal holding company" as defined in section 552 of such Code; or

(3) which receives more than 50 percent of its ordinary gross income for the taxable year in the form of one or more of the following:

(A) dividends;

(B) interest;

(C) royalties from patents, copyrights, trademarks, or other intangible property; or

(D) mineral, oil, or gas royalties.

23. H.R. 11798, 89th Cong., 2d Sess. § 531 (1966).

24. *Recommendation*, 123 *supra* note 15.

25. "It is no longer debatable that Congress, in the exercise of the commerce power, may authorize the states, in specific ways, to regulate interstate commerce or impose burdens upon it." International Shoe Co. v. Washington, 326 U.S. 310, 315 (1945); see Hooven & Allison Co. v. Evatt, 324 U.S. 652, 679 (1945), where Chief Justice Stone, speaking for the Court, said that "Congress, through the commerce clause, possesses the . . . power of control of state taxation of all merchandise moving in interstate . . . commerce." See also Hartman, *supra* note 5, at 120-22. Professor Hartman concludes that "There seems little doubt . . . that under its power over interstate commerce, Congress can fix the bounds of state taxation of that commerce. It can either authorize such taxation by the states as Congress deems appropriate, or it can prohibit facets of state taxation, otherwise valid, when Congress uses its power as the basis for the establishment of national policy over interstate commerce." *Id.* at 122.

26. While the state net income tax is generally considered a primary source of state tax revenue, it is by no means the only source. There are also state sales, use, gross receipts, and capital stock taxes which must be considered. However, it is not the purpose of this paper to go beyond an examination of the state net income tax.

III. A CLOSER LOOK AT H.R. 11798

A. *Definition of Net Income*

Section 601, following generally the definition of net income in the Internal Revenue Code of 1954,[27] defines net income tax as follows:

> A 'net income tax' is a tax which is imposed on or measured by net income, including any tax which is imposed on or measured by an amount arrived at by deducting from gross income expenses one or more forms of which are not specifically and directly related to particular transactions.[28]

At present, only nine states[29] out of the thirty-eight using a net income measure in their corporate levies, take the federal taxable income as the starting point for the computation of the state tax base. In each of six others,[30] a static federal base is used, the federal definition of taxable income in effect on a particular date being incorporated by reference. In the remaining twenty-three states,[31] net income is defined independent of the definitions prescribed by the federal government. Section 601 would erase these discrepancies and provide a uniform definition, thereby virtually eliminating one of the existing complexities of the multistate tax system.[32] Since section 211 requires that the corporation's entire taxable income be defined according to the Internal Revenue Code of 1954, as it may be amended, the present diversities in this area would also disappear.[33]

> A State or political subdivision may impose a net income tax on a corporation, other than an excluded corporation . . . only on condition that the

27. INT. REV. CODE OF 1954, § 63(a).

28. H.R. 11798, 89th Cong., 2d Sess. § 601 (1966).

29. Alaska, Connecticut, Delaware, Massachusetts, New Jersey, New Mexico, New York, Pennsylvania and Rhode Island.

30. Hawaii, Idaho, Indiana, Iowa, Kentucky and Vermont.

31. Alabama, Arizona, Arkansas, California, Colorado, District of Columbia, Georgia, Kansas, Louisiana, Maryalnd, Minnesota, Mississippi, Missouri, Montana, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, Tennessee, Utah, Virginia and Wisconsin.

32. *Report* 99-112.

33. Twenty-one states and the District of Columbia define gross income very broadly to include "income derived from any source whatever." These are Alabama, Arizona, California, Colorado, Georgia, Kansas, Louisiana, Maryland, Minnesota, Missouri, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, South Carolina, Utah, Virginia and Wisconsin. Twelve others rely upon the federal tax provisions for the definition of gross income. These are Alaska, Delaware, Idaho, Iowa, Kentucky, Massachusetts, Montana, New Jersey, New York, Pennsylvania, Tennessee and Vermont. In either case all but ten states provide that certain types of income, such as various types of insurance, annuity and endowment proceeds, property received by gift, demise, or bequest, and interests on obligations of the state or United States government, shall be exempt from inclusion in gross income. These 10 states are: Alaska, Connecticut, Delaware, Idaho, Iowa, Kentucky, Massachusetts, Pennsylvania, Tennessee and Vermont. See Hartman, *supra* note 5, at 51-52.

> statute or other legislative act imposing the tax requires that such a corporation's entire taxable income shall be determined under the provisions of the Internal Revenue Code of 1954, as it may be amended . . . .[34]

In addition, by providing that "A 'net income tax' is a tax which is imposed on or measured by net income . . . ." section 601 finally disposes of the artificial, judicial distinction between *Spector Motor Service, Inc. v. O'Conner*[35] and *Northwestern-Stockham.*

> *Spector* was distinguished by the *Northwestern-Stockham* Court on the purely artificial, ritualistic ground that the *Spector* tax was imposed upon the franchise of a foreign corporation for the privilege of doing business within the state, with the net income used as the measure of the tax, and was not a levy on the net income; whereas the *Northwestern-Stockham* taxes were imposed on the net income.[36]

Thus, after 1959, the constitutionality of the state net income taxes on foreign corporations, when challenged under the commerce clause, depended entirely upon statutory formality. Adoption of H.R. 11798, however, would indicate that Congress has consented to ignore this difference and accept as constitutional either a tax directly "on" net income or a tax "measured by" net income.[37]

B. *Division of Income*

In either case, the income must be divided among the states. Three standard methods for such division have developed: separate accounting specific allocation, and formula apportionment. Under the separate accounting method, an attempt is made to isolate that part of the corporate activity which is carried on wholly within the taxing state and to treat such activity for income tax purposes as a distinct entity.[38] Since corporate activity infrequently lends itself to this

34. H.R. 11798, 89th Cong., 2d Sess. § 211 (1966).

35. 340 U.S. 602 (1951). In *Spector*, Connecticut imposed a franchise tax on a foreign corporation for the privilege of doing business within the state. The tax was computed at a nondiscriminatory rate on that portion of the corporation's net income reasonably attributable to its business activities within the state. The Supreme Court of the United States held that as applied to a foreign corporation which was engaged exclusively in interstate trucking, the tax was invalid under the commerce clause of the federal constitution.

36. Hartman, *supra* note 5, at 36.

37. "This judicial distinction between *Spector* and *Northwestern-Stockham*, by Justice Clark, becomes somewhat amusing when we remember that in a most trenchant and realistic dissent in the *Spector* case he declared that 'there is no reasonable warrant for cloaking a purely verbal standard with constitutional dignity,' and that 'exclusively interstate commerce receives adequate protection when state levies are fairly apportioned and nondiscriminatory.' " *Ibid.*

38. *Report* 160-68. "Separate accounting, while preferred in five States, prohibited in three States and the subject of broad generalized provisions in the remaining States which permit its use where formulary division of income produced a distorted or inequitable result, is in fact only rarely actually used." Hellerstein, *supra* note 15, at 266.

type of treatment, however, it affects only few taxpayers and small amounts of income. Likewise, the effort to achieve a precise measure through specific allocation has had little impact upon the net income of most companies. Specific allocation represents an attempt to single out certain items of income, such as interest, wages and rent, lending themselves to precise geographical locations. "Inevitably, there is disagreement among the states as to the types of income which are so identified with a particular place that their source may be truly located."[39] Therefore, the drafters of H.R. 11798 decided not to allow separate accounting (except in rare and extraordinary circumstances)[40] and specific allocation, but rather adopted the method of dividing income by an apportionment formula.[41] All income is apportioned by a two-factor formula based on property and payroll. Section 201 provides in part that

> the amount of net income . . . attributed to the State or political subdivision shall be determined by multiplying the corporation's base by an apportionment fraction which is the average of the corporation's property factor and the corporation's payroll factor for the State for the taxable year. . . . [T]he base to which the apportionment fraction is to be applied shall be the corporation's entire taxable income for that taxable year.[42]

Under the tax structure now existing in the states, we find that twenty-six states have adopted three-factor formulas consisting of property, payroll and receipts.[43] As to the property factor, intangibles are universally excluded by the states, but there are variations in methods of valuation and rules of attribution.[44] "Notwithstanding

39. *Report* 248. "There are variations as to specific allocation of items such as dividends, royalties, capital gains from sale of intangibles, the deduction of overhead and executives' salaries, but these items do not have a major impact on the net income of most companies." Hellerstein, *supra* note 15, at 266. See *Report* at 197-232.

40. See note 80 *infra*.

41. Section 201 of this bill provides, in part, that "A State or political subdivision thereof may impose a net income tax . . . on a corporation other than an excluded corporation only on condition that the State law imposing the tax provides for the division of such a corporation's income . . . for tax purposes in accordance with this Act." H.R. 11798, 89th Cong., 2d Sess. § 201 (1966).

42. *Ibid.*

43. Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Montana, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Vermont and Virginia. In Hawaii, the formula is applicable to those concerns whose principal business in the State is mercantile. In addition to these 26 states, New Mexico suggests a three-factor property-payroll-sales type formula but does not prescribe it.

44. The variations and ambiguities in property factors seem to occur primarily with questions other than location. There are at least six different standards for valuing property owned by the taxpayer as well as a variety of standards for valuing leased property. Also, variations occur as to the inclusion of property rented from another, property which produces specifically allocable income, property in interstate transit, and property under construction. See *Report* 247.

these variations, the property factor appears to be the least complicated of the three prevalent factors."[45] In the case of the payroll factor, again we see diversities. Three basic standards of attribution are used either separately or conjunctively in combination: "place of service, place of business within which the employee is connected, and residence of the employee."[46]

> Here, too, the difference among the states do not appear to be grounded in considerations more important than the tastes and judgment of the draftsmen of existing laws. These areas of difference are not, it is believed, likely to produce an acrimonious struggle as to which methods ought to be adopted in prescribing uniformity of division of income.[47]

The sales factor in apportionment formulas, however, has been the center of continual controversy, primarily because there is no fixed answer to the question of how to locate a sale.

> Whenever one person sells goods to another, a number of events occur at one or more places: The seller uses an office or home base, the seller and buyer negotiate, a contract of sale is concluded, the goods leave the seller, and they reach the buyer. Each of these events has been seized upon to establish the location of sales.[48]

At the present time, a majority of the states have included a destination sales factor in their apportionment formulas.[49]

C. *Property and Payroll Factors*

H.R. 11798 attempts to solve this complexity by eliminating the sales factor completely and confining the uniform apportionment

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45. *Ibid.* "Of the three standard factors, the property factor shows the least diversity among the thirty-two States which use it. . . . The property factor appears to he the least complicated of the three prevalent factors. Indeed, the rules for the attribntion of property are more uniform than any other step in the apportionment process." *Ibid.*

46. *Ibid.*

47. Hellerstein, *supra* note 15, at 267.

48. *Report* 247-48. Another point of controversy has been over the need for any sales factor in determining state net income taxes on multistate business.

49. *Recommendations* 1146. The major controversy in this area is between those advocating that the sale be attribnted to the state of origin and those espousing the view that it should be attributed to the state of destination. In recent years, the trend has been toward the use of the "state of destination" and "state of solicitation" definitions of the taxable situs of a sale. See Studenski & Glasser, *New Threat in State Business Taxation,* 36 Harv. Bus. Rev., Nov.-Dec. 1958, pp. 77, 86-87. For a comprehensive discussion of the sales factor and a delineation of both sides of the argument, see Hartman, *supra* note 5, at 71-81.

formula to property[50] and payroll[51] factors. Both conform generally to the present rules. Property is to be composed of all real and tangible personal property which is leased to or owned by the corporation, except for property included in inventory, property permanently retired from use, and tangible property rented out for more than one year. Moving property, such as motor vehicles, rolling stock, vessels, and the like, shall be considered located in the state if its operation is "localized"[52] in the state, or if its principal

50. The relevant portion of H.R. 11798 provides:

§ 202. PROPERTY FACTOR.

(a) IN GENERAL.—A corporation's property factor for any State is a fraction, the numerator of which is the average value of the corporation's property located in that State and the denominator of which is the average value of all of the corporation's property located in any State.

(b) PROPERTY INCLUDED.—The corporation's property factor shall include all the real and tangible personal property which is owned by or leased to the corporation during the taxable year, except—

(1) property which is included in inventory,

(2) property which has been permanently retired from use, and

(3) tangible personal property rented out by the corporation to another person for a term of one year or more.

51. The relevant portion of H.R. 11798 provides:

§ 203. PAYROLL FACTOR.

(a) IN GENERAL.—A corporation's payroll factor for any State is a fraction, the numerator of which is the amount of wages paid by the corporation to employees located in that State and the denominator of which is the total amount of wages paid by the corporation to all employees located in any State.

(b) PAYROLL INCLUDED.—The corporation's payroll factor shall include all wages paid by the corporation during the taxable year to its employees, except that there shall be excluded from the factor any amount of wages in excess of $40,000 paid to any one employee during the taxable year, and any amount of wages paid to a retired employee.

(c) EMPLOYEES NOT LOCATED IN ANY STATE.—If an employee is not located in any State, the wages paid to that employee shall not be included in either the numerator or the denominator of the corporation's payroll factor for any State or political subdivision.

(d) DEFINITION OF WAGES.—The term "wages" means wages as defined for purposes of Federal Income tax withholding in section 3401(a) of the Internal Revenue Code of 1954, but without regard to paragarph (2) thereof.

52. "The operation of property shall be considered to be localized in a State if during the taxable year it is operated entirely within that State, or it is operated both within and without that State but the operation without the State is—(A) occasional, or (B) incidental to its use in the transportation of property or passengers from points within the State to other points within the State, or (C) incidental to its use in the production, construction, or maintenance of other property located within that state." H.R. 11798, 89th Cong., 2d Sess. § 613(d)(1) (1966).

53. "The term 'base of operations' . . . means the premises at which any such property is regularly maintained by the corporation when—(A) in the case of rented-out property, it is not in possession of the lessee, or (B) in the case of moving property which is not rented out, it is not in operation, regardless of whether such premises are maintained by the corporation or by some other person; except that if the premises are maintained by an employee of the corporation primarily as a dwelling place they shall not be considered to constitute a base of operations." H.R. 11798, 89th Cong., 2d Sess. § 613 (d)(2) (1966).

"base of operations"[53] is in the state. Payroll is to include all wages paid by the corporation to its employees during the taxable year, except wages in excess of 40,000 dollars paid to any one employee and wages paid to a retired employee. The bill uses essentially the same definition of payroll as that used to prescribe what constitutes "wages" for federal income tax withholding purposes.[54]

The Subcommittee argues that such a two-factor formula would (a) alleviate much of the present compliance cost burden on interstate firms,[55] resulting from the use of sales factors, and, at the same time, (b) result in only a modest drop in state tax revenue.[56]

D. *Revenue Effects*

As to the first contention, it should be noted that, at best, it is highly speculative. The results of a field study of 100 corporations, conducted by the Subcommittee on State Taxation of Interstate Commerce,[57] reveal that compliance costs are far lower than supposed.[58] The explanation offered is that there is a wide-spread noncompliance with the state laws.

> Although it cannot be said that interstate business is today incurring burdensome compliance costs, the reasons for the absence of these costs raise serious issues in themselves. What has happened is that the complexity of the multistate tax system, instead of producing large amounts of compliance

54. This definition would require figures which are definite in amount and readily available to the taxpayer. *Recommendations* 1153. See INT. REV. CODE OF 1954, § 3401(a).

55. "Wholly apart from the costs of factor computation, the choice of sales factor has great relevance for the compliance problem. Most companies engaged in interstate commerce make sales into many more States than the number in which they have places of business, and probably into many more States than the number in which they have payroll even under the place-of-service standard. . . . While it may be assumed that no market-oriented sales factor would be adopted without some jurisdictional limitations on its applicability, the adoption of a market-oriented standard clearly implies a much broader spread of tax liability than the adoption of an origin-oriented standard. The cost of such a standard is thus not only the cost of computing the factor, but includes all the costs of the additional tax returns which would necessarily be associated with it." *Report* 528-29.

56. In terms of revenue impact, the detailed analysis undertaken by the Subcommittee indicates that the importance of choice among the apportionment formulas is much smaller than has traditionally been thought. See *id.* at 529-55.

57. *Supra* note 11.

58. The median range of total costs for handling state income taxes for smaller companies, those grossing from $50,000 to $200,000, was estimated to be only $93. For companies grossing $200,000 to $500,000, the median cost was $50; at $500,000 to $1 million, the median was $207; at $1 million the median was $1347, and over $50 million the median cost was $10,277. Hellerstein, *supra* note 15, at 264. See *Report* 346 (table 11-2). Hellerstein points out, however, that "the study as to compliance costs suffers from the small size of the sampling used . . . . A sharp variation by 10 to 15 of the selected companies from the general experience could seriously distort the results." Hellerstein, *supra* note 15, at 264, n.20.

costs, has resulted in non-compliance and in the inequities which come with a tax system in which formal requirements have been abandoned.[59]

In light of this conclusion, one might seriously question whether the two-factor formula will, in fact, further substantially reduce the burden of compliance costs.

Also open to serious question is the second argument, that is, that there will be little revenue difference. The first report of the Subcommittee[60] concluded that while heavily industrialized states would gain additional revenues from such a two-factor formula, and those states least industrialized would lose revenues from the elimination of the receipts factor, nevertheless, these alterations would be insignificant.[61] Indeed, except for Idaho, whose tax revenue would decline by more than one per cent, the reduction would amount to less than one-half of one per cent of the states' tax revenues.[62] Apparently, the drafters of H.R. 11798 relied upon this information. These percentages, however, are somewhat misleading since they are percentages of the state's *total tax revenues* rather than of the corporate income tax revenues which would be lost.[63] By changing our perspective and assessing the impact of a two-factor formula on the income tax revenue collected by states from manufacturing and merchantile companies, as compared with the three-factor destination formula, it has been pointed out that a marked reduction does in fact occur in certain states.[64]

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59. *Report* 384. The report further assumes that "it would seem that simplification in the multistate tax system, through reduction of its multiplicity, variety, and mutability, is a necessary preliminary to achieving a reasonable level of compliance with tolerable cost levels." *Ibid.* Unfortunately, nowhere does the report present concrete facts in support of this assumption.

60. *Supra* note 9.

61. *Report* 542 (table 16-1).

62. *Id.* at 545.

63. See Hellerstein, *supra* note 15, at 268. "Thus viewed in terms of its impact on the taxable income of manufacturing and mercantile companies, the question of choice of formula can in some cases have quite substantial effects." *Report* at 539.

64. "North Dakota would suffer a reduction in its corporate income tax revenues from such companies of 47 per cent, Idaho, the District of Columbia and New Mexico over 20 per cent, and six other States, including such widely scattered jurisdictions as Mississippi, Colorado and Alaska, would have their receipts from this source out of 10 to 19 per cent. The great majority, however, 28 States, would lose somewhat less than 10 per cent of these tax revenues, with 16 of these losing under 5 per cent." Hellerstein, *supra* note 15, at 268-69. "In terms of estimated dollar losses, Colorado, Oregon and Georgia would each suffer about $1 million a year of reduction in taxes from manufacturing and mercantile companies, Mississippi and Montana would lose about half a million dollars each, Minnesota about $1.7 million and New York $13 million. And the gainers would be the heavy industrial States—Indiana and Massachusetts would each pick up about $1.5 million, New Jersey $2.5 million, and Pennsylvania about $7¼ million in taxes." *Ibid.*; see *Report* 544 (table 16-2); *Report*, appendix P, at A483, A489, A493-94, A496-97, A502-03.

> To judge the revenue impact of varying apportionment methods under State corporate income taxes as applied to interstate manufacturers and merchants by the effects on total collections by the State from all its taxes is to distort and water the results.[65]

Unfortunately, it appears that the practical considerations of convenience, simplicity and uniformity rode roughshod over the most important consideration of all in determining any new tax policy, *i.e.*, its ultimate effect upon the state tax revenues. As stated in the final report,

> there are neither present nor prospective revenue considerations to deter Congress from prescribing the formula which is most practical and which satisfies basic notions of fairness. Since the property-payroll formula is the most desirable in terms of both efficiency and equity it commends itself in the choice of the uniform formula.[66]

E. *Jurisdiction To Tax*

H.R. 11798 provides that a state shall have jurisdiction to tax only those corporations owning or leasing real property physically present within the state, or having one or more employees located in the state.[67] An employee shall be considered located in the state if his service is performed entirely within the state, or his service is performed within and without the state but the latter is incidental to the former, or some of his services are performed in the state and his "base of operations"[68] is in that State.[69] Under this rule, it appears that a state has no power to tax corporate net income, even though it is attributable to that state, if such income is derived solely from solicited orders without, for delivery within, a state in which said corporation neither owns nor leases any real property. Thus suppose

65. Hellerstein, *supra* note 15, at 269. "To give meaningful perspective to revenue significance, the impact of alternative methods of apportioning the income of interstate manufacturers and merchants under State corporate income taxes ought to be judged by the effects on collections from the same taxpayers under the tax under consideration." *Id.* at 270.

66. *Recommendations* 1151.

67. Section 101 provides that "No State or political subdivision thereof shall have power—(1) to impose a net income tax . . . on a corporation other than an excluded corporation unless the corporation has a business location in the State during the taxable year. . . ." Section 612 provides that "A person shall be considered to have a business location within a State only if that person—(1) owns or leases real property within the State, or (2) has one or more employees located in the State." H.R. 11798, 89th Cong., 2d Sess. §§ 101, 612 (1966).

68. "(c) EMPLOYEE'S BASE OF OPERATIONS.—The term 'base of operations,' with respect to an employee, means a single place of business with a permanent location which is maintained by the employer and from which the employee regularly commences his activities and to which he regularly returns in order to perform the functions necessary to the exercise of his trade or profession." H.R. 11798, 89th Cong., 2d Sess. § 614(c) (1966).

69. H.R. 11798, 89th Cong., 2d Sess. § 614 (1966).

an employee's base of operations is in Tennessee, but he performs services only in Georgia and Alabama. Clearly, Tennessee could levy an apportioned net income tax upon the corporation because the company would necessarily own or lease real property within that state. But, under this bill neither Georgia nor Alabama could reach the company for net income tax purposes. The corporation neither owns nor leases real property within either state; the employees' services (comprised exclusively of solicitation of orders) are not entirely within either state; the services performed in Alabama are certainly not incidental to those performed in Georgia and vice versa; and the employees' base of operations is in neither of the two states. This clearly indicates a congressional intent to limit the scope of the decision in *Northwestern-Stockham*.[70] No longer will a corporation be permitted to maintain a sales office within a state solely for the purpose of soliciting orders to be filled out of state and escape the apportioned net income tax. If the court interprets the sales office as the company's base of operations, then the state can reach the corporation because it owns or leases real property located in said state.

Problem areas will still remain, however. First, the failure of Congress to define "incidental" could result in problems of interpretation. Second, what is to prevent an employee from moving into a hotel room for several months in order to solicit orders within a state without subjecting his employer to a state apportioned net income tax? If he does this in Alabama, Arkansas and Georgia during one year, the base of operations still being in Tennessee, there appears to be no way under H.R. 11798 that these three states can reach the employer's net income derived from such sales.[71] And third, Congress has failed to provide a means by which a state can reach a foreign mail-order company which derives most of its net income from that state through telephone calls, television advertising and solicitation by mail. Also, there is the distinct possibility that H.R. 11798 will encourage corporations to establish their "base of operations" in one of the few states which do not presently impose a corporate net

70. See notes 1 and 2 *supra* and accompanying text.

71. The corporation neither owns nor leases property in any of the three states; the employee's services cannot be said to be entirely within any one of the states; the services performed in any one of the states is not incidental to the services performed in one of the others; and the employee's base of operations is in none of the three states, but in Tennessee. Only if the Court interprets the word "entirely" to mean services performed entirely within the state during the period that he was in the state—could Alabama, Arkansas and Georgia possibly reach the employer with a net income tax. This interpretation, however, seems very unlikely. To say that the word "entirely" pertains only to a certain period of time during which the employee was within the state would be counter to its "plain meaning" and the intent of the drafters.

income tax on multistate businesses, and then send their employees into neighboring taxing states for short periods of time to solicit orders. This practice would enable the corporations to escape all state corporate net income taxes since there is no state imposing such a tax in which the businesses have either real property or employees located.

Even so, the jurisdictional standard set up by this bill has much to commend it. It compliments the uniform apportionment formula by recognizing the power of a state to tax any income attributable to it, and denying the claims of any other state.[72]

> The exclusion of jurisdiction in cases in which a company has no payroll or real property in a State is designed to provide a jurisdictional rule which is clear, easy to apply, and which eliminates the necessity of a large number of returns showing very small liabilities. It is also designed to reduce the possibility of income being attributed to States in which the corporation has no place of business—a circumstance in which the filing of returns is rare under the present system and in which income tax laws do not appear capable of systematic enforcement by the states on an equitable basis.[73]

F. *The Tax Base*

Section 211 of this bill provides that federal taxable income be used as the starting point for the computation of state tax bases. Each state might require its own adjustment in the computation of taxable income, but none would be permitted which favor local taxpayers or which involve depreciation, amortization, or the time for reporting items of income or expense.[74]

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72. Under H.R. 11798, the jurisdictional assertions of the States will harmonize with and implement the basic policy expressed in the uniform apportionment formula rather than operate inconsistently with the attribution of income, as is often the case in the present system.

73. *Recommendations* 1156.

74. H.R. 11798 provides as follows:

> § 212. PHOHIBITED ADJUSTMENTS.
>
> Any adjustments to Federal taxable income required by the State law described in section 211 shall be void and of no force or effect, with respeet to a corporation to which this title applies, if—
>
> (1) it would change—
>
> (A) the year in which any item which is taxable under both State and Federal law shall be included in gross income,
>
> (B) the year in which any item which is deductible under both State and Federal law shall be deducted (except that this paragraph shall not apply to deductions for earryovers and carrybacks),
>
> (C) the amount of any deduction for depreciation or amortization with respect to any property whieh is subject to depreciation or amortization under both state and Federal law; or
>
> (D) the adjusted basis for purposes of determining gain or loss of any property which is subject to depreciation or amortization under both State and Federal law; or
>
> (2) it would include the entire taxable income of a corporation not incor-

Presently, three major causes appear to underlie the existing diversity in the computation of taxable income. Some can be explained only historically;[75] some reflect constitutional difficulties believed to be barriers to conformity;[76] and some are deliberate policy decisions to use a different base.[77] Under this disparate system, taxpayers are generally unwilling to incur the substantial expense necessary to account for state variations from federal rules, and thus they frequently compute their state taxes according to the more familiar federal rules, irrespective of the requirements of state law. At the same time state tax administrators apparently sympathize with the multistate taxpayers and are often reluctant to require them to respect differences between state and federal law.

> By requiring the Federal base to be used as a point of departure for computation of State bases, Congress will eliminate the present situation in which Federal-State differences are sometimes ignored and sometimes respected by taxpayers; are sometimes disregarded and sometimes enforced by administrators. Because this situation is a breeding ground for tax inequities and because it fosters disrespect for laws in general, its elimination is sorely needed.[78]

While it does seem that uniformity in this area should result in a more efficient and more equitable administration of income tax programs, it is questionable how much of this noncompliance is attributable to present day high compliance costs, and how much is attributable to the fact that the corporations simply refuse to pay

porated in any State any income which under the Internal Revenue Code of 1954 is not taxable by the United States as a result of being considered to be from sources without the United States or as a result of being otherwise connected or associated with or attributed to activities or occurrences without the United States. H.R. 11798, 89th Cong., 2d Sess. § 212 (1966).

75. "Among those States which do not use either a moving Federal base or a static Federal base derived from Federal law in effect as of a relatively recent date, the conclusion is inescapable that many of the departures from the Federal definition do not represent deliberate decisions to treat particular income or deduction items differently. . . . Thus, as the Federal law has changed over the years and as the States have changed their own laws, many differences between them have been permitted to arise simply because of a lack of interest in similarity." *Report* 570.

76. Some states have constitutional doubts relating to the power of the state legislature to adopt amendments to the federal tax law prospectively. "The extent to which such doubts have inhibited the use of conformity in income tax laws is speculative, but they probably provide at least a partial explanation of the use of a static Federal base rather than a moving base by six of the income tax States." *Ibid.*

77. Certain departures from the federal base represent considered decisions to adopt tax policies at variance with those of the federal government. Some of these reflect the application at the state level of the rationale of federal law. Others are designed to give favored treatment to locally established taxpayers. "Many of the policy departures . . . however . . . represent simply the different answers given by different legislative bodies to the same questions of income tax policy." *Id.* at 572.

78. *Recommendations* 1159.

a tax if there is no corporate property or no employees in the state. In the latter case, is it not just as easy for the multistate business to allege that it is not subject to the state net income tax? Certainly the risk of being caught is extremely small.

G. *Administration*

While the administration of state income taxes under H.R. 11798 would remain substantially in the hands of the states themselves, the Secretary of the Treasury, through the Internal Revenue Service, would be authorized to "prescribe such rules, regulations, and forms as may be necessary to carry out this Act and for its uniform application . . . ."[79] Furthermore, in "rare and extraordinary circumstances" where strict adherence to the apportionment formula would produce inequitable results, the Secretary could modify the prescribed formula upon application by a corporation or state and upon notice and opportunity for hearing. This power to permit or require limited modification of the apportioument formula includes: (1) modifications in items or amounts includable in the payroll or property factors; (2) changes in the weight given to the two factors; and (3) use by the corporation of the method of separate accounting.[80] However, the burden of establishing the need for alternative methods would be upon the corporation or state requesting the change.[81] Under the present system of taxation, the states generally empower their tax administrators to modify the rules for the division of net income in cases where the normal rules produce an inequitable result.[82]

With regard to procedure, the bill sets up an Apportionment Board within the Treasury Department. All multistate tax disputes in which the interested states refuse to be bound by the findings of a single state are to be removed to this Board for determination, with

79. H.R. 11798, 89th Cong., 2d Sess. § 511 (1966).

80. The bill provides as follows:

§ 521. ADMINISTRATIVE MODIFICATION.

(a) GENERAL RULE.—In rare and extraordinary circumstances the Secretary may, upon application by a corporation or a State and npon notice and opportunity for hearing to the corporation and all interested States, permit or require one or more of the following modifications in the method for the division of the corporation's net income . . . .

(1) modification of the items includible, or the values of the items includible, in the corporation's property or payroll factor;

(2) modification of the weight assigned to the corporation's property and payroll factors; or

(3) use by the corporation of a method of separate accounting.

81. The Bill further provides as follows: "(b) BURDEN OF ESTABLISHING NEED FOR MODIFICATION.—The need for a modification must be established by the corporation or State alleging the need to the satisfaction of the Secretary through clear and convincing evidence." H.R. 11798, 89th Cong., 2d Sess. § 521(b) (1966).

82. *Recommendations* 1162.

an appeal to the United States Tax Court.[83] The findings of fact of the Apportionment Board, however, if supported by substantial evidence, are to be conclusive on the Tax Court. The United States Courts of Appeal shall have jurisdiction to review de novo any issues relating to an interstate apportionment dispute, and its decision will be subject to review by the Supreme Court of the United States.[84]

Admittedly H.R. 11798 vests far more administrative control over state taxation of interstate businesses in the federal government than has heretofore existed. But, it seems apparent that such a policy is essential if the bill is to meet with success. While the "preservation of states' rights" argument is a strong one and will undoubtedly fall on many sympathetic ears, it seems that the need for uniformity is the paramount consideration. Without ultimate administrative control resting in one body, The Interstate Taxation Act, as a practical matter, will differ little, if at all, from the present complex system. There will be no way to guarantee conformity with the provisions of the bill, and any enforcement will be purely theoretical. That such control should rest with the federal government appears sound in light of (1) the present functions of the Treasury Department and the United States Tax Court, (2) the specialized tax knowledge or expertise of the personalities involved, and (3) the advantages of past experience in the field of taxation. Furthermore, it seems to be a logical conclusion since many of the disputes involved will be between two or more states, a situation generally indicative of a need for federal intervention.

IV. Conclusion and Comment

While the foregoing analysis of H.R. 11798 may help to provide a better understanding of the bill, it brings us no closer to a clear

83. H.R. 11798, 89th Cong., 2d Sess. § 522(c) (1966). Section 522(e) provides as follows: "(e) Review by Tax Court.—Within 30 days after the decision of the Apportionment Board, any party may petition the Tax Court of the United States for review of the decision. . . . The findings of fact by the Apportionment Board, if supported by snbstantial evidence, shall be conclusive."

84. Section 522(f) reads:

> (f) Judicial Review.—Notwithstanding section 1251(a) of title 28, United States Code, the United States Court of Appeals for the District of Columbia shall have jurisdiction to review de novo any issues relating to an interstate apportionment dispute. Within 30 days of the decision of the Tax Court, any party to the determination may petition the Court of Appeals for a review de novo of any such issues. The Court of Appeals may issue all necessary orders and process to bring before it the claims of all States to a share of the corporation's net income for the taxable year or years in issue, whether or not such States have previously been parties. The findings of fact by the Apportionment Board shall be considered with other evidence of the facts. The judgment of the Court of Appeals shall be subject to review by the Supreme Court of the United States as provided in section 1254 of title 28, United States Code. H.R. 11798, 89th Cong., 2d Sess. § 522(f) (1966).

assessment of the ultimate impact upon the state and local net income taxes on interstate corporations. In fact, the only concrete conclusion that can be drawn is that the provision finally provides a uniformity as to the definition of jurisdiction, income, and factors in the apportionment formula, as well as a uniformity as to attribution of income, which heretofore has been conspicuous in its absence.

Those willing to accept the major premise of the Subcommittee, *i.e.*, that both unreasonable compliance cost and noncompliance are attributable to existing diversities in the present state and local tax system, would insist that such uniformity is mandatory. This necessarily follows from the assumption that

> simplification in the multistate tax system through reduction of its multiplicity, variety, and mutability, is a necessary preliminary to achieving a reasonable level of compliance within tolerable cost levels.[85]

But this may be open to some speculation. In the first place, the major argument in support of this position appears to be a complete non sequitur. To contend that interstate business today is not incurring burdensome compliance costs due to almost universal noncompliance,[86] but that such would not be the case were they to comply,[87] is questionable. Without the former, any determination of the latter depends upon pure conjecture. In the second place, the Subcommittee has failed to present sufficient facts in its report showing that noncompliance is due to the existing complexities in the multistate tax system. While the assumption is appealing, is it not as valid to assume that interstate corporations will not take the time to comply even under a uniform system? As long as the states are willing to turn their backs on noncompliance, there appears to be no impetus encouraging compliance.

Even if there is not unanimity as to the proposition that uniformity is mandatory, few would argue that it is not desirable.

> Because of the divergencies in the tax structures of the various states, there continue to exist a number of inequities in the nature of multiple taxation by the states. . . . Uniformity is thus an obviously desirable objective in order to provide equality of tax treatment at the state level.[88]

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85. *Report* 384.
86. *Supra* notes 56-58 and accompanying text.
87. "Present costs are high enough, however, to warn against an effort to meet problems of unfairness through rigorous enforcement of those requirements of law which are presently disregarded." *Report* 384.
88. Hartman, *State Taxation of Corporate Income From a Multistate Business*, 13 VAND. L. REV. 21, 75 (1959). Professor Hartman then stated, "To summarize, these inequities stem primarily from three sources: (1) the varying rules for allocation of nonbusiness income; (2) the divergent factors included in the statutory apportionment formulas; and (3) the differing definitions of superficially identical factors in the apportionment formulas." *Ibid.*

From this point of view, H.R. 11798 should prove to be extremely helpful. But whether the benefits of uniformity will outweigh the reduction in corporate net income tax revenue[89] remains to be seen. The Subcommittee on State Taxation of Interstate Commerce was primarily concerned with the adoption of a formula which met the tests of workability and basic fairness; and therefore, the subcommittee minimized the disturbances to state tax revenue.[90] It is likely, however, that with the continued growth of multistate corporations, both in number and in size, and the corresponding increase in state net income tax revenues derived therefrom, such an oversight may prove detrimental in the future. The complete elimination of the sales factor from the apportionment formula, to assure workability and simplicity, may eventually result in a substantial revenue reduction.[91] Should this occur, it is highly doubtful that the benefits of uniformity will be accepted as an adequate justification.

APPENDIX

INTERSTATE TAXATION ACT—H.R. 11798

TITLE 1–JURISDICTION TO TAX

SEC. 101. UNIFORM JURISDICTIONAL STANDARD.

No State or political subdivision thereof shall have power—

(1) to impose a net income tax or capital stock tax on a corporation other than an excluded corporation unless the corporation has a business location in the State during the taxable year;

(2) to require a seller to collect a sales or use tax with respect to a sale of tangible personal property unless the seller has a business location in the State or regularly makes household deliveries in the State, although the seller may be required by this Act to collect a sales tax imposed by a State which is a member of the cooperatively administered system for interstate sales tax collection; or

(3) to impose a gross receipts tax with respect to a sale of tangible personal property unless the seller has a business location in the State.

A State or political subdivision shall have power to impose a corporate net income tax or capital stock tax or a gross receipts tax or require seller collection of a sales or use tax if it is not denied power to do so under the preceding sentence.

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89. *Supra* notes 59-64 and accompanying text.

90. "The Committee has generally not viewed the problem of attributing income as primarily one of determining the single formula which is 'correct' in the sense of being derived from some basic principles concerning the source of income. Rather, it has been concerned with the adoption of a formula which meets tests of workability and basic fairness, while minimizing the disturbance to State tax revenue." *Recommendations* at 1149.

91. See notes 62-64 *supra* and accompanying text.

TITLE II–CORPORATE NET INCOME TAXES AND CAPITAL STOCK TAXES

Part A–Division of Income or Capital for Tax Purposes

SEC. 201. TWO-FACTOR FORMULA.

A State or a political subdivision thereof may impose a net income tax (or capital stock tax) on a corporation other than an excluded corporation only on condition that the State law imposing the tax provides for the division of such a corporation's income (or capital) for tax purposes in accordance with this Act. The statute or other legislative act imposing the tax shall require that the amount of net income (or capital) attributed to the State or political subdivision shall be determined by multiplying the corporation's base by an apportionment fraction which is the average of the corporation's property factor and the corporation's payroll factor for the State for the taxable year. It shall require that the base to which the apportionment fraction is applied shall be the corporation's entire taxable income for that taxable year (or its entire capital as determined under State law for the valuation date at or after the close of that taxable year).

SEC. 202. PROPERTY FACTOR.

(a) In General.–A corporation's property factor for any State is a fraction, the numerator of which is the average value of the corporation's property located in that State and the denominator of which is the average value of all the corporation's property located in any State.

(b) Property Included.–The corporation's property factor shall include all the real and tangible personal property which is owned by or leased to the corporation during the taxable year, except–

(1) property which is included in inventory,

(2) property which has been permanently retired from use, and

(3) tangible personal property rented out by the corporation to another person for a term of one year or more.

(c) Exclusion of Personalty From Denominator.–The denominator of the the corporation's property factor for all States and political subdivisions shall not include the value of any property located in a State in which the corporation has no business location.

(d) Standards for Valuing Property in Property Factor.–

(1) Owned Property.–Property owned by the corporation shall be valued at its original cost as determined under regulations prescribed by the Secretary.

(2) Leased Property.–

(A) Tangible Personalty.–Tangible personal property leased to the corporation shall be valued at its fair market value at the time the corporation first acquired it under the lease.

(B) Realty.–Real property leased to the corporation shall be valued at eight times the gross rents payable by the corporation during the taxable year without any deduction for amounts received by the corporation from subrentals.

(e) Averaging of Property Values.–The average value of the corporation's property shall be determined by averaging values at the beginning and ending of the taxable year; except that the Secretary may require the averaging of values on a semi-annual, quarterly, or monthly basis if reasonably required to reflect properly the location of the corporation's property during the taxable year.

SEC. 203. PAYROLL FACTOR.

(a) IN GENERAL.—A corporation's payroll factor for any State is a fraction, the numerator of which is the amount of wages paid by the corporation to employees located in that State and the denominator of which is the total amount of wages paid by the corporation to all employees located in any State.

(b) PAYROLL INCLUDED.—The corporation's payroll factor shall include all wages paid by the corporation during the taxable year to its employees, except that there shall be excluded from the factor any amount of wages in excess of $40,000 paid to any one employee during the taxable year, and any amount of wages paid to a retired employee.

(c) EMPLOYEES NOT LOCATED IN ANY STATE.—If an employee is not located in any State, the wages paid to that employee shall not be included in either the numerator or the denominator of the corporation's payroll for any State or political subdivision.

(d) DEFINITION OF WAGES.—The term "wages" means wages as defined for purposes of Federal income tax withholding in section 3401(a) of the Internal Revenue Code of 1954, but without regard to paragraph (2) thereof.

SEC. 204. ZERO DENOMINATORS.

If the denominator of either the property factor or the payroll factor is zero, then the other factor shall be used as the apportionment fraction for each State and political subdivision. If the denominators of both the property factor and the payroll factor are zero, then the apportionment fraction for the State where the corporation has its business location shall be 100 percent.

SEC. 205. DIVISION OF INCOME OF MULTICORPORATE ENTERPRISES.

(a) IN GENERAL.—In any case where a corporation, other than an excluded corporation, having a business location in any State in any taxable year is affiliated with one or more other corporations—

(1) that State or any political subdivision thereof may require the corporation to determine the amount of its net income attributed to that State for that taxable year by consolidation with any one or more of the corporations, other than excluded corporations, with which it is affiliated; and

(2) the corporation shall have the privilege of determining the amount of its net income attributed to that State for that taxable year by consolidation with any one or more of the corporations, other than excluded corporations, with which it is affiliated.

(b) METHOD OF CONSOLIDATION.—In the case of any determination by consolidation under subsection (a), the amount of the corporation's net income attributed to the State shall be determined as follows:

(1) the income of the affiliated corporations involved shall be fully consolidated, with intercorporate transactions eliminated, on a single taxable year basis notwithstanding section 212, and the consolidated entire taxable income of such corporations shall be determined under the law of that State referred to in section 211;

(2) a consolidated apportionment fraction shall be determined for the taxable year, including in its property and payroll factors the property and payroll (to the extent they would be includable in the factors of the corporations involved in the absence of the consolidation, but adjusted so

as to avoid any duplication resulting from intercorporate transactions) of all such corporations; and

(3) the amount determined under paragraph (1) shall be multiplied by the fraction determined under paragraph (2).

In any such case, only corporations having a business location in the State shall be liable for the tax.

(c) AFFILIATED CORPORATIONS.—For purposes of subsection (a), two or more corporations are "affiliated" if they are members of the same group comprised of one or more corporate members connected through stock ownership with a common owner, which may be either corporate or noncorporate, in the following manner:

(1) more than 50 percent of the voting stock of each member other than the common owner is owned directly by one or more of the other members; and

(2) more than 50 percent of the voting stock of at least one of the members other than the common owner is owned directly by the common owner.

The fact that a corporation is an "excluded corporation" shall not be taken into account in determining whether two or more other corporations are "affiliated."

SEC. 206. CAPITAL ACCOUNT TAXES ON DOMESTIC CORPORATIONS.

The State in which a corporation is incorporated may impose a capital account tax on that corporation without division of capital, notwithstanding the jurisdictional standard and requirement of apportionment otherwise imposed by this Act.

SEC. 207. LOCAL TAXES

The amount of net income (or capital) of a corporation attributed to a political subdivision for tax purposes shall be determined under this part in the same manner as though the political subdivision were a State; except that the denominators of the corporation's property factor and payroll factor shall be the denominators applicable to all States and political subdivisions. For this purpose, the numerators of the corporation's property factor and payroll factor shall be determined by treating every reference to location in a State, except the references in sections 202(c) and 203(c), as a reference to location in the political subdivision.

Part B—Determination of Entire Taxable Income

SEC. 211. FEDERAL STARTING POINT.

A State or political subdivision may impose a net income tax on a corporation, other than an excluded corporation or a corporation which has no business location outside the State, only on condition that the statute or other legislative act imposing the tax requires that such a corporation's entire taxable income shall be determined under the provisions of the Internal Revenue Code of 1954 as it may be amended on, before, cr after the enactment of such act, with such particularized adjustments to Federal taxable income as the act may provide.

SEC. 212. PROHIBITED ADJUSTMENTS.

Any adjustment to Federal taxable income required by the State law described in section 211 shall be void and of no force or effect, with respect to a corporation to which this title applies, if—

(1) it would change—

(A) the year in which any item which is taxable under both State and Federal law shall be included in gross income,

(B) the year in which any item which is deductible under both State and Federal law shall be deducted (except that this paragraph shall not apply to deductions for carryovers and carrybacks),

(C) the amount of any deduction for depreciation or amortization with respect to any property which is subject to depreciation or amortization under both State and Federal law, or

(D) the adjusted basis for purposes of determining gain or loss of any property which is subject to depreciation or amortization under both State and Federal law; or

(2) It would include in the entire taxable income of a corporation not incorporated in any State any income which under the Internal Revenue Code of 1954 is not taxable by the United States as a result of being considered to be from sources without the United States or as a result of being otherwise connected or associated with or attributed to activities or occurrences without the United States.

SEC. 213. FEDERAL BOND INTEREST.

No provision of the State law described in section 211 or adjustment to Federal taxable income required by such law shall subject to taxation any interest on obligations of the United States which is exempt from such taxation under Federal law; but nothing in section 211 or 212 shall affect the power of any State or political subdivision to subject to taxation any interest which is not so exempt.

TITLE III—SALES AND USE TAXES

(These provisions of H.R. 11798 have been omitted since they were not dealt with in this paper)

TITLE IV—GROSS RECEIPTS TAXES

(These provisions of H.R. 11798 have been omitted since they were not dealt with in this paper)

TITLE V—ADMINISTRATION

Part A—Interstate Tax Conference

SEC. 501. ESTABLISHMENT AND PROCEEDINGS.

(a) ORGANIZATION.—There is hereby established an Interstate Tax Conference to consult with the Secretary concerning the operation of the system for the taxation of interstate commerce provided by this Act. The tax administrator of each State shall be a member. As soon as possible after the enactment of this Act the Secretary shall call an organizational meeting of the Conference, which shall adopt such bylaws and take such other actions as may be necessary or appropriate for its organization. The bylaws of the Conference shall govern its subsequent meetings and operations, consistently with subsection (b).

(b) MEETINGS.—

(1) Time and Place.—The Secretary shall call one meeting of the Conference each year. The Conference may hold special meetings called under its bylaws.

(2) Payment of Expenses of Certain Meetings.—The Secretary shall pay the amount of any reasonable expenses incurred in connection with the organizational meeting or any annual meeting called by the Secretary under paragraph (1), including travel expenses and per diem in lieu of subsistence for members of the Conference attending such meeting.

(3) Participation in Meetings.—The Secretary shall be represented at meetings of the Conference.

(4) Use of Federal Facilities and Personnel.—The Secretary shall make available to the Conference such facilities and personnel of the Federal Government as he deems advisable for purposes of its meetings and other operations.

Part B—Rulemaking Under This Act

SEC. 511. RULES, REGULATIONS, AND FORMS.

(a) IN GENERAL.—The Secretary shall prescribe such rules, regulations, and forms as may be necessary to carry out this Act and for its uniform application, and for the uniform application and operation of the uniform sales and use tax law set forth in section 322.

(b) LIMITATIONS.—The exercise of the Secretary's authority under subsection (a) shall not supersede authority which is specifically given or reserved by this Act to another person or broaden any power to prescribe rules, regulations, and forms which is specifically conferred on the Secretary by other provisions of this Act.

(c) EFFECT.—Rules and regulations prescribed by the Secretary under this Act shall have the force of law.

Part C—Administrative Provisions for Apportionment Formula

SEC. 521. ADMINISTRATIVE MODIFICATION.

(a) GENERAL RULE.—In rare and extraordinary circumstances the Secretary may, upon application by a corporation or a State and upon notice and opportunity for hearing to the corporation and all interested States, permit or require one or more of the following modifications in the method for the division of the corporation's net income or capital prescribed by title II of this Act, effective with respect to all States and political subdivisions, as he may deem necessary to effectuate the purposes of this Act—

(1) modification of the items includable, or the values of the items includable, in the corporation's property or payroll factor;

(2) modification of the weight assigned to the corporation's property and payroll factors; or

(3) use by the corporation of a method of separate accounting.

(b) BURDEN OF ESTABLISHING NEED FOR MODIFICATION.—The need for a modification must be established by the corporation or State alleging the need to the satisfaction of the Secretary through clear and convincing evidence.

(c) PUBLIC RECORD.—The nature of a modification and the supporting findings shall be made a matter of public record.

(d) JUDICIAL REVIEW.—Within 90 days after a modification is permitted under subsection (a), any State or corporation which is adversely affected may petition the United States Court of Appeals for the District of Columbia for review. The Court shall have jurisdiction to set aside any modification not authorized by this section. The judgment of the Court shall be subject to review by the Supreme Court of the United States as provided in section 1254 of title 28, United States Code.

SEC. 522. DETERMINATION OF INTERSTATE APPORTIONMENT DISPUTES.

(a) EXISTENCE OF DISPUTE.—If a State makes any assessment or initiates any proceeding against a corporation, seeking payment of any amount of additional income tax or capital stock tax based on the assertion that the corporation's apportionment fraction for that State should be larger than the fraction reported on the corporation's return or that an apportionment fraction should be reported where no return was filed, the corporation may give notice of the existence of an interstate apportionment dispute to that State and any other State to which it paid or owed an income tax or capital stock tax, or to which an affiliated corporation paid an income tax or capital stock tax on a consolidated basis, for any taxable year involved. The notice may be given at any time prior to a judicial hearing at which all issues raised by the assertion are open. No administrative body or court shall initiate or continue to conduct any proceedings relating to the corporation's apportionment fraction for the asserting State until at least 30 days have elapsed from the time notice of an interstate apportionment dispute was given to that State, unless all States notified have earlier appeared in the proceedings.

(b) EFFECT OF STATE DETERMINATION.—A final determination, subsequent to notice of the existence of an interstate apportionment dispute, in a proceeding in any court initiated by the asserting State, of any issues actually contested with respect to the corporation's apportionment fraction shall be accorded full faith and credit in any court or administrative body as against the corporation and any States which received notice or subsequently became parties to the determination, notwithstanding any prior determinations of the courts or administrative bodies of any State completed after notice to that State. The determination shall be binding as to all taxable years involved and shall not be binding as to any other taxable years. No statute of limitations shall bar the right of a State or corporation to an amount of tax increased or decreased in accordance with the determination, provided action is begun within one year after the determination has become final.

(c) REMOVAL TO FEDERAL APPORTIONMENT BOARD.—Within 30 days after receipt of notice of the existence of an interstate apportionment dispute, any State may remove to an Apportionment Board which shall be established within the Treasury Department by the Secretary the determination of the apportionment fractions of the corporation for the asserting State and all other States which would have been bound had the case not been removed. Upon receipt of a petition for removal, the Apportionment Board shall give the States involved notice as parties and opportunity for a hearing on the record. On motion of a party State or any other State or on its own motion, the Apportionment Board may give notice to and admit as parties other States to which the corporation paid or owed an income tax or capital stock tax, or to which an affiliated corporation paid an income tax or capital stock tax on a consolidated basis, for any taxable year involved and determine the apportionment fractions for each party State. The Apportionment Board may require the corporation whose attribution of net income is in issue to disclose all facts pertinent thereto; and shall give such corporation notice and opportunity to be heard, but not as a party. The Apportionment Board shall make findings of fact and render a written opinion as to its determination. Unless reviewed in the manner set forth in subsection (e), a determination of the Apportionment Board shall become final upon the expiration of 30 days. Upon receiving notice of the removal, the courts of the

State from which the determination was removed shall not proceed with any determination related to the corporation's apportionment fraction.

(d) FORM OF NOTICE.—Any notice given under this section with respect to an interstate apportionment dispute by a corporation, the Apportionment Board, or the Tax Court shall be in writing and must identify the corporation, the asserting State, and the taxable year or years affected, must include a reference to this Act, and must be sent by certified mail or delivered in hand to the tax administrator of the State being notified.

(e) REVIEW BY TAX COURT.—Within 30 days after the decision of the Apportionment Board, any party may petition the Tax Court of the United States for review of the decision. A copy of the petition shall be forthwith transmitted by the clerk of the court to the Apportionment Board, which shall thereupon file in the court the record of the proceedings on which it based its determination. The findings of fact by the Apportionment Board, if supported by substantial evidence, shall be conclusive.

(f) JUDICIAL REVIEW.—Notwithstanding section 1251(a) of title 28, United States Code, the United States Court of Appeals for the District of Columbia shall have jurisdiction to review de novo any issues relating to an interstate apportionment dispute. Within 30 days of the decision of the Tax Court, any party to the determination may petition the Court of Appeals for a review de novo of any such issues. The Court of Appeals may issue all necessary orders and process to bring before it the claims of all States to a share of the corporation's net income for the taxable year or years in issue, whether or not such States have previously been parties. The findings of fact by the Apportionment Board shall be considered with other evidence of the facts. The judgment of the Court of Appeals shall be subject to review by the Supreme Court of the United States as provided in section 1254 of title 28, United States Code.

(g) EFFECT OF FEDERAL DETERMINATION.—The determination of the interstate apportionment dispute by the Apportionment Board or any Federal court shall be binding for the taxable years involved on any State given notice or appearing as a party, notwithstanding any prior determinations of the courts or administrative bodies of that State completed after notice to that State. No statute of limitations shall bar the right of a State or the corporation to an amount of tax increased or decreased in accordance with the determination, provided action is begun within one year after the determination has become final.

Part D—Required Studies

SEC. 531. EXCLUDED CORPORATIONS AND PERSONAL INCOME TAXES.

The Secretary shall make a study of the need for uniform rules with respect to the taxation of the income derived from interstate activities of excluded corporations, unincorporated businesses, and individuals, with particular reference to the feasibility of extending to the taxation of such income rules conforming with the operation of the apportionment formula provided or in this Act. The Secretary, within two years after the date of the enactment of this Act, shall report to the Congress his findings and recommendations, including recommendations for appropriate legislation if he finds that such a need does exist.

TITLE VI–DEFINITIONS AND MISCELLANEOUS PROVISIONS

Part A–Definitions

SEC. 601. NET INCOME TAX.

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

SEC. 602. CAPITAL STOCK TAX; CAPITAL ACCOUNT TAX.

(a) Capital Stock Tax.–A "capital stock tax" is any tax measured in any way by the capital of a corporation considered in its entirety.

(b) Capital Account Tax.–A "capital account tax" is any capital stock tax measured by number of shares par or nominal value of shares, paid-in capital, or the like, not including any tax the measure of which includes any element of earned surplus.

SEC. 603. SALES TAX.

A "sales tax" is any tax measured by the sales price of goods or services sold which is required by State law to be stated separately from the sales price by the seller.

SEC. 604. USE TAX.

A "use tax" is any nonrecurring tax imposed on or with respcct to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership of that property or the leasing of that property from another, including any consumption, keeping, retention, or other use of tangible personal property.

SEC. 605. GROSS RECEIPTS TAX.

A "gross receipts tax" is any tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in tcrms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax a net income tax.

SEC. 606. SECRETARY.

The term "Secretary" means the Secretary of the Treasury, or any officer, employee, or agency of the Treasury Department duly authorized by the Secretary (directly or indirectly by one or more redelegations of authoirty) to perform the function mentioned or described in the context.

SEC. 607. EXCLUDED CORPORATION.

(a) In General.–An "excluded corporation" is any corporation–

(1) which derives more than 50 percent of its ordinary gross income for the taxable year from regularly carrying on any one or more of the following business activities:

(A) the transportation for hire of property or passengers, including the rendering by the transporter of services incidental to such transportation;

(B) the furnishing of telephone service or the sale of electrical energy, gas, or water;

(C) the issuing of insurance or annuity contracts or reinsurance; or

(D) banking, the lending of money, or the extending of credit;

(2) which is a "personal holding company" as defined in section 542 of the Internal Revenue Code of 1954 or a "foreign personal holding company" as defined in section 552 of such Code; or

(3) which receives more than 50 percent of its ordinary gross income for the taxable year in the form of one or more of the following:

(A) dividends;

(B) interest;

(C) royalties from patents, copyrights, trademarks, or other intangible property; or

(D) mineral, oil, or gas royalties.

(b) ORDINARY GROSS INCOME.—The term "ordinary gross income" means gross income as determined for the taxable year under the applicable provisions of the Internal Revenue Code of 1954, except that there shall be excluded therefrom—

(1) all gains and losses from the sale or other disposition of capital assets, and

(2) all gains and losses from the sale or other disposition of property of a character described in section 1231(b) of the Internal Revenue Code of 1954 (determined without regard to holding period).

SEC. 608. SALE; SALES PRICE.

The terms "sale" and "sales price" shall be deemed to include leases and rental payments under leases.

SEC. 609. INTRASTATE SALE; INTERSTATE SALE.

(a) INTRASTATE SALE.—An "intrastate sale" is a sale with its origin and destination in the same State.

(b) INTERSTATE SALE.—An "interstate sale" is a sale with either its origin or its destination in a State, but not both in the same State.

SEC. 610. ORIGIN.

The origin of a sale is—

(1) in the State or political subdivision in which the seller owns or leases premises at which the property was last located prior to delivery or shipment of the property by the seller to the purchaser or to a designee of the purchaser, or

(2) if the property was never located at premises owned or leased by the seller, in the State or political subdivision in which a business location of the seller is located and in or from which the sale was chiefly negotiated.

SEC. 611. DESTINATION.

The destination of a sale is in the State or political subdivision where the purchaser or a designee of the purchaser receives physical delivery of the property.

SEC. 612. BUSINESS LOCATION.

(a) GENERAL RULE.—A person shall be considered to have a business location within a State only if that person—

(1) owns or leases real property within the State, or

(2) has one or more employees located in the State.

(b) BUSINESS LOCATION IN SPECIAL CASES.—If a person does not own or lease

real property within any State or have an employee located in any State (or in a case described in the last sentence of section 204), that person shall be considered to have a business location—

(1) in the State in which the principal place from which its trade or business is conducted is located, or

(2) if the principal place from which its trade or business is conducted is not located in any State, in the State of its legal domicile.

SEC. 613. LOCATION OF PROPERTY.

(a) GENERAL RULE.—Except as otherwise provided in this section, property shall be considered to be located in a State if it is physically present in that State.

(b) RENTED-OUT PERSONALTY.—Personal property which is rented out by a corporation to another person shall be considered to be located in a State if the last base of operations at or from which the property was delivered to a lessee is in that State. If there is no base of operations in any State at which the corporation regularly maintains property of the same general kind for rental purposes, such personal property shall not be considered to be located in any State.

(c) MOVING PROPERTY WHICH IS NOT RENTED-OUT.—Personal property which is not rented out and which is characteristically moving property, such as motor vehicles, rolling stock, aircraft, vessels, mobile equipment, and the like, shall be considered to be located in a State if—

(1) the operation of the property is localized in that State, or

(2) the operation of the property is not localized in any State but the principal base of operations from which the property is regularly sent out is in that State.

If the operation of the property is not localized in any State and there is no principal base of operations in any State from which the property is regularly sent out, the property shall not be considered to be located in any State.

(d) MEANING OF TERMS.—

(1) Localization of Operation.—The operation of property shall be considered to be localized in a State if during the taxable year it is operated entirely within that State, or it is operated both within and without that State but the operation without the State is—

(A) occasional, or

(B) incidental to its use in the transportation of property or passengers from points within the State to other points within the State, or

(C) incidental to its use in the production, construction, or maintenance of other property located within that State.

(2) Base of Operations.—The term "base of operations," with respect to a corporation's rented-out property or moving property which is not rented out, means the premises at which any such property is regularly maintained by the corporation when—

(A) in the case of rented-out property, it is not in the possession of a lessee, or

(B) in the case of moving property which is not rented out, it is not in operation,

regardless of whether such premises are maintained by the corporation or

by some other person; except that if the premises are maintained by an employee of the corporation primarily as a dwelling place they shall not be considered to constitute a base of operations.

SEC. 614. LOCATION OF EMPLOYEE.

(a) GENERAL RULE.—An employee shall be considered to be located in a State if—

(1) the employee's service is localized in that State, or

(2) the employee's service is not localized in any State but some of the service is performed in that State and the employee's base of operations is in that State.

(b) LOCALIZATION OF EMPLOYEE'S SERVICE.—Service of any employee shall be considered to be localized in a State if—

(1) the service is performed entirely within that State, or

(2) the service is performed both within and without that State, but the service performed without the State is incidental to service performed within the State.

(c) EMPLOYEE'S BASE OF OPERATIONS.—The term "base of operations," with respect to an employee, means a single place of business with a permanent location which is maintained by the employer and from which the employee regularly commences his activities and to which he regularly returns in order to perform the functions necessary to the exercise of his trade of profession.

SEC. 615. HOUSEHOLD DELIVERIES.

A seller makes household deliveries in a State or political subdivision if he delivers goods, either by his own vehicles or by a private parcel service, to the dwelling places of his purchasers located in that State or subdivision.

SEC. 616. STATE.

The term "State" means the several States of the United States and the District of Columbia.

SEC. 617. STATE LAW.

References in this Act to "State law," "the laws of the State," and the like shall be deemed to include a State constitution, and to include the statutes and other legislative acts, judicial decisions, and administrative regulations and rulings of a State and of any political subdivision.

SEC. 618. TAXABLE YEAR.

A corporation's "taxable year" is the calendar year, fiscal year, or other period upon the basis of which its taxable income is computed for purposes of the Federal income tax.

SEC. 619. VALUATION DATE.

The "valuation date," with respect to a capital stock tax, is the date as of which capital is measured.

SEC. 620. TAX ADMINISTRATOR.

The "tax administrator" of a State for any of the purposes of this Act is the officer of the State designated by the Governor as having primary responsibility under State law for the administration of the taxes involved or such other officer of the State exercising comparable functions as the Governor may designate for

one or more of the purposes of this Act. A designation shall be made in writing to the Secretary, who shall maintain and publish in the Federal Register a current list of the persons designated.

Part B—Miscellaneous Provisions

SEC. 621. PERMISSIBLE FRANCHISE TAXES.

The fact that a tax to which this Act applies is imposed by a State or political subdivision thereof in the form of a franchise, privilege, or license tax shall not prevent the imposition of the tax on a person engaged exclusively in interstate commerce within the State; but such a tax may be enforced against a person engaged exclusively in interstate commerce within the State solely as a revenue measure and not by ouster from the State or by criminal or other penalty for engaging in commerce within the State without permission from the State.

SEC. 622. PROHIBITION AGAINST GEOGRAPHICAL DISCRIMINATON.

(a) IN GENERAL.—No provision of State law shall make any person liable for a greater amount of corporate net income tax, capital stock tax, sales tax, use tax or gross receipts tax, by virtue of the location of any occurrence in a State outside the taxing State, than the amount of the tax for which such person would otherwise be liable if such occurrence were within the State (subject to sections 306, 402, and 623). For purposes of this subsection, the term "occurrence" includes incorporation, qualification to do business, and the making of a tax payment, and includes an activity of the taxpayer or of a person (including an agency of a State or local government) receiving payments from or making payments to the taxpayer.

(b) COMPUTATION OF TAX LIABILITY UNDER DISCRIMINATORY LAWS.—When any State law is in conflict with subsection (a), tax liability may be discharged in the manner which would be provided under State law if the occurrence in question were within the taxing State.

SEG. 623. APPLICABILITY OF ACT TO EXCLUDED CORPORATIONS.

Nothing in this Act shall affect the power of any State or poltiical subdivision to impose or assess a net income or capital stock tax with respect to an excluded corporation.

SEC. 624. PROHIBITION AGAINST OUT-OF-STATE AUDIT CHARGES.

No charge may be imposed by a State or political subdivision thereof to cover any part of the cost of conducting outside that State an audit for a tax to which title II, III, or IV applies.

SEC. 625. APPLICATION OF PUBLC LAW 86-272.

Title I of the Act of September 14, 1959 (Public Law 86-272) shall not apply to any corporation with respect to which title II of this Act is applicable. This section shall not have the effect of reviving (in the case of such a corporation for any taxable year with respect to which title II of this Act is not applicable) any power to tax, or any assessment of or right to collect a tax, which was barred by the Act of September 14, 1959 (Public Law 86-272).

SEC. 626. LIABILITY WITH RESPECT TO UNASSESSED TAXES.

(a) PERIODS ENDING PRIOR TO ENACTMENT DATE.—No State or political subdivision thereof shall have the power to assess, after the date of the enactment of this Act, a corporate net income tax, capital stock tax (other than a capital account tax imposed on corporations incorporated in the State), sales tax, use

tax, or gross receipts tax against any person for any period ending prior to such date in or for which that person became liable for the tax, if during such period that person did not have a business location in the State; or, in the case of a sales or use tax, was not registered in the State for the purpose of collecting tax, had no business location in the State, and did not regularly make household deliveries in the State.

(b) PERIODS ENDING WITHIN TWO YEARS AFTER ENACTMENT DATE.—No State or political subdivision thereof shall have the power to assess, after two years from the date of the enactment of this Act, a corporate net income tax, capital stock tax (other than a capital account tax imposed on corporations incorporated in the State), sales tax, use tax, or gross receipts tax against any person for any period ending less than two years from such date in or for which that person became liable for the tax, if during such period that person did not have a business location in the State; or, in the case of a sales or use tax, was not registered in the State for the purpose of collecting tax, had no business location in the State, and did not regularly make household deliveries in the State.

(c) CERTAIN PRIOR ASSESSMENTS AND COLLECTIONS.—The provisions of subsection (a) and subsection (b) shall not be construed—

(1) to invalidate the collection of a tax prior to the time assessment became barred under subsection (a) or (b), as the case may be, or

(2) to prohibit the collection of a tax at or after the time assessment became barred under subsection (a) or (b), as the case may be, if the tax was assessed prior to such time.

SEC. 627. EFFECTIVE DATES.

(a) CORPORATE NET INCOME TAXES AND CAPITAL STOCK TAXES.—Title II of this Act, and the provisions of section 101, part C of title V, and this title (except section 626) insofar as they relate to corporate net income taxes or capital stock taxes, shall apply in the case of corporate net income taxes only with respect to taxable years ending more than 2 years after the date of the enactment of this Act, and in the case of capital stock taxes only with respect to taxes for which the valuation date is later than the close of the first taxable year ending more than 2 years after the date of the enactment of this Act. Any corporation shall be permitted to adjust its reporting period for net income tax purposes to the extent necessary to comply with this Act, effective for the first taxable year to which title II applies.

(b) SALES AND USE TAXES.—Title III of this Act, and the provisions of section 101 and this title (except section 626) insofar as they relate to sales or use taxes, shall take effect 2 years after the date of the enactment of this Act; except that the Secretary may make the certifications provided for in section 308(c) and perform the functions described in section 309, with respect to a State which has adopted the uniform sales and use tax law set forth in part B or title III, at any time on or after the date of the enactment of this Act.

(c) GROSS RECEIPTS TAXES.—Title IV of this Act, and the provisions of section 101 and this title (except section 626) insofar as they relate to gross receipts taxes, shall take effect 2 years after the date of the enactment of this Act.

(d) OTHER PROVISIONS.—The remaining provisions of this Act shall take effect on the date of the enactment of this Act.