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State Taxation of Interstate Commerce: Chaos and New Hope

Donald K. Barnes*

I. BACKGROUND AND SCOPE

WITH AMPLE REASON, the tax bar has for years been so preoccupied with federal taxation that state and local taxation have received only scant attention. Recently, however, interest in the state and local area, particularly because of its impact upon multistate businesses, has developed to a new high level. Federal tax problems are still the giant, but it is recognized that state and local problems have grown out of the pygmy stage and can no longer be ignored.

Although much work needs to be done in the purely local aspects of state and local taxation, this article is limited to considerations pertinent to multistate business, i.e., to those special problems which arise because a single business entity has business contacts with more than one taxing jurisdiction. Otherwise stated, it is limited to the federal aspects of state and local taxation, including a consideration of taxes imposed by political subdivisions as well as by the states. The former is necessarily included as there is much multistate business which is not strictly interstate commerce.

The problems relative to state and local taxation have existed from the inception of our federal system. However, they were relatively insignificant until the development of efficient long-distance transportation and communication, the concomitant growth of interstate commercial intercourse, and the burgeoning of income and gross receipts taxes. While they have generally been far overshadowed by federal taxes since the adoption of the sixteenth amendment, they have had serious notice from taxpayers, tax administrators, writers, and courts for most of the present century. In the last few years, they have risen to their present prominence through a combination of factors, the most significant of which are the constantly increasing demands of all levels of government for revenue.

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the increasing integration of the American common market, and
the increasing reluctance of the United States Supreme Court to
circumscribe state taxes on or affecting interstate commerce.

The problems involved in state and local taxation are very
broad. If they could be stated as a single problem, it would be to
find a way for multistate business to pay its share of local expenses
to the appropriate jurisdictions without imposing upon it any extra
burdens merely because of its multistate nature. As noted previ-
ously, the taxing jurisdictions involved are not only the states them-
selves, but also include counties, municipalities, townships, school
districts, metropolitan districts, public authorities, irrigation dis-
tricts, drainage districts, and many others. The types of businesses
involved are not only the classic examples of pure interstate com-
merce — interstate transportation and communication, and inter-
state sale of tangible goods — but also businesses which though
not engaging directly in interstate commerce, significantly affect
interstate commerce. Examples of the latter type are abundant and
include, among others, manufacturing before interstate commerce
begins or selling after interstate commerce ends as well as multi-
state businesses which are not interstate commerce at all, as for
example hotel chains. All sorts of service industries are affected, as
are construction, publishing, and many others.

The taxes involved are not only those measured by business net
income, but also ad valorem taxes on realty, tangible personality and
intangibles; taxes measured by gross receipts such as sales, use, and
gross income taxes and taxes measured by unit of product or service
such as cigarette taxes are also involved. Personal income taxes,
fees and taxes for special benefits such as gasoline taxes, corporation
registration fees, miscellaneous taxes such as business licenses and
taxes on capital, severance, employment, chain stores, and security
transfers also become involved in this area. Even inheritance taxes
and escheats, in their administrative aspects, and responsibility for
collecting taxes imposed upon others must be considered in any
analysis of this subject in light of the rather complex problems they
raise.

A. The Congressional Investigation

Aroused by what it considered startling actions of the Supreme
Court, Congress, in 1959, directed an investigation of net-income-

1. See, e.g., the decision in Northwestern States Portland Cement Co. v. Minnesota,
358 U.S. 450 (1959), which held that a fairly apportioned net income tax may be
based taxes, and in 1960 broadened it to include all taxes. This task was assigned to the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives which has been most industrious. Its hearings on net-income-based and sales-and-use taxes of manufacturing and merchandising businesses developed transcripts of over 850 thousand words. Over 30,000 short questionnaires and 5,500 long ones were sent to taxpayers. Other questionnaires were sent to state and local tax administrators.

In June of 1964, the Special Subcommittee released its first or interim report. It constitutes the first comprehensive factual study ever made of state taxes based on net income. Its findings are not surprising since in general they merely confirm impressions which tax practitioners have had for a long time. For the first time, however, there are now adequate authoritative data upon which to base arguments for the need for reform and the directions it might take.

The number of businesses selling tangible goods across state lines is estimated at between 120,000 and 200,000. Most of these enterprises have places of business in only a few states, often only one, but nevertheless sell to customers located in many states. Thus, attributing income to the location of the customer (the "destination sales factor" used in some apportionment formulae) requires returns to be filed in, and audited by, many states with which the taxpayer has only minimal contact. One result is that tax liabilities are often less than the cost of full compliance or the cost of complete administration. The complexities of the mass of laws, regulations, judicial interpretations, and administrative practices, taken together, are staggering. Definitions of income, rules for its allocation and formulae for its apportionment vary widely and bewilderingly.

imposed upon pure interstate commerce conducted through a sales office in the state; the refusal to review Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So. 2d 70 (1958), cert. denied, 359 U.S. 28 (1959); International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640, cert. denied, 359 U.S. 984 (1959), in which the Supreme Court of Louisiana upheld imposition of an income tax upon businesses which had nothing but traveling salesmen in the state; Scripto, Inc. v. Carson, 362 U.S. 207 (1960), which held that a foreign vendor could be held responsible for collecting use tax on transactions through an independent manufacturers' agent in the state.


4. The term "allocation" refers to direct assignment of specific types of income to a particular location, as for example rents to the situs of the property. The term "appor-
This is extremely burdensome to large enterprises and impossible for small ones with widely dispersed activities.

The overlapping rules for allocation and apportionment tend toward overtaxation, although there are sometimes gaps which permit undertaxation. In actual practice, however, there is much more undertaxation than overtaxation since so many taxpayers escape the hopeless confusion by simple failure to comply. For that same reason, actual current compliance costs are not excessively high.

Insofar as apportionment formulae are concerned, the Congressional Report lays most of the fault to the sales factor, particularly if it is customer-oriented. Sales are always troublesome, but much more so when attributed to the situs of the customer ("destination sales") than when attributed to the office through which the sale is made ("sales through offices") or the situs of the goods at the time of sale ("sales from inventory"). Property and payroll factors cause little trouble because they are easily located, and for most taxpayers, are in relatively few jurisdictions.

Perhaps the biggest surprise in the Congressional Report is its finding that choice of an apportionment formula has very little impact upon the revenue of any state.\(^4\) The greatest difference between the most and least "favorable" formula for any state is less than one and a half per cent of total revenues.

The Congressional Report notes that efforts to achieve an end to the chaos by state action have been barren of significant results and hold no promise for the future. It therefore concludes that a federally imposed uniformity would be beneficial to both business and the states. It is stated: "Certainly, the problems presented are not easy problems, but they are important problems. They are important to the States and they are important to the vitality of the American common market. Congress has a responsibility to both, and it is time for it to seek a solution."\(^4\) The Special Subcommittee, of course, is not stopping with this initial report. It has promised a second and final report for June 1965. Again there will be two volumes: the first will contain a factual study of sales, use, gross receipts, and capital stock taxes, and the second some legislative recommendations containing the substance of a proposed fed-

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\(^4\) The same is not true of tax costs to individual taxpayers.

\(^4\) Congressional Report, supra note 3 at 5999.
eral statute regulating some aspects of state and local taxation of multistate business. Although the recommendation will presumably fall far short of the detail necessary to achieve complete uniformity in all phases of the subject, it will almost certainly be far more comprehensive than the present stop-gap Interstate Income Law.\(^6\)

B. Other Attempts at Uniformity

Long before Congress interested itself in the problems involved in state and local taxation of interstate commerce, others had recognized them and made futile efforts toward their solution. For many years, numerous scholars and practitioners have urged that the states adopt uniform definitions and formulae. The largest of these efforts is the Uniform Division of Income for Tax Purposes Act, developed in 1957 by the National Conference of Commissioners on Uniform State Laws. The Uniform Act has been approved by the American Bar Association and has been adopted in substance by Alaska, Arkansas, Kansas, Indiana, and, most recently, Oregon, Idaho, New Mexico, North Dakota, and the District of Columbia. Motivation for the 1965 state enactments may be traced to the activities of the Congressional Special Subcommittee, and action in the District of Columbia is forced by the decision in *General Motors Corp. v. District of Columbia.*\(^6\)

The Uniform Act was designed so that it could be easily adopted by the states, thus achieving the objective of uniformity rather than establishment of a theoretically ideal system. The act has been severely criticized, principally for its incorporation of a destination sales factor. It does not attempt to define income, but rather prescribes that certain income — rents, royalties, interest, dividends, and capital gains — shall be directly allocated, along with its related expenses, with the rest apportioned by equally weighted factors of tangible property (including rented property) payroll, and sales (assigned to the location of the customer). Having created a “nexus” problem by attributing income to the location of the customer who may be and often is in a state which cannot obtain jurisdiction over the taxpayer, the act fails to offer any definition of “nexus.” To make sure that no income escapes tax, it directs that income which the formula ascribes to states in which the taxpayer is “not taxable” shall be brought back to the state of the taxpayer’s headquarters.

\(^6\) 380 U.S. 553 (1965).
It contemplates the businesses of manufacturing and merchandising, but contains no provisions for the special problems of other industries such as construction, publishing, broadcasting, finance, insurance, transportation, and communication.

Less ambitious undertakings have been more successful in their limited fields. For several years, many western states have had an interstate compact covering taxation of highway carriers. Under this compact, the tax obligations of an interstate trucking business are divided among the participating states in a manner thought to be fair to each, avoiding both overlaps and gaps. The results are satisfactory to both states and the truckers. Unfortunately, this precedent has not been widely followed. However, Congress has recently consented to two interstate compacts entered into by northeastern states for the proration on a mileage basis of fuel taxes and registration fees imposed upon bus operators, and has directed the District of Columbia to join.

Since the states have shown no eagerness to agree upon uniform rules, and especially a reasonable apportionment formula, much interest has been displayed in having one federally imposed. Individual Justices of the Supreme Court, despairing erection of a coherent set of rules through ad hoc decisions, have frequently remarked that the problem is peculiarly susceptible to legislative rather than judicial solution. Congress is just now getting around to accepting the invitation.

II. CONSTITUTIONAL RULES IN THE ABSENCE OF STATUTE

A. The Principles

There are three constitutional factors which influence what states and their subdivisions may do in the absence of action by Congress. The first is the basic principle that authority of a state is

10. The analysis which follows is necessarily an oversimplification. For a thorough background the reader is referred to Beam, Paying Taxes to Other States (1963); Hartman, State Taxation of Interstate Commerce (1953). Even the latter must be read in connection with later cases, especially General Motors Corp. v. Washington, 377 U.S. 436, rehearing denied, 379 U.S. 873 (1964). See also A Symposium on State Taxation of Interstate Commerce, 46 VA. L. REV. 1051 (1960); Note, Federal Limitation on State Taxation of Interstate Business, 75 HARV. L. REV. 953 (1962).
limited to its geographical territory and therefore it may not tax
persons, things, or events not within its own boundaries. Since
adoption of the fourteenth amendment, this principle has been in-
corporated into the concept of due process which may not be with-
held by the states. Under due process, sometimes aided by the
equal protection clause of the fourteenth amendment, this principle
has been enlarged a bit — at least until recently — to require
some degree of reasonableness in the relationship between the mea-
ure of the tax and the things taxed.

The second constitutional consideration is this same point de-
veloped under state constitutions, plus other state constitutional re-
quirements such as uniformity in rates of tax and assessment. Al-
though instances are extremely rare in which courts have given tax-
payers the benefit of state due process and equal protection require-
ments, there are exceptions.

The third constitutional factor is the familiar but confusing in-
terstate commerce clause. Article I, section 8 of the federal consti-
tution confers upon Congress the power to regulate commerce
among the states. This, apparently, was one of the principal rea-
sons for abandoning the original Articles of Confederation and re-
placing them with our present Constitution. Once the Supreme
Court had decided that taxation is a form of regulation, it might
have concluded either that the grant of regulatory power to Con-
gress was exclusive and that hence the states could not tax interstate
commerce at all, or on the other hand, that the power was concur-
rent so that the states could regulate (including tax) in any manner
not forbidden by Congress. Hindsight makes it easy to see that had
the Court adopted either of these all-or-nothing approaches, the
present chaos could have been averted. Congress would have been
compelled either to permit taxation sufficient to make interstate
commerce pay its way, i.e., remove any constitutional discrimination
in favor of interstate commerce, or, on the other tack, to lay down
rules to prevent discrimination against interstate commerce. It

this case at pp. 868-71 infra.
would have had to do something to define the extent to which and the manner in which states and their subordinate jurisdictions may tax interstate commerce, matters affecting interstate commerce, and multistate business.

The Supreme Court did neither, but rather chose a middle course which the Court, as well as lower courts and practitioners, found extremely difficult to follow. The commerce clause, said the Court, is a self-executing restraint upon the powers of states to interfere with interstate commerce or impose discriminatory or undue burdens upon it. As one can see now, this relatively simple principle has led to unending complexities, confusion, and conflicts. Life would have been much easier for taxpayers, tax administrators, and courts had the Court chosen either of the other approaches. A reasonable synthesis of all but the latest decisions is: states may not tax the privilege of engaging in interstate commerce, nor its inseparable local incidents, unless such incidents are tied in with intrastate commerce, or are sufficiently extensive to be assimilated to intrastate commerce, nor may they discriminate against interstate commerce, nor subject it to multiple burdens; but they may tax its net income, its property, its capital, even though property or capital be measured by value imparted by extra-state connections, its use of local facilities, or its payrolls.

B. Application of the Principles

The application of these principles to the concrete facts of an individual case is a problem of an entirely different order. The

29. This subject is aided by a federal statute. See, e.g., International Shoe Co. v. Washington, 326 U.S. 1 (1945). The unemployment compensation statute expressly provided that interstate commerce should not be a defense. INT. REV. CODE OF 1954 § 3305(a).
30. See, e.g., Mr. Justice Clark's opinion in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 452 (1959). Mr. Justice Black has expressed the view
Business and Occupation Tax imposed by the State of Washington\(^{31}\) looked like a tax on the privilege of engaging in interstate commerce, and for that reason and because unapportioned was held to be invalid.\(^{32}\) Nevertheless, its application to another taxpayer whose business appeared to be pure interstate commerce was approved;\(^{33}\) it further survived an attack by another taxpayer who claimed that it should be apportioned and who proved what a proper apportionment would be.\(^{34}\) Although it was once decided\(^{35}\) and has since seemed to be assumed\(^{36}\) that a tax must be properly apportioned, the Court has been extremely slow to find fault with an apportionment formula, or even, as in the later Washington cases, with the absence of any apportionment. Nevertheless, some apportionments will be held improper. The so-called “apportionment” must not be unduly arbitrary,\(^{37}\) nor such as to impose multiple burdens, directly and obviously, upon interstate commerce. If it is too distorted, it may violate due process by taxing extraterritorial values. Those are the principles, but in only one case has the Supreme Court applied them to the taxpayer’s advantage.\(^{38}\) In that case the taxpayer demonstrated by a species of separate accounting that income arising from activities within the taxing state was considerably less than the formula attributed. Notwithstanding a similar demonstration, California was permitted to tax a portion of the net income of a chain store operator although its California operations produced a net loss.\(^{39}\) A very recent decision suggests that an unreasonable appor-

\(^{31}\) WASH. REV. CODE ANN. § 82.04.270 (1961).
\(^{37}\) Gulf Oil Corp. v. Joseph, 307 N.Y. 342, 121 N.E.2d 360 (1954). The New York City Business and Financial tax prescribed factors for an apportionment formula, and then directed that if application of those factors attributed less than one-third of the income to the city, one-third should nevertheless be taxed. The New York Court of Appeals struck down the one-third floor.
tionment will be held constitutionally infirm. The actual decision was that the District of Columbia Income and Franchise Tax Act, in directing the District Commissioners to apportion to the District that part of net income which is "fairly attributable" to it, does not permit the District to tax 100 per cent of the income arising from the segment of a taxpayer's business conducted both within and without the District. The language of the opinion uses terms appropriate to both interstate commerce and due process considerations.

C. Impact of General Motors v. Washington

As noted previously, all prior decisions must be read in light of General Motors Corp. v. Washington. One noted authority has made the following comments in this respect:

Contrary to expectations, the opinion in General Motors Corporation v. State of Washington did not clarify the Court's views on the extent to which the Commerce Clause protects interstate transactions from multiple gross receipts tax burdens, although the case presented facts which were, in most respects, ideal for an exposition of views on that subject. The tax was imposed upon the privilege of engaging in business activities within Washington. Its measure was the gross proceeds of sales. The sales whose gross proceeds were taxed were made pursuant to orders received and accepted at offices of the seller outside of Washington. The goods sold were manufactured in states other than Washington and shipped from points outside of Washington to vendees (automobile dealers) located in Washington. The tax was applied to all sales to Washington destinations regardless of whether there was much, little or no business activity with respect to such sales within Washington. The taxpayer had volunteered the tax with respect to sales "channeled through" a Seattle office, and the lower Washington court had held that certain other sales were taxable because they were related to a Seattle office. The bulk of the sales in issue, however, were unrelated to any Washington office.

Most authorities expected that the General Motors decision would clarify the Court's position on the major issues existing in this area. First, there was the issue that at least with respect to the sales unrelated to Washington offices, the tax appeared to be levied upon the privilege of engaging in interstate activities, seemingly in contravention of the position taken in Spector Motor Service

42. Letter From Mr. Walter H. Beaman of the New York Bar to the Author, March 12, 1965.
43. Ibid.
Inc. v. O'Connor,\(^{44}\) which was strongly reaffirmed in *Northwestern States Portland Cement Co. v. Minnesota*,\(^{45}\) that no state may tax that privilege. "Second, the tax exposed the interstate sales to multiple taxation in every state with which they had any relation, such as Oregon, where the sales office was located, and Michigan, California and Missouri, where the manufacture of the goods took place."\(^{46}\) In fact, there was evidence that showed that in St. Louis, Missouri, a gross receipts tax had been imposed on some of the sales which were in turn taxed in Washington. "Third, the tax was unapportioned and its imposition on the total gross receipts of the interstate sales seemed to contravene the requirements of fair apportionment laid down in the *Northwestern States* opinion."\(^{47}\) Fourth, the *General Motors* case involved "no local or intrastate incident of the type that had been previously used as a peg on which to hang a tax from one end or another of an interstate transaction (e.g., local manufacturing, or the making of a contract of sale within the state)."\(^{48}\) One authority has commented on the matter of interpreting the *General Motors* decision as follows:

The difficulty of assaying the precedential effect of the majority's opinion lies principally in the fact that the result reached cannot be reconciled with the basic principles just mentioned, yet three of the four rules were restated in their classic form. First, the Court repeated the proposition that a state may not levy a tax on the privilege of engaging in interstate commerce; yet it sustained a privilege tax on the transactions in issue, which were clearly not intrastate commerce. Second, the majority stated that "we have specifically held that interstate commerce cannot be subjected to the burden of 'multiple taxation,'" yet the judgment of the Court sustained a Washington tax on transactions which were exposed to taxation in Oregon, California, Michigan and Missouri, and which were shown to have been subjected to a gross receipts levy in St. Louis. Third, the Court, after citing the proposition that "it is well established that taxation measured by gross receipts is constitutionally proper [only] if it is fairly apportioned," sustained the tax on an unapportioned basis, though it was obvious that the business activity within the state was minuscule in relation to the total business activity that produced the entire gross receipts from the sales in issue.

The result reached by the majority in this case was constructed upon a novel extension of the "local incident" exception to the

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\(^{44}\) 340 U.S. 602 (1951).
\(^{45}\) 358 U.S. 450 (1959).
\(^{46}\) Letter From Mr. Walter H. Beaman of the New York Bar to the Author, March 12, 1965.
\(^{47}\) Ibid.
\(^{48}\) Ibid.
prohibition against taxation of the unapportioned gross receipts from commerce which crosses state lines. Previously, *Norton Co. v. Department of Revenue* had represented the farthest reach of the local incident doctrine. That case held that where a local place of business was engaging in activities which had traditionally been treated as taxable local (intrastate) incidents of interstate commerce, such as the delivery of goods from local stocks or the acceptance of orders locally received, other transactions clearly interstate in nature might become "tainted" by a connection with the intrastate business to an extent that it might be constitutionally impossible to separate nontaxable interstate gross receipts from the receipts of the taxable intrastate activities. Though citing the *Norton* case as a precedent, the majority went far beyond the facts of that case and actually disregarded its holding, since there was not in Washington any place of business or business activity connected with the sales in issue which could qualify as a vortex of intrastate business activity under *Norton*. Even the dubious conclusion that the homes of General Motors employees in Washington were offices of General Motors would not serve this purpose, since the business (if any) carried on at those homes was exclusively in aid of General Motors' interstate commerce, rather than a separable intrastate activity, and in any event would seem to be negligible in proportion to the total business activity which earned the gross income that was fully taxed.

From the foregoing analysis, it would appear that "the Court left intact those of the classic propositions concerning the protection which the commerce clause affords in gross receipts tax cases, yet used the local incident rule to reach a result which favored the application of the tax in circumstances that appeared to violate all three of those canons." This potentiality has always been "present in the local incident doctrine, as Mr. Justice Rutledge pointed out in his concurring opinion in *Freeman v. Hewit*. . . . The real meaning of the majority's opinion in the *General Motors* case appears to be that when the five justices for whom Mr. Justice Clark wrote feel that a tax of the Washington type has not actually curtailed interstate commerce, they will extend the local incident doctrine as far as words can be stretched to sustain the constitutional validity of the tax." The Court, however, has recently considered a very similar situation in which it reached the opposite conclusion. Distinguish-
ing General Motors, the Court reversed the Supreme Court of Idaho and held that Idaho could not levy a tax with respect to certain shipments into the state where the entire contract was negotiated and executed without the state and title passed without the state, even though the taxpayer had qualified to do business in the state and was in fact doing business there. In this situation, the Court found that there were no local activities connected with the taxed sales and the local business had no connection with them.

The foregoing examples do not establish anything in themselves, but are merely illustrative of the difficulty in applying the principles. Along the way some nice distinctions have been created, although not always observed. A franchise tax measured by net income is constitutionally different from a tax on net income; and yet it seems obvious that their economic impact is exactly the same. Similarly, the economics of sales and use taxes are identical, as should be those of all other taxes measured by gross receipts or units of product or service, but the constitutional rules are very different.

For present purposes, the significance of all this lies in the net effect of uncertainty as to constitutional requirements, which when superimposed upon the welter of statutory and regulatory definitions, formulae, and requirements creates a compelling need for reform.

III. CONGRESSIONAL ACTION

A. Developments Leading to Public Law 86-272.

Congress has exercised its powers under the commerce clause in many fields with the approval of the Supreme Court. However, Congress has moved cautiously in the field of state taxation, leaving to the Supreme Court the task of protecting the national common market from repressive local taxation. Indeed, until P.L. 86-272, the concern here is with interstate commerce and due process, not with what Congress has done to protect its own creatures, as for example in 42 Stat. 1499 (1923), 12 U.S.C. § 548 (1958), which limits the ways in which states may tax national banks,

60. E.g., Wickard v. Filburn, 317 U.S. 111 (1942), in which Congress was permitted to limit the amount of grain a farmer could raise for his own use in furtherance of its regulation of grain moving in interstate commerce.
61. The concern here is with interstate commerce and due process, not with what Congress has done to protect its own creatures, as for example in 42 Stat. 1499 (1923), 12 U.S.C. § 548 (1958), which limits the ways in which states may tax national banks,
the few steps that Congress had taken were in enlargement rather than curtailment of state taxing powers.

As noted previously, the Federal Unemployment Tax Act\(^6^6\) enacted in 1935 undertook specifically to subject interstate commerce to state taxation from which it might have been immune under the Supreme Court's interpretations of the commerce clause as a self-executing restraint. This provision was carried into the Internal Revenue Code which provides: "No person required under a State law to make payments to an unemployment fund shall be relieved from compliance therewith on the ground that he is engaged in interstate or foreign commerce, or that the State law does not distinguish between employees engaged in interstate or foreign commerce and those engaged in intrastate commerce."\(^6^4\)

It is obvious that this was not intended as an aid to the states' taxing power as such. Rather, it was to fill out the scheme for unemployment compensation which was designed to force the states to create and administer unemployment compensation funds.

With respect to the business of insurance, an unusual situation developed. Congress had not undertaken to regulate insurance, but in order to permit states to regulate insurance the Supreme Court held in 1869 that insurance is not commerce.\(^6^5\) That doctrine was reaffirmed in many cases, as for example in 1913 when it was used to permit a discriminatory local tax against a foreign insurance company.\(^6^6\) Elaborate state regulatory and taxing schemes were built upon that premise. Then, in 1944, the Court had to consider whether associations of insurance companies could be prosecuted for violation of the Sherman Antitrust Act.\(^6^7\) The Sherman Act has its constitutional basis in Congress' power to regulate interstate commerce. Hence, if insurance was not interstate commerce the indictments would fall; but if it was, existing state regulation and taxation would be destroyed. The Court held, four to three, that insurance is interstate commerce.\(^6^8\)

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\(^{62}\) nor with congressional inducements to "voluntary" state action, as for example in employment taxes, INT. REV. CODE OF 1954, §§ 3303-05.


\(^{64}\) INT. REV. CODE OF 1954, §§ 3301-08.

\(^{65}\) INT. REV. CODE OF 1954, § 3305(a).

\(^{66}\) Paul v. Virginia, 75 U.S. (8 Wall.) 168 (1869).

\(^{67}\) New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495 (1913).


\(^{68}\) United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533 (1944).
Congress promptly adopted the McCarran Act by which it declared "that the continuing regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States." In 1946, the Supreme Court held that a discriminatory tax on a foreign insurance company, which it assumed would otherwise have been unconstitutional under the commerce clause, had been validated by the act.

By the McCarran Act, Congress came to the rescue of the states for the first time in the matter of their powers of taxation as such, free from ties to any program which Congress itself sought to implement. Its motivation was to restore the status quo ante which had been unsettled by the Supreme Court. It had not yet dealt with any situation in which the states sought to extend their powers into previously proscribed areas.

As state cigarette taxes grew in number and in burden, a substantial business in "bootlegging" cigarettes developed. Mail order houses in states not having such taxes could sell cigarettes and pay for mailing them to consumers in other states at substantial savings under the cost of tax-paid cigarettes. The taxing states obviously had no power to pursue the foreign vendors and had no practical means of identifying the vendees so as to pursue them. In 1949, Congress put an effective stop to this situation with the Jenkins Act. Section 376(a) of that act provides: "Any person who sells or transfers for profit cigarettes in interstate commerce whereby such cigarettes are shipped into a State taxing the sale or use of cigarettes ... shall ... file with the tobacco tax administrator of the State into which such shipment is made, a memorandum or a copy of the invoice covering each and every shipment of cigarettes made ...." Thus, Congress exerted its power to regulate interstate commerce to require vendors to give tax-collecting assistance to states which due process prevented them from requiring them-

71. Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946); however, there is a question as to whether the authority of this decision has been impaired by Reserve Life Ins. Co. v. Bowers, 379 U.S. 810 (1964), reversing 119 Ohio App. 251, 196 N.E.2d 114 (1963), which had upheld a discriminatory tax on foreign insurance companies. See also State Bd. of Ins. v. Todd Shipyards Corp., 370 U.S. 451 (1962).
selves. The Supreme Court affirmed a declaratory judgment of a three-judge district court upholding the act.\textsuperscript{74}

In these three actions, Congress had used its power over interstate commerce \textit{in aid of} state taxation: (1) to implement a Congressional program; (2) by disclaiming the power in limited circumstances, to extricate the states from a court-created upheaval; and (3) to do for the states what they could not constitutionally do for themselves in a new tax area. It had not done anything to restrict the states’ exercise of their taxing powers. It had, however, given the matter some thought. When in 1944 the Supreme Court permitted Minnesota to levy a property tax, unapportioned, on Northwest Airlines’ entire fleet of airplanes, notwithstanding that some of them had been taxed elsewhere,\textsuperscript{75} Congress directed the Civil Aeronautics Board to investigate and recommend ways of preventing such double taxation.\textsuperscript{76} In 1945, the Board recommended a federally-imposed uniform apportionment, but the bill incorporating that recommendation did not pass either then or in a second attempt four years later.

In 1959, the Supreme Court created another situation very similar to that of 1944: it held unequivocally that a state could tax the net income of purely interstate commerce.\textsuperscript{77} Complaints from business were so loud and numerous that Congress finally acted, this time to impose a limitation upon the exercise of state taxing powers.\textsuperscript{78} Strictly as a stop-gap measure, it held the line at the \textit{Northwestern States} decision, overruling \textit{Brown-Foreman} and \textit{International Shoe}.\textsuperscript{79} In addition to the call for a study of the entire situation, the statute provides that states and their subdivisions may not impose any tax on or measured by net income of a non-domiciliary taxpayer whose only business activities in the state are

\textsuperscript{74} Consumer Mail Order Ass'n v. McGrath, 340 U.S. 925 (1951), rehearing denied, 341 U.S. 906 (1952).

\textsuperscript{75} Northwest Airlines, Inc. v. Minnesota, 322 U.S. 292 (1944).


\textsuperscript{78} The writer has never understood why the \textit{Northwestern States} case has created such consternation, for West Publishing Co. v. McColgan, 328 U.S. 823 (1946), had held virtually the same thing in 1946. The surprising decisions were the Court's refusal to hear Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So. 2d 70 (1958), cert. denied and appeal dismissed, 359 U.S. 28 (1959), and International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640, cert. denied, 359 U.S. 984 (1959), where in each case the Supreme Court of Louisiana had held a company, which had nothing in the state but traveling salesmen who solicited orders for acceptance and shipment outside the state, subject to net income tax. While those decisions were part of the background, it was the \textit{Northwestern States} case that created most of the furor.

\textsuperscript{79} See note 78 \textit{supra}.
the solicitation of orders for goods, which orders are either to be filled by the taxpayer from without the state or are turned over to a customer of the taxpayer.80

Looking at its language alone, P.L. 86-27281 might be interpreted to overrule the Northwestern States decision. However, the legislative history indicates otherwise. As reported to the Senate by the Finance Committee, the bill extended the prohibition to cases in which the foreign vendor maintained an office in the state for the primary purpose of serving the salesmen. Even an offer to substitute “sole” for “primary” did not satisfy the opponents who wanted any office to be deemed a sufficient “nexus” for tax. Accordingly, that section, which would have overruled the Northwestern States decision, was deleted, leaving among decided cases only Brown-Forman and International Shoe beyond the pale of the statute.82 Thus, it is here that Congress has for the first time undertaken actually to define the limits of state taxing power, probably in exercise of its interstate commerce power, but also possibly under its power to implement the fourteenth amendment.

B. Public Law 86-272 in the Courts

It is beyond question that in the exercise of its commerce clause power Congress can override, supersede, or prohibit otherwise valid state regulation.83 It was inevitable, however, that the constitutionality of P.L. 86-272 would be challenged on the ground that whatever else Congress can do it cannot impair the fundamental attribute of sovereignty — the power to tax.84

(1) The Tests of Constitutionality.—The earliest case involving P.L. 86-272 did not have to apply it directly, but rather used it to reinforce a decision against the taxpayer.85 In that case, a taxpayer whose operations were all in Tennessee sought to apportion part of its income to other states in which it had customers (“des-
tination sales”) but no substantial operations. The Supreme Court of Tennessee held that Tennessee could tax its entire income for the reason, among others, that P.L. 86-272 prevented any other state from taxing any part thereof. Note that this treats P.L. 86-272 as an apportionment statute. If it were strictly a nexus statute as it reads and as it has been held to be, the fact that it prohibited taxation by other states would have no bearing at all on the permissible tax base for Tennessee. The constitutionality of the statute of course was not an issue.

The first test of constitutionality came in Louisiana in a case that was carefully set up to present just that one issue.\(^{86}\) It was agreed that under the earlier decision which the Supreme Court had refused to review,\(^ {87}\) the taxpayer had income subject to tax by Louisiana and there was no dispute as to the amount. It was also agreed that the taxpayer’s activities in Louisiana were fully protected by the statute, thus eliminating any question of statutory interpretation such as arose in later cases. The sole question was whether Congress had the constitutional power to restrict state taxation in circumstances to which the self-executing prohibitions of the commerce clause did not extend. Briefs amicus were filed on behalf of nineteen states urging that the statute be held unconstitutional and on behalf of forty trade associations urging its constitutionality — an indicator of the importance attached to the case.

The trial court held for the statute and the Supreme Court of Louisiana unanimously affirmed. The principal argument for unconstitutionality was an ingenious one: since the Supreme Court had indicated that taxing the net income derived from interstate commerce is not taxing the commerce itself and hence is not a regulation of it, a federal statute restricting state net income taxes could not be a regulation of interstate commerce and hence not within the commerce power of Congress. The court answered this argument by saying that while “net income taxes are not to be regarded, in the absence of action by Congress, either as a regulation of commerce or as burdening the free flow of commerce to such an extent as to be violative of the commerce clause,” Congress nevertheless “retained plenary power to regulate [activities in interstate commerce] by prohibiting the imposition of a state tax when it determines such tax to unduly burden the free flow of such


The court also rejected arguments that because Congress had not acted in this area in 170 years, its power to do so had atrophied, and that the statute discriminated against intrastate commerce in violation of the fifth amendment. This last argument seems a strange one and hardly worth mentioning except that the opponents of any federal regulation of state taxation urge it so persistently. Apparently it stems from the fallacious concept that the vendor "takes money out of the market" and should be required to put some back by paying taxes to the jurisdiction in which his customer is located merely because the customer is located there. Since a Louisiana manufacturer of shoes which he sells to Louisiana customers must pay tax to Louisiana on the income derived from that business, a Missouri manufacturer of shoes who sells to Louisiana customers should pay tax to Louisiana on the income derived from that business — lest the Louisiana manufacturer be competitively disadvantaged. The non sequitur is obvious. The Louisiana manufacturer owes tax to Louisiana not because his customers are there, but because his plant and activities are there, receiving the benefit of governmental services there. The Missouri manufacturer pays taxes for similar reasons to Missouri. The argument would make sense with respect to tax on the consumer (sales or use), but it makes none in the context of a tax on net income. Net income is properly taxed where it is earned and arises, which is to say where capital and labor are employed to produce it.89

It probably is not too much to say that this is the most important state tax case to have been presented to the Supreme Court in 150 years. It was a perfectly "clean" case, presenting a single, solid, novel constitutional issue. Representatives of many tax collectors and of many taxpayers urged the Court to decide it. Surely the issue must be faced eventually. In fact, at the present time a subcommittee of Congress is considering an expansion of P.L. 86-272 and it would presumably welcome any such guidance. Why then did the Court refuse to consider it? Several inferences are possible: (1) the Court was satisfied with the decision below and saw no occasion to spend further time on it; (2) the Court found the subject so delicate that it did not want to deal with it until it had to, or until a larger body of lower court decisions had developed; (3) the Court, knowing it would eventually have to interpret the statute

as well as consider its constitutionality, preferred to wait for a case that was less clear-cut; and there may be others. The writer prefers, however, to draw no inference at all.

The next case to test P.L. 86-272 required an interpretation of the law as well as a determination of its constitutionality. The taxpayer manufactured drugs in New Jersey and sold them to druggists in Missouri where it had twelve resident salesmen but no offices. The State Tax Commission decided that P.L. 86-272 did not apply because the taxpayer’s activities went beyond the minimum (solicitation of orders) protected by the act in that: (1) the salesmen did missionary work with doctors to get them to prescribe the drugs — promoting the intrastate business of the druggists; (2) the residences of the salesmen, their company-owned automobiles, and their personally owned property invoked the exception that P.L. 86-272 does not apply to domiciliaries; (3) sales meetings were held in Missouri; and (4) CIBA Pharmaceutical Company had qualified as a foreign corporation, thus becoming a domiciliary.

The trial court found all the activities to be within the statutory protection and gave judgment for the taxpayer without considering the question of constitutionality. The Missouri Supreme Court unanimously affirmed. It held that all the described activities were within the category protected by the statute. The promotion work with doctors, the sales meetings, the use of automobiles were all in furtherance of the interstate sales to the druggists.

On the constitutional issue, the State Tax Commission, supported again by representatives of several other states, made the same principal argument that had been made in Louisiana. In response, the court concluded: "In adopting Public Law 86-272 Congress is clearly, in our opinion, undertaking to regulate interstate commerce by providing a uniform statement of the facts, circumstances and conditions under which a state may not burden interstate commerce by state income taxes where the activities of the corporation in a foreign state do not exceed the minimum

90. State ex rel. CIBA Pharmaceutical Prods., Inc. v. State Tax Comm’n, 382 S.W.2d 645 (Mo. 1964).

91. In so holding, the court distinguished Eli Lilly & Co. v. Sav-on-Drugs, Inc., 366 U.S. 276 (1961). Although the Missouri court did not mention it, the most important distinction seems to be that Eli Lilly was not a tax case, but rather involved a question of "doing business" so as to be required to qualify.
standard set up in the act." Thus, the argument of discrimination against intrastate commerce received the short shrift it deserves.

The scene then shifted to Oregon. The facts in a case here were substantially identical to those in *CIBA Pharmaceutical*. The State Tax Commission supported its assessments on the twin grounds that the taxpayer's activities were not within the protected area and that the statute was unconstitutional. On the first point, the Tax Court found, as had the Missouri court, that "Congress intended to exempt not only the specifically described phase [actual solicitation of orders] of interstate sales efforts but also all lesser, included phases." Sales promotion is merely a form of sales solicitation.

Having crossed that bridge in the same manner as the Missouri court, the Oregon court approached the constitutional question, and, aided again by the amici curiae representing various states, adopted the principal argument made unsuccessfully to the Supreme Courts of Louisiana and Missouri. Stated differently, the argument was that although P.L. 86-272 is not a legislative attempt to define due process, which is a judicial function, it fails as a regulation of interstate commerce. In a brilliant analysis of the distinctions between a franchise tax measured by net income and a tax laid directly upon net income the court stated: "[T]he logical and practical conclusion is that, by its nature, a net income tax is not imposed on interstate commerce but upon the profits of a business after the proceeds of its commerce have left interstate commerce." "Because the burden of a net income tax is not on that commerce which Congress may preempt or otherwise regulate, the distinction between undue burdens and due burdens permitted until Congress acts is inapplicable. Congress' power to prohibit state taxation terminates when the limits of interstate commerce are reached." The real concern of the Oregon Tax Court was with fundamental principles of federalism: "If, as interstate commerce Congress can prohibit a state tax on net income derived from interstate commerce, the argument of discrimination against intrastate commerce received the short shrift it deserves.

92. State *ex rel. CIBA Pharmaceutical Prods., Inc.* v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964).
commerce, then, Congress can prohibit all state taxation under its broad power to regulate intrastate affairs affecting interstate commerce. 97 Congress could, said the court, validly impose a uniform apportionment formula to prevent overlapping taxation, but P.L. 86-272 is not such a statute. It provides that "no state shall have power," and creates an exemption. Thus, the decision was in effect an invitation to Congress to achieve the same result by using different words. 98 Had that decision survived the appeal to the Oregon Supreme Court, it would virtually have forced the United States Supreme Court to settle the issue. After affirming the Tax Court's holding that the taxpayer's activities were within the protection of the statute, the Supreme Court of Oregon went on to hold the statute constitutional. It found an area of "overlap" of the powers of states to legislate matters affecting interstate commerce in the absence of congressional action and the powers of Congress in the exercise of its delegated authority to override such legislation. "In Northwestern Cement the Court simply held that a state income tax upon revenues derived from interstate commerce 'does not offend constitutional limitations upon state interference with such commerce.' The Court was deciding the extent of the restrictions imposed by the unexercised delegation of power made by the Commerce Clause. In the instant case the power delegated has been exercised. 99

(2) Interpretations of Nexus.—Viewing P.L. 86-272 as a nexus rule rather than an apportionment rule, an interesting and far from academic question arises. There are two kinds of nexus: jurisdiction over the person of the taxpayer, and jurisdiction over the transaction taxed. Jurisdiction is a due process problem, and yet in enacting P.L. 86-272 Congress apparently relied entirely upon its commerce power rather than its power under the fifth section of the fourteenth amendment to implement due process. The three cases discussed above all looked solely to the commerce power.

It is clear that in any taxing situation the state must have jurisdiction over either the person or the transaction, but it is not clear which. In the unemployment tax case, the state had jurisdiction over the transaction (employees earning commissions in the state),

97. Ibid.
98. Instead of providing that "no state shall have power to tax" under certain circumstances, Congress might say that under such circumstances, "all income is apportioned to the home state." This, it seems to this writer, is a distinction without a difference. Ownbey Co. v. Butler, 221 Tenn. 366, 365 S.W.2d 33 (1963).
but not in the traditional sense over the taxpayer.\textsuperscript{100} The Supreme Court transmuted the jurisdiction in the nature of in rem to in personam to the extent of permitting the state to sue the taxpayer \textit{with respect to that transaction}. There was no hint that International Shoe could have been sued in Washington on any other account.

More often, however, jurisdiction over the person seems to be sufficient. If such jurisdiction exists for any reason, the state can tax transactions over which it has no direct jurisdiction,\textsuperscript{101} except that sometimes a purely interstate transaction will escape even though the taxpayer is admittedly present through other transactions.\textsuperscript{102}

The question under P.L. 86-272 is whether transactions which in themselves are clearly entitled to the protection of the statute lose that immunity if the taxpayer has other contacts with the state which are not so protected. To date, at least two cases have presented that issue without conclusive result. In \textit{United States Steel Corp. v. Undercofler},\textsuperscript{103} the point, unfortunately, probably did not arise directly because the assessments may have been made before the effective date of P.L. 86-272, and hence was not considered by the court. The taxpayer, United States Steel Corporation, operated a diversified steel business through fourteen separate divisions, each of which dealt in products largely peculiar to itself. Several of these divisions did business in Georgia: the American Bridge Division engaged in construction contracting; the American Steel and Wire Division sold and installed fencing; the National Tube Division sold pipe. At issue were the activities of the Tennessee Coal and Iron Division which shipped tinplate and rails to customers at Georgia locations pursuant to contracts solicited and negotiated outside Georgia. The division had no offices in Georgia. The court held that the gross receipts from these sales had to be assigned to Georgia because "it is the receipt of money... that produces income,"\textsuperscript{104} and because of the presence of other, admittedly taxable, activities, relying for this latter point on \textit{General Motors Corp. v. Washington}.\textsuperscript{105}

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\item \textsuperscript{100} International Shoe Co. v. Washington, 326 U.S. 310 (1945).
\item \textsuperscript{101} General Motors Corp. v. Washington, 377 U.S. 436 (1963), in which the taxed transactions were wholly without the jurisdiction, but were nevertheless held taxable, apparently because the taxpayer engaged in other admittedly taxable business in the state.
\item \textsuperscript{102} Norton Co. v. Department of Revenue, 340 U.S. 534 (1951). There is a question, however, as to whether this has been overruled by \textit{General Motors}.
\item \textsuperscript{103} United States Steel Corp. v. Undercofler, 220 Ga. 553, 140 S.E.2d 269 (1965).
\item \textsuperscript{104} \textit{Id.} at 563, 140 S.E.2d at 277.
\item \textsuperscript{105} 377 U.S. 436 (1963).
\end{itemize}
\end{footnotesize}
In the other case, the point was strongly urged under facts similar to those in *United States Steel Corp. v. Undercofler*, but the statute was held inapplicable. If the protection was lost because of unrelated activities, a question of unconstitutional discrimination is now raised. Compare the taxpayer’s position with that of a competitor who has the same transactions as those taxed, but not the unrelated activities. The court avoided the argument, and this point was not carried to the Supreme Court where other aspects of the case were argued.

There is nothing in the wording of P.L. 86-272 nor in its legislative history to suggest that Congress contemplated the *United States Steel Corp.* and *General Motors* type of situation. Rather, it seems that the all-or-nothing circumstances of *International Shoe*, *CIBA Pharmaceutical*, and *Smith, Kline & French* received all the attention. Whether the statute will be interpreted to apply separately to segments, or whether constitutional considerations will force such an interpretation, will be for determination in later litigation.

IV. A CONCEIVABLE FEDERAL STATUTE

The Congressional Report reveals a chaotic condition throughout state and local taxation of multistate business, and concludes that Congress should do something about it. To that end, the Special Subcommittee will almost surely recommend a federal statute to regulate such taxation. Whatever its content, it will be heatedly opposed by some state tax administrators, even though it may be as much for their benefit as for that of business. The more comprehensive the proposal, the more difference of opinion will be generated as to specific provisions within such groups as taxpayer representatives, tax administrators, and academicians.

A. Outline of the Structure

The Special Subcommittee’s proposal will probably be more comprehensive than P.L. 86-272, but it is very unlikely to cover the


108. See note 103 *supra*.


entire field in any such ambitious manner as is suggested in the outline below. Almost surely it will prescribe one or more formulae for the apportionment of income; and probably there will be some rules governing liability for collecting use and other taxes imposed upon others.

The following outline represents in a general way the possible structure of an all-inclusive federal statute regulating state and local taxation of multistate business. Although it is perhaps much more elaborate than can be expected of an actual enactment, it may serve to describe the perimeter of the field and the interrelation of the aspects of the problem, only some of which are likely to be selected for statutory attention.

(1) Findings.—The setting for the legislation ought to include the findings of the Special Subcommittee as an aid to its subsequent interpretation. Based primarily upon the Congressional Special Subcommittee’s Report, this section would note the growing economic impact of state and local taxes, describe the chaotic conditions causing unreasonable burdens on taxpayers, administrators, and courts, and recite the economic bases and incidences of various types of taxes.

(2) Definitions.—The important definitions in such a statute would be: (1) “state,” which includes subdivisions; (2) “taxes,” which includes all governmental charges and requirements for collecting taxes from others; and (3) “enterprise,” which includes every business except that of being an employee.

(3) Declaration of Policy.—This declaration should not be directory, but rather a statement of objectives to assist in applying the directory provisions, including: (1) multistate business must “pay its own way” and accept the same burdens as local business in each locality; (2) multistate business should not be subject to burdens not imposed upon local business; (3) states should not tax values outside their territorial jurisdictions; (4) collection of taxes of others should be properly compensated and involuntary collectors should be given some protection against innocent mistakes; and (5) business should assist in collection of taxes which it is genuinely difficult for administrators to collect, as by being required to report transactions to states having no jurisdiction to impose such a requirement.

(4) Prohibition of State Taxation of Multistate Business Except as Expressly Permitted.—Permitted types of taxes, subject to de-
tails later prescribed, would include: (1) taxes on or measured by net income, without distinction; (2) ad valorem taxes; (3) the duty to collect taxes, in some cases, imposed upon others, and in other cases to report transactions so that tax administrators could pursue the taxpayer directly; (4) use tax, including in that term all taxes on or measured by gross receipts, or by units of goods or services; (5) personal income tax; (6) value-added tax; (7) fees and charges for special services; (8) capital tax; (9) severance tax; and (10) social security taxes, and perhaps others. It would be required that taxes be equal for all, including the state, in the same business.

(5) Tax on or Measured by Net Income.—Net income would be defined by reference to the Internal Revenue Code, with adjustments, the principal problem being to make appropriate provision for transition where there have been substantial deviations in matters of timing, such as in depreciation and in installment sales. A uniform apportionment formula would be prescribed, or perhaps more than one to accommodate particular industries. A universal formula would be possible if some variation were prescribed in one or more of the factors. The most likely formula would be based on property and payroll, perhaps combined, by converting property to rental value, into a single fraction to achieve automatic weighting. A third factor of sales, presumably assigned to permanent establishments, but possibly to "destination," might be permissible provided that no enterprise had its tax increased thereby. Thus, while a state would not be permitted to penalize imports, it could if it wished subsidize exports. It is very important that a two-factor formula of property and payroll not be rigidly imposed, because without other adjustments, such as to rates, serious dislocations would be caused. Another likely formula would have three factors of property, payroll, and sales, but the sales would not be assigned to "destination" because of the lack of economic justification for so doing and the impossible problems of compliance and administration which such a procedure would create.

Payroll would be assigned either to permanent establishments or by reference to unemployment taxes, and could be the same for all businesses. The content of the property factor would need a few variations to achieve a meaningful measure for all industries. For manufacturing, construction, and many other industries, only capital goods would need to be included. In mercantile enterprises, inventory is too important a factor to be omitted. In financial enterprises, tangible property is insignificant, while in-
tangibles are the principal income-producing factor. In transportation, ton-miles, or pick-ups and discharges, avoid the problem of fixing the location of moving equipment.

One of the adjustments which might be made to "federal" income to determine apportionable net income would be to add back all state taxes. After the apportionment, the ad valorem and other taxes paid to each state, and its subdivisions, would be deducted from the income apportioned to that state. A similar provision might be made for tax-exempt interest.

(6) Discrimination.—Protection against discrimination in ad valorem taxes, a problem for railroads, manufacturers, merchants, and public utilities, ought to be included.

(7) Collecting Taxes Imposed Upon Others.—This is the most difficult problem of all, because here and only here there is a genuine conflict of interest between the professional collectors and the involuntary ones, and because of the extreme difficulty of devising an appropriate scale of compensation. The power to impose such a requirement would be limited to instances in which the transaction, as distinguished from the person of the collector, is within the jurisdiction, and reasonable compensation would be required. Several statutes now provide for compensation, but all are based on percentages of tax collected and are completely unsatisfactory. A given percentage may be gross underpayment in a case of numerous small transactions and a gross overpayment in a case of a few large transactions. A satisfactory scale would be tied directly to the amount of work required, e.g., a stated amount for each return filed, or for each item reported. The principle of the Jenkins Act,\(^\text{112}\) which requires reporting of interstate shipments of cigarettes, would be extended to apply to shipments of all goods when requested. This for the first time would give the states a means of enforcing a use tax on mail order purchases.

(8) Taxes Measured by Gross Receipts or by Units of Goods or Services.—Since all of these taxes are almost universally passed on to the purchaser in the particular transaction, as for example where cigarette prices are higher in one state than in another by the precise amount of the difference in the cigarette tax rates, all such taxes would be deemed not only to be paid by, but to be imposed upon, the purchaser, i.e., to be "use" taxes, regardless of their statutory description as franchise taxes on the seller or otherwise. As

\(^{112}\) See note 72 supra and accompanying text.
such, they could be imposed only with respect to use within the jurisdiction and would be subject to the rules governing requirements for collection. The principal problems occur in dealing with property, such as construction equipment, that is moved from one jurisdiction to another, and with sale for use in another jurisdiction when delivery is taken in the jurisdiction of sale. These are not insurmountable.

(9) Value Added.—This is the amount remaining after subtracting the value of purchases and imports from the value of sales and exports. This type of tax, not currently in use, would be offered as a substitute for the gross-receipts-franchise taxes now imposed by a few jurisdictions. In effect, gross receipts would be taxable to the extent generated by activities in the jurisdiction. In most cases, the books of the enterprise would furnish the figures directly, but in some instances an apportionment would be necessary. This could be done with the same sort of property-payroll formula used for income apportionment.

(10) Fees for Special Services.—Such fees would be excluded from coverage, except to confine them to charges which actually pay only for such services. Examples are gasoline taxes exclusively for highway construction and maintenance, and incorporation, qualification, registration, and license fees exclusively to support supervisory agencies.

(11) Capital Tax.—Capital would be defined and apportionment would be on the basis of location of property.

(12) Personal Income Tax.—This tax may be imposed on residents as such, but only in addition to, and not in lieu of, any taxes for which an individual may be liable as an enterprise.

(13) Administrative Provisions.—Minimum rules of fairness in administrative matters would be included. They would require adequate taxpayer remedies, a reasonable statute of limitations in all cases except fraud, limitations and interest with respect to refunds equal to those applicable to deficiencies, and protection for good faith reliance on statements, such as exemption certificates, of other taxpayers. These rules would provide for adjustment of transactions not at arm’s length, but with protection to taxpayers caught between inconsistent adjustments by two or more taxing jurisdictions.

It can be seen from the foregoing outline that such a statute would greatly benefit both taxpayers and tax administrators. By cutting down the number of jurisdictions to which a taxpayer would
have to report, costs of compliance and administration would be reduced making possible more nearly complete enforcement. By eliminating the distinction between “on net income” and “measured by net income,” states would be permitted to tax interstate commerce without regard to labels\textsuperscript{113} and without omitting federal interest. The burden of collecting taxes imposed upon others would be reduced and states would be given the means they do not now have for collecting such taxes. The statute would not interfere with rates of tax nor limit revenues, but it would prevent discrimination against foreigners. A few — but very few — taxes now imposed would have to be changed. An example is St. Louis’ gross receipts tax,\textsuperscript{114} which would have to be limited either to receipts from sales to St. Louis residents (use tax), or the portion of receipts generated by activities in St. Louis (value added tax), or both.

B. \textit{Would Such a Statute Be Constitutional?}

Whether or not an act of Congress contravenes the Constitution is a question for the Supreme Court.\textsuperscript{115} Speculation thereon by any lawyer is rash, but there are guides upon which to base such speculation. In this case, those guides suggest strongly that a statute as outlined above to regulate state and local taxation of multi-state business would be held constitutional, at least in its major provisions. The discussion above of “P.L. 86-272 in the Courts” is some support for this conclusion.\textsuperscript{116} There are also the numerous asides by several Supreme Court Justices to the effect that the problem is legislative rather than judicial, and that Congress has and should exercise the power to define the limits of state taxation of interstate commerce.\textsuperscript{117} Probably the clearest expression of this view, from which there is no recorded judicial dissent, is Mr. Justice Frankfurter’s dissent in \textit{Northwestern States Portland Cement Co. v. Minnesota}\textsuperscript{118} in which he said:

\textsuperscript{115} Much of the material in this section is drawn from a thorough study of the area made by Leslie M. Swope of the Pennsylvania Bar in 1963. (unpublished).
\textsuperscript{116} See text at pp. 875-82 supra.
\textsuperscript{118} 358 U.S. 450 (1959).
The problem calls for solution by dividing a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the taxing freedom of the States and the needed limits on such state taxing power. Congressional committees can make studies and give the claims of the individual States adequate hearing before the ultimate legislative formulation of policy is made by the representatives of all the States. The solution to these problems ought not to rest on the self-serving determinations of the States of what they are entitled to out of the Nation's resources. Congress alone can formulate policies founded upon economic realities, perhaps to be applied to the myriad situations involved by a properly constituted and duly informed administrative agency.¹¹⁹

The best summary of this attitude appears in the following comment: "There is only one proposition upon which all the justices . . . both those who would narrowly restrict the states' taxing power and those who would give it the greatest breadth possible . . . would seem to be in accord, and that is that Congress should undertake to define the areas within which the state taxing powers are permissible and within which they are forbidden."²²⁰

There is no doubt that Congress can, in the exercise of any of its delegated powers, supersede otherwise valid state regulation.²¹ It is equally clear that Congress can prevent state interference by taxation with Congressional objectives in at least some areas. Thus, under its power to regulate money, Congress can and has limited and prohibited state taxation of privately owned but federally incorporated financial enterprises.²²² It is firmly established also that under its power to regulate interstate commerce, Congress can regulate matters which are not themselves interstate commerce, but which merely affect it, though even remotely.²²³ It should follow,

¹¹⁹. Id. at 476-77.
²²⁰. Rosenberg, Interstate Commerce: To What Extent May Congress Define the Areas of State and Local Taxation? (paper presented to the ABA Committee on State and Local Taxes in 1956).
²¹. E.g., South Carolina State Highway Dep't v. Barnwell Bros., 303 U.S. 177 (1938).
²²². Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941); Currin v. Wallace, 306 U.S. 1 (1939); NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937). But cf. Carter v. Carter Coal Co., 298 U.S. 238 (1936). Strongest of the recent pronouncements is Katzenbach v. McClung, 379 U.S. 294 (1964); Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964). In Katzenbach, it was held that Congress could require a local restaurant to serve Negro customers because a substantial part of its meat supply had been purchased from a local supplier who in turn had acquired it through interstate commerce. For a further discussion of these
although it has not yet been expressly decided by the Supreme Court, that Congress can limit or even prohibit state taxation of interstate commerce or matters which Congress determines to have an effect upon interstate commerce.

The next question is whether Congress can limit or prohibit a state tax which the Supreme Court has held valid in the absence of Congressional action, or whether it can permit a state tax which the Supreme Court has held invalid in the absence of Congressional action. Here the answer should be a confident "yes." The first clear instance of Supreme Court approval appears to have occurred in 1856. In 1852, the Court had held a certain bridge to be an obstruction to navigation, and ordered its removal.\(^{124}\) Congress promptly adopted an act declaring the bridge to be a "lawful structure."\(^{125}\) The Supreme Court then concluded that although the bridge "still may be an obstruction in fact," by reason of the act of Congress it had ceased to be such "in the contemplation of law."\(^{126}\) That principle was later applied in a tax case in which the Court sustained a state tax discriminating against interstate commerce because Congress had permitted it.\(^{127}\) The Court said the controlling cases "are the ones involving situations where the silence of Congress or the dormancy of its power has been taken judicially, on one view or another of its constitutional effects, as forbidding state action, only to have Congress later disclaim the prohibition or undertake to nullify it. Not yet has this Court held such a disclaimer invalid or that state action supported by it could not stand. On the contrary, in each instance it has given effect to congressional judgment contradicting its own previous one."\(^{128}\)

The invalidity of the tax in that case would have resulted, but for the congressional action, from the commerce clause. An instance in which Congress used its commerce clause power to require a reporting for tax purposes which the states could not have required without violating due process occurred in the Jenkins Act\(^{129}\) which


\(^{125}\) Act of August 31, 1852, 10 Stat. 112.


\(^{128}\) Id. at 423-24.

\(^{129}\) See note 72 supra.
required the reporting of interstate shipments of cigarettes. As noted previously, these provisions have been upheld. 130

These decisions make it clear enough that Congress can permit an otherwise invalid tax. To date, there are only dicta to support the corollary that Congress, solely as a regulation of interstate commerce, can prohibit an otherwise valid tax—but the dicta are strong. An example is Mr. Justice Jackson's concurring opinion upholding the tax in *Northwest Airlines, Inc. v. Minnesota* 131 wherein he said of Congress: "It may exact a single uniform federal tax on the property or the business to the exclusion of taxation by the states. It may subject the vehicles or other incidents to any type of state and local taxation, or it may declare them tax-free altogether." 132

No doubt Congress must be reasonable in use of its commerce power to impose restraints on state taxation. While the cases support a strong inference that Congress has such power in the abstract and can apply it very broadly, there is still the question as to whether each specific enactment is within the power. The statute outlined above seems to meet any test of reasonableness that is likely to be applied to an act of Congress. Its impact on state revenues is minimal and is in fact as likely to increase them as to diminish them. Its most important provisions—prescribing a uniform formula for the apportionment of net income and limiting liability for the collection of taxes from others—seem clearly to be proper regulation and protection.

At least passing consideration should be given to the due process clause which Congress is authorized to implement by statute. 133 If, as seems unlikely, there is some business so local that a congressional finding that a tax on it "affects" interstate commerce could not stand, the question arises whether Congress could effectively declare that such a tax denies due process. Otherwise stated, a phase of the question is whether Congress can, through due process, confine municipalities to their own territories and prevent their discrimination against inter-municipal commerce which does not cross state lines. 134 This is essentially a matter of defining due

130. See note 74 supra.
132. Id. at 303-04.
133. U.S. CONST. amend. XIV, § 5.
process. The cases dealing with congressional action under the fourteenth amendment suggest that Congress' power with respect thereto is limited to such things as providing remedies for what the Supreme Court determines to be denial of due process, and does not include determining what constitutes due process.135

It is sometimes suggested that a most valuable aid to protecting taxpayers from unreasonable exactions would be to give them access to federal courts. The eleventh amendment provides that "the Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State..."136 It has been held to proscribe taxpayer suits against state officials as well as against the states themselves.137 For this reason, the statute outlined above omits any attempt to confer federal court jurisdiction.

V. CONCLUSION

Improvement of transportation and communication have led to increased integration of our national economy and growth of interstate commerce — a growth more rapid than the expansion of the economy as a whole. Revenue demands of governments at all levels have expanded even more rapidly, so that state and local tax burdens have become proportionately greater, leading to administrative extension of old tax laws and the addition of new legislation. The laws and practices of the states and their subdivisions are overwhelming in their diverse requirements of multi-state business for filing reports, keeping records, and otherwise complying with the tax laws. In many cases, they are impossible of full enforcement and indeed, to a substantial extent they are not enforced.

As burdens become heavier, inequities which could formerly be ignored as de minimis become major problems. The long process of litigation and eventual decision by the United States Supreme

higher than a sales tax would have been had the transaction been intrastate, as a discrimination against interstate commerce. The circumstances were identical in Spatt, except that the transaction was over city lines rather than state lines, and the Supreme Court allowed New York's refusal to invalidate the tax to stand. In Halliburton, the Supreme Court said that the inducement to keep commerce local was an improper objective. In Spatt, the New York court said the inducement to keep commerce local was a valid reason for the difference between the sales and use taxes.

136. U.S. CONST. amend. XI.
Court is wholly inadequate to supply the remedy. Indeed, much confusion results from the difficulty of ascertaining the principles established by the Court and the still greater difficulty of applying any such principles to concrete facts. The cure must therefore lie in legislation; and, since the states have shown almost no inclination to deal constructively with the problem, the need for federal legislation becomes apparent. Congress could define income, prescribe the method of its apportionment, prescribe the conditions under which business may be required to collect taxes from others, require business to aid states in collecting by reporting transactions, prohibit some kinds of taxes, and limit or regulate all others. All of these appear to be well within Congress' power to regulate interstate commerce, which includes the power to regulate matters affecting interstate commerce.