STATE TAXATION OF INTERSTATE COMMERCE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

NINETY-THIRD CONGRESS

FIRST SESSION

ON

PROPOSALS REGARDING STATE TAXATION OF INTERSTATE COMMERCE

SEPTEMBER 18 AND 19, 1973

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STATE TAXATION OF INTERSTATE COMMERCE

TUESDAY, SEPTEMBER 18, 1973

U.S. SENATE,
SUBCOMMITTEE ON STATE TAXATION OF
INTERSTATE COMMERCE, OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2221, Dirksen Senate Office Building, Senator Walter F. Mondale [chairman of the subcommittee] presiding.

Present: Senators Long [chairman of the full committee], Mondale, and Hansen.

Senator MONDALE. The subcommittee will come to order.

On behalf of the members of the Subcommittee on State Taxation of Interstate Commerce, I wish to welcome you to our hearing this morning. As many of you may know, we are directing our attention to a problem today on which the Committee on Finance has long sought to focus.

When the Committee on Finance was organized this year, a new Subcommittee on State Taxation of Interstate Commerce was established. The purpose of this subcommittee, of which I am chairman, is to examine the problems posed for interstate businesses by the multifarious corporate income and sales and use taxes imposed by the different States. These problems have already been considered by the House which, in two previous Congresses, passed bills which subsequently were not acted upon by the Senate. Further House action now appears unlikely unless the Senate acts first and, in an effort to begin Senate action, the subcommittee is holding hearings today and tomorrow. Hopefully, we will be able to recommend legislation to the full Finance Committee.

As I have previously pointed out, the work done so far to this problem reveals wide disagreement on several important points. Staff work in preparation for subcommittee action has made clear that the reason for the failure of Congress to act, among other things, has been the almost total lack of agreement among the interested parties—the States, their tax administrators, and the principal business interests involved. Coordination of State taxation now appears to be essentially a State problem, requiring agreement among the States if congressional action is to become a reality. If, therefore, the subcommittee's hearings are to be productive, and if these hearings are to lead to a legislative proposal, there should, if possible, be agreement among the interested parties on the principal points of that proposal. There are signs that some consensus is evolving among the States and the business interests most deeply involved. I would hope that further steps along that road can be taken.

As my colleague, Senator Hansen, who will soon be here, has already pointed out in our announcement of these hearings, the problems involved in State taxation of interstate commerce have been with us since the earliest days of the Republic. Such long-standing problems do not lend themselves to simple and quick solution. What is needed now is serious attention to these problems with the objective of developing a well-thought-out and balanced remedy which recognizes the fundamental taxing power of the States under our federal system and the need for eliminating tax levies and/or administrative compliance requirements which impair or impede the free flow of commerce in our national marketplace.

We will now hear from our first witness, the Honorable Charles McC. Mathias, Jr., from the State of Maryland, and the original sponsor of S. 1245, one of the bills now pending on this subject.

[The subcommittee's press release announcing these hearings and the bills, S. 1245 and S. 2092, follow:]

PRESS RELEASE

FOR IMMEDIATE RELEASE
August 3, 1973

FINANCE SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE
UNITED STATES SENATE
2227 Dirksen Senate Office Bldg.

FINANCE SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE ANNOUNCES HEARINGS ON PROPOSALS REGARDING STATE TAXATION OF INTERSTATE COMMERCE

Senators Walter F. Mondale (D., Minn.) and Clifford P. Hansen (R., Wyo.) have jointly announced they will chair Senate hearings on proposals bearing on the state taxation of interstate commerce.

The hearings before this Subcommittee of the Senate Finance Committee will commence each day at 10:00 A. M. on September 18 and 19 in Room 2221, Dirksen Senate Office Building.

In commenting upon the problems involved in state taxation of interstate commerce, Senator Mondale, Chairman of the Subcommittee, stated:

> "As I have previously pointed out, the work done so far on this problem by the Congress since the early 1960's reveals wide disagreement on several important points. Since the problem involves state financial matters, consensus on the part of the states as to the contents of any Federal legislation as well as acceptance of such provisions by business taxpayers is vitally important if our hearings and subsequent Subcommittee deliberations are to be productive.
>
> "It appears some consensus is evolving among the states and business interests most deeply involved. I want to encourage additional efforts in this direction prior to our hearings so that the hearings can focus upon realistic substantive proposals. Hopefully, the work of the Subcommittee will help to precipitate a workable solution to the thorny issues involved in this subject which have been plaguing us for so long."

Senator Clifford P. Hansen (R., Wyo.), ranking minority member of the Subcommittee added:

> "Today I am joining with the distinguished Senator from Minnesota (Mr. Mondale) in announcing the hearings of the Senate Finance Subcommittee on the State Taxation of Interstate Commerce which have been set for September 18 and 19.
>
> "The problems of state taxation of interstate commerce have been with us since the earliest days

of the Republic. It has even been suggested that this issue is in part responsible for the post-revolutionary war movement for a stronger Union. A dispute between Maryland and Virginia over the regulation of commerce on the Potomac river led to the Annapolis Convention of 1786, the forerunner of the Constitutional Convention. The burdensome and often discriminatory levies imposed in those days on interstate commerce have since been eliminated. Today, however, instead of discriminatory taxes, we have a situation characterized by non-uniformity, burdensome and costly compliance procedures, and very substantial uncertainty as to total tax liabilities.

"I have long held the belief that in most instances the Federal Government should leave the resolution of problems such as these to the states themselves. However, it may well be that these hearings will directly focus the states' attention upon the difficulties faced by interstate business operations and will precipitate state cooperation and a general consensus with respect to these problems. Such state action can only inure to the benefit of the nation as a whole by removing some of the present burdens now placed on tax administrators, by eliminating the overlapping and voluminous amounts of paperwork required by businesses involved in interstate commerce, and in general by removing the remaining impediments to the free flow of commerce across state lines."

These hearings will consider S. 1245, cosponsored by Senators Charles Mc. Mathias (R., Md.), Abraham D. Ribicoff (D., Conn.) and Hubert H. Humphrey (D., Minn.), S. 2092, sponsored by Senator Warren Magnuson (D., Wash.), and the various proposals bearing on this issue which will be brought to the attention of the Subcommittee in the statements of witnesses and other interested persons. Additional bills introduced in connection with this subject prior to the date of these hearings will also be considered.

Request to Testify. -- Senators Mondale and Hansen advised that witnesses desiring to testify during this hearing must make their request to testify to Tom Vail, Chief Counsel, Committee on Finance, 2227 Dirksen Senate Office Building, Washington, D. C., not later than Friday, September 7, 1973. Witnesses will be notified as soon as possible after this cutoff date as to when they are scheduled to appear. Once the witness has been advised of the date of his appearance, it will not be possible for this date to be changed. If for some reason the witness is unable to appear on the date scheduled, he may file a written statement for the record of the hearing in lieu of a personal appearance.

Consolidated Testimony. -- Senators Mondale and Hansen also stated that the Subcommittee urges all witnesses who have a common position or with the same general interest to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee. This procedure will enable the Subcommittee to receive a wider expression of views on the total bill than it might otherwise obtain. They urged very strongly that all witnesses exert a maximum effort, taking into account the limited advance notice, to consolidate and coordinate their statements.

Legislative Reorganization Act. -- In this respect, they observed that the Legislative Reorganization Act of 1946, as amended, requires

all witnesses appearing before the Committees of Congress "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Senators Mondale and Hansen stated that in light of this statute and in view of the large number of witnesses who desire to appear before the Subcommittee in the limited time available for the hearing, all witnesses who are scheduled to testify must comply with the following rules:

(1) All statements must be filed in advance of the day on which the witness is to appear. Witnesses scheduled to testify on Tuesday or Wednesday must file their written statements by the Friday preceding their appearance.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least 50 copies must be submitted.

(4) Witnesses are not to read their written statements to the Subcommittee, but are to confine their ten-minute oral presentations to a summary of the points included in the statement.

(5) Not more than ten minutes will be allowed for the oral summary. Witnesses who fail to comply with these rules will forfeit their privilege to testify.

Written Statements. -- Witnesses who are not scheduled for oral presentation, and others who desire to present a statement to the Subcommittee, are urged to prepare a written position of their views for submission and inclusion in the printed record of the hearings. These written statements should be submitted to Tom Vail, Chief Counsel, Committee on Finance, Room 2227, Dirksen Senate Office Building not later than Friday, September 28, 1973.

PR #31

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93D CONGRESS
1ST SESSION

S. 282

IN THE SENATE OF THE UNITED STATES

JANUARY 9, 1973

Mr. CRANSTON (for himself and Mr. TUNNEY) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To regulate and foster commerce among the States by providing a uniform system for the application of sales and use taxes to interstate commerce.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Interstate Sales and Use
4 Tax Act".

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1 # TITLE I—JURISDICTION TO TAX

2 **SEC. 101. UNIFORM SALES AND USE TAX JURISDICTIONAL**
3 **STANDARD.**

4 No State or political subdivision thereof shall have
5 power to impose a sales tax or to require a person to collect
6 a sales or use tax with respect to an interstate sale of tan-
7 gible personal property for delivery in the State unless the
8 person—

9 (1) has a business location in the State, or

10 (2) regularly solicits orders for the sale of tangible
11 personal property by salesmen, solicitors, or represent-
12 atives in the State, unless his activity in the State con-
13 sists solely of solicitation by direct mail or advertising
14 via newspapers, radio, or television, or

1 (3) regularly engages in the delivery of property
2 in the State other than by common carrier or United
3 States mail.
4 A State or political subdivision shall have power, subject to
5 the provisions of sections 201, 205, and 324 of this Act,
6 to impose a sales tax, or, to require seller collection of a sales
7 or use tax with respect to an interstate sale of tangible per-
8 sonal property, if it is not denied power to do so under the
9 preceding sentence.

10 TITLE II—UNIFORM RULES FOR 11 APPLICATION OF TAX

12 **SEC. 201. REDUCTION OF MULTIPLE TAXATION.**

13 (a) LOCATION OF SALES.—A State or political sub-
14 division thereof may impose a sales tax or require a seller
15 to collect a sales or use tax with respect to an interstate sale
16 of tangible personal property only if the destination of the
17 sales is—
18 (1) in that State, or
19 (2) in a contiguous State or political subdivision
20 of a contiguous State for which the tax is required to
21 be collected under reciprocal collection agreements as
22 authorized under section 324 of this Act.
23 (b) CREDIT FOR PRIOR TAXES.—The amount of any
24 use tax imposed with respect to tangible personal property
25 shall be reduced by the amount of any sales or use tax

1 previously incurred and paid by a person with respect to
2 the property on account of liability to another State or
3 political subdivision thereof.

4 (c) REFUND.—A person who pays a use tax imposed
5 with respect to tangible personal property shall be entitled
6 to a refund from the State or political subdivision thereof
7 imposing the tax, up to the amount of the tax so paid, for
8 any sales or use tax subsequently paid with respect to the
9 same property on account of prior liability to another State
10 or political subdivision thereof.

11 (d) LIMITATION ON CREDIT FOR PRIOR TAXES.—A
12 credit or refund otherwise permitted under subsections (b)
13 and (c) shall not be allowed with respect to taxes which are
14 measured by periodic payments made under a lease to the
15 extent that the taxes imposed by the other State or political
16 subdivision thereof were also measured by periodic pay-
17 ments made under a lease for a period prior to the possession,
18 storage, use, or other consumption of the property in the
19 State or political subdivision thereof imposing the tax.

20 (e) VEHICLES AND MOTOR FUELS.—

21 (1) VEHICLES.—Nothing in subsection (a) shall
22 affect the power of a State or political subdivision thereof
23 to impose or require the collection of a sales or use tax
24 with respect to vehicles that are registered in the State.

25 (2) FUELS.—Nothing in this section shall affect

1 the power of a State or political subdivision thereof to
2 impose or require the collection of a sales or use tax
3 with respect to motor fuels consumed in the State.

4 **SEC. 202. EXEMPTIONS FOR HOUSEHOLD GOODS, INCLUD-**
5 **ING MOTOR VEHICLES, IN THE CASE OF PER-**
6 **SONS WHO ESTABLISH RESIDENCE.**

7 No State or political subdivision thereof may impose a
8 sales tax, use tax, or other nonrecurring tax measured by cost
9 or value with respect to household goods, including motor
10 vehicles, brought into the State by a person who establishes
11 residence in that State if the goods were acquired and used
12 by that person ninety days or more before use of the property
13 in the State in which he establishes such residence.

14 **SEC. 203. TREATMENT OF TRANSPORTATION CHARGES**
15 **WITH RESPECT TO INTERSTATE SALES.**

16 Where the freight charges or other charges for transport-
17 ing tangible personal property from the seller or supplier
18 directly to the purchaser incidental to an interstate sale are
19 separately stated in writing by the seller to the purchaser, to
20 the extent that such charges do not exceed a reasonable
21 charge for transportation by facilities of the seller or the
22 charge for the transportation by the carrier when the trans-
23 portation is by other than the seller's facilities, no State or
24 political subdivision may include such charges in the measure

1 of a sales or use tax imposed with respect to the sale or use
2 of the property.

3 **SEC. 204. LIABILITY OF SELLERS OF EXEMPT SALES.**

4 No seller shall be liable for the collection or payment
5 of a sales or use tax with respect to an interstate sale of
6 tangible personal property if the purchaser of such property
7 furnishes or has furnished to the seller a certificate or other
8 written form of evidence indicating the basis for exemption,
9 or the reason the seller is not required to pay or collect the
10 tax. Any such certificate or writing shall give the name and
11 address of the purchaser, his registration number, if any, and
12 shall be signed by the purchaser or his representative.

13 **SEC. 205. LOCAL SALES AND USE TAXES.**

14 (a) LIMITATION ON SELLER COLLECTION.—No seller
15 shall be required by a State or political subdivision thereof—
16 (1) to collect a sales or use tax of a political sub-
17 division with respect to interstate sales, or
18 (2) to classify interstate sales for sales or use tax
19 purposes according to geographic areas of the State in
20 any manner,
21 except with respect to those interstate sales with destina-
22 tions in political subdivisions in which the seller has a busi-
23 ness location, or regularly makes delivery other than by
24 common carrier or United States mail.
25 (b) LOCAL TAXES TREATED AS STATE TAXES.—Not-

1 withstanding the limitations in subsection (a), to the extent
2 that State and any local sales and use taxes are imposed in
3 all geographic areas of a State upon like transactions at the
4 same combined State and local rate, are administered by the
5 State, and are otherwise applied uniformly so that the seller
6 is not required to classify interstate sales according to geo-
7 graphic areas of the State in any manner whatsoever, such
8 sales or use taxes, whether imposed by the State or by
9 political subdivisions, shall be treated as State taxes for the
10 purposes of this Act.

11 # TITLE III—DEFINITIONS AND MIS-
12 # CELLANEOUS PROVISIONS

13 ## PART A—DEFINITIONS

14 **SEC. 301. SALES TAX.**

15 A "sales tax" is any tax imposed with respect to retail
16 sales, and measured by the sales price of tangible personal
17 property or services with respect thereto, which is required
18 by State law to be stated separately from the sales price by
19 the seller, or which is customarily stated separately from the
20 sales price.

21 **SEC. 302. USE TAX.**

22 A "use tax" is any nonrecurring tax complementary to
23 a sales tax measured by the purchase price or value of tangi-
24 ble personal property or services sold, which is imposed on
25 or with respect to the exercise or enjoyment of any right or

1 power over tangible personal property incident to the owner-
2 ship or possession of that property or the leasing of that
3 property from another, including any consumption, keeping,
4 retention, or other use of tangible personal property.

5 **SEC. 303. SALE; SALES PRICE; PURCHASE PRICE.**

6 The terms "sale", "sales price", and "purchase price"
7 shall be deemed to include leases and rental payments under
8 leases.

9 **SEC. 304. INTERSTATE SALE.**

10 An "interstate sale" is a sale in which the tangible
11 personal property sold is shipped or delivered to the pur-
12 chaser in a State from a point outside that State.

13 **SEC. 305. DESTINATION.**

14 The destination of a sale is in the State or political sub-
15 division in which possession of the property is physically
16 transferred to the purchaser or to which the property is
17 shipped to the purchaser regardless of the free on board point
18 or other conditions of the sale.

19 **SEC. 306. BUSINESS LOCATION.**

20 (a) GENERAL RULE.—A person shall be considered to
21 have a business location within a State or within a political
22 subdivision only if that person—
23 (1) owns or leases real property within the State
24 or within the political subdivision,

1 (2) has one or more employees located in the State,
2 or in the political subdivision,
3 (3) regularly maintains a stock of tangible personal
4 property in the State, or in the political subdivision, for
5 sale in the ordinary course of its business, or
6 (4) regularly leases out tangible personal property
7 for use in the State, or in the political subdivision.
8 For the purpose of paragraph (3), property which is on
9 consignment in the hands of a consignee, and which is offered
10 for sale by the consignee on his own account, shall not be
11 considered as stock maintained by the consignor. If a person
12 has a business location in a State, or in the political sub-
13 division, solely by reason of paragraph (4), he shall be con-
14 sidered to have a business location in the State, or in the
15 political subdivision, only with respect to such leased prop-
16 erty.

17 **SEC. 307. LOCATION OF EMPLOYEE.**

18 An employee shall be considered to be located in a State
19 or in a political subdivision if—
20 (1) his service is performed entirely within that
21 State, or within that political subdivision, or
22 (2) his service is performed both within and with-
23 out that State, or that political subdivision, but in the
24 performance of his service he regularly commences his

1 activities at, and returns to, a place within the State or
2 within the political subdivision.

3 **SEC. 308. STATE.**

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

6 **SEC. 309. STATE LAW.**

7 References in this Act to "State law", "the laws of the
8 State", and the like shall be deemed to include a State con-
9 stitution, and to include the statutes and other legislative
10 acts, judicial decision, and administrative regulations and
11 rulings of a State and of any political subdivision.

12 **PART B—MISCELLANEOUS PROVISIONS**

13 **SEC. 321. PROHIBITION AGAINST GEOGRAPHICAL DIS-**
14 **CRIMINATION.**

15 (a) IN GENERAL.—No provision of State law shall
16 make any person liable for a greater amount of sales or use
17 tax with respect to tangible personal property by virtue of
18 the location of any occurrence in a State outside the taxing
19 State, than the amount of the tax for which such person
20 would otherwise be liable if such occurrence were within the
21 State. For purposes of this subsection, the term "occur-
22 rence" includes incorporation, qualification to do business,
23 and the making of a taxpayment, and includes an activity of
24 the taxpayer or of a person (including an agency of a State
25 or local government) receiving payments from or making
26 payments to the taxpayer.

1 (b) COMPUTATION OF TAX LIABILITY UNDER DIS-
2 CRIMINATORY LAWS.—When any State law is in conflict
3 with subsection (a), tax liability may be discharged in the
4 manner which would be provided under State law if the oc-
5 currence in question were within the taxing State.

6 **SEC. 322. PROHIBITION AGAINST OUT-OF-STATE AUDIT**
7 **CHARGES.**

8 No charge may be imposed by a State or political sub-
9 division thereof to cover any part of the cost of conducting
10 outside that State an audit for a tax to which this Act applies.

11 **SEC. 323. PERMISSIBLE TAXES.**

12 The fact that a tax to which this Act applies is imposed
13 by a State or political subdivision thereof in the form of an
14 excise, privilege, or license tax shall not prevent the imposi-
15 tion of the tax on a person engaged exclusively in interstate
16 commerce within the State; but such a tax may be enforced
17 against a person engaged exclusively in interstate commerce
18 within the State solely as a revenue measure and not by
19 ouster from the State or by criminal or other penalty for en-
20 gaging in commerce within the State without permission from
21 the State.

22 **SEC. 324. RECIPROCAL COLLECTION AGREEMENTS.**

23 When authorized by State law, reciprocal agreements
24 may be made between two contiguous States for the purpose
25 of requiring a seller with a business location in one of the
26 States to collect applicable State use tax (including any tax

1 treated as a State tax under subsection (b) of section 205 of
2 this Act) for, and to remit that tax to, the other State into
3 which the seller makes sales of tangible personal property,
4 even though he is otherwise not subject to the jurisdiction of
5 such other State under section 101 of this Act.

6 **SEC. 325. LIABILITY WITH RESPECT TO UNASSESSED**
7 **TAXES.**

8 No State or political subdivision thereof shall have the
9 power, after the date of the enactment of this Act, to assess
10 against any person for any period ending on or before such
11 date a sales or use tax with respect to tangible personal
12 property, if during such period that person was not registered
13 in the State for the purpose of collecting tax, had no business
14 location in the State, did not regularly solicit orders for the
15 sale of tangible personal property by salesmen, solicitors, or
16 other representatives in the State, or did not regularly en-
17 gage in the delivery of property in the State, other than by
18 common carrier or United States mail.

19 **SEC. 326. EFFECTIVE DATES.**

20 Sections 101, 321, 322, and 325 of this Act shall take
21 effect on the date of the enactment of this Act. Section 205
22 shall take effect on the first day of the first calendar quar-
23 ter commencing five years after the enactment of this Act.
24 The remaining provisions of this Act shall take effect on the
25 first day of the second calendar quarter commencing after
26 the enactment of this Act.

93D CONGRESS
1ST SESSION

S. 1245

IN THE SENATE OF THE UNITED STATES

MARCH 15, 1973

Mr. MATHIAS (for himself and Mr. RIBICOFF) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To regulate and foster commerce among the States by providing a system for the taxation of interstate commerce.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act be cited as the "Interstate Taxation Act of
4 1973."

5 TITLE I—JURISDICTION TO TAX

6 SEC. 101. UNIFORM JURISDICTIONAL STANDARD.

7 No State or political subdivision thereof shall have
8 power—
9 (1) to impose a net income tax or a capital stock
10 tax on a corporation other than an excluded corporation

II

1 unless the corporation has a business location in the
2 State or political subdivision during the taxable year;
3 (2) to impose a gross receipts tax with respect to
4 a sale of tangible personal property unless the seller has
5 a business location in the State or political subdivision;
6 (3) to require a person to collect and remit a sales
7 or use tax with respect to an interstate sale of tangible
8 personal property unless the person—
9 (A) has a business location in the State or
10 political subdivision; or
11 (B) regularly makes household deliveries in
12 the State or political subdivision other than by com-
13 mon carrier or United States Postal Service; or
14 (C) regularly engages in the State or political
15 subdivision in solicitation of orders for the sale of
16 tangible personal property by means of salesmen,
17 solicitors, or representatives (unless such solicitation
18 of orders is carried on solely by direct mail or adver-
19 tising by means of printed periodicals, radio, or tele-
20 vision); or
21 (4) to require a seller without a business location in
22 the State to collect or pay a sales or use tax when such
23 seller has obtained in writing the buyer's registration
24 number in accordance with section 304.
25 An advance payment of a sales or use tax to a seller as

1 agent for a State made by a purchaser of tangible personal
2 property for resale shall not constitute a sales or use tax
3 for purposes of this Act if credit for the advance payment
4 is allowed in determining sales tax liability of the pur-
5 chaser under statutory provisions in effect in any State prior
6 to January 1, 1973. A State or political subdivision shall
7 have power to impose a corporate net income tax or capital
8 stock tax, or a gross receipts tax with respect to a sale of
9 tangible personal property or to require seller collection
10 of a sales or use tax with respect to an interstate sale of
11 tangible personal property, subject to the limitations of
12 section 306, if it is not denied the power to do so under
13 the Constitution of the United States and this or other
14 Federal statute.

15 TITLE II—MAXIMUM INCOME OR 16 CAPITAL ATTRIBUTABLE TO TAX- 17 ING JURISDICTION

18 **SEC. 201. OPTIONAL THREE-FACTOR FORMULA.**

19 A State or a political subdivision thereof may not
20 impose on a corporation with a business location in more
21 than one State, other than an excluded corporation, a net
22 income tax (or capital stock tax) measured by an amount
23 of net income (or capital) in excess of the amount deter-
24 mined by multiplying the corporation's base by an apportion-
25 ment fraction which is the average of the corporation's

1 property, payroll, and sales factors for the State or political
2 subdivision thereof for the taxable year plus, in the case of
3 a tax measured by income, the amount of income allocable
4 to the State or political subdivision thereof for the taxable
5 year. For this purpose the base to which the apportionment
6 fraction is applied shall be the corporation's apportionable
7 income as defined in this Act for the taxable year (or its
8 entire capital, reduced by investments in and advance-
9 ments to subsidiary and affiliated corporations, as deter-
10 mined under State law for the valuation date at or after
11 the close of that taxable year).

12 **SEC. 202. PROPERTY FACTOR.**

13 (a) IN GENERAL.—A corporation's property factor for
14 any State is a fraction, the numerator of which is the
15 average value of the corporation's real and tangible per-
16 sonal property owned and used or rented and used in that
17 State and the denominator of which is the average value
18 of all of the corporation's real and tangible personal prop-
19 erty owned and used or rented and used during the taxable
20 year and located within the United States.

21 (b) STANDARDS FOR VALUING PROPERTY IN PROP-
22 ERTY FACTOR.—

23 (1) OWNED PROPERTY.—Property owned by the
24 corporation shall be valued at its original cost.

25 (2) RENTED PROPERTY.—Property rented to the

1 corporation shall be valued at eight times the net rents
2 payable by the corporation during the taxable year.
3 Net rent is the gross rent payable by the corporation
4 less rent received by the corporation from subrentals.
5 (c) AVERAGING OF PROPERTY VALUES.—The aver-
6 age value of the corporation's property shall be determined
7 by averaging values at the beginning and ending of the
8 taxable year; except that values shall be averaged on a
9 semiannual, quarterly, or monthly basis if reasonably re-
10 quired to reflect properly the location of the corporation's
11 property during the taxable year.
12 **SEC. 203. PAYROLL FACTOR.**
13 (a) IN GENERAL.—A corporation's payroll factor for
14 any State is a fraction, the numerator of which is the amount
15 of wages paid by the corporation to employees located in
16 that State and the denominator of which is the total amount
17 of wages paid by the corporation to all employees located
18 within the United States during the taxable year.
19 (b) PAYROLL INCLUDED.—The corporation's payroll
20 factor shall include all wages paid by the corporation during
21 the taxable year to its employees, except that there shall be
22 excluded from the factor any amount of wages paid to a
23 retired employee.
24 (c) DEFINITION OF WAGES.—The term "wages"
25 means wages as defined for purposes of the Federal Unem-

1 ployment Tax Act in section 3306(b) of the Internal Rev-
2 enue Code of 1954.

3 **SEC. 204. SALES FACTOR.**

4 (a) In General.—A corporation's sales factor for any
5 State is a fraction, the numerator of which is the total sales
6 of the taxpayer in the State during the taxable year and the
7 denominator of which is the total sales of the taxpayer within
8 the United States during the taxable year.

9 (b) Sales Included.—

10 (1) Sales of tangible personal property are in the
11 State if such property is received in the State by the
12 purchaser. In the case of delivery of tangible personal
13 property by common carrier or by other means of trans-
14 portation, the place at which such property is ultimately
15 received after all transportation has been completed shall
16 be considered as the place at which such property is re-
17 ceived by the purchaser. Direct delivery in the State,
18 other than for purposes of transportation, to a person or
19 firm designated by a purchaser constitutes delivery to
20 the purchaser in the State and direct delivery outside the
21 State to a person or firm designated by a purchaser does
22 not constitute delivery to the purchaser in the State,
23 regardless of where title passes or other conditions of
24 sale.

1 (2) Sales, other than sales of tangible personal
2 property, are in the State if—
3 (A) the income-producing activity is performed
4 in the State, or
5 (B) the income-producing activity is performed
6 both in and outside that State and a greater propor-
7 tion of the income-producing activity is performed
8 in that State than in any other State, based on costs
9 of performance.
10 (3) Sales shall include receipts from the rental of
11 tangible personal property, and such receipts shall be
12 considered to be in the State in which the property is
13 located.
14 **SEC. 205. ZERO DENOMINATORS.**
15 If the denominator of any factor is zero, then the other
16 factors shall be used as the apportionment fraction for each
17 State and political subdivision. If the denominators of all fac-
18 tors are zero, then the apportionment fraction for the State
19 where the corporation has its business location shall be
20 100 percent.
21 **SEC. 206. LOCAL TAXES.**
22 The maximum percentage of net income (or capital)
23 of a corporation attributable to a political subdivision for
24 tax purposes shall be determined under this title in the same
25 manner as though the political subdivision were a State; ex-

1 cept that the denominators of the corporation's property, pay-
2 roll, and sales factors shall be the denominators applicable
3 to all States and political subdivisions. For this purpose the
4 numerators of the corporation's property, payroll, and sales
5 factors shall be determined by treating every reference to
6 location in a State as a reference to location in the political
7 subdivision.

8 **SEC. 207. APPORTIONABLE INCOME.**

9 (a) APPORTIONABLE INCOME.—Apportionable income
10 means taxable income as determined under State law, except
11 there shall be excluded—
12 (1) income from sources without the United States
13 provided that all expenses, losses and other deductions
14 are properly apportioned or allocated thereto in accord-
15 ance with section 862 (b) of the Internal Revenue Code,
16 and
17 (2) dividends.
18 However, dividend income shall be treated as apportionable
19 income if the taxpayer's principal business activity is dealing
20 in securities. No State shall, because of the exclusions of this
21 section, make any offsetting adjustment of an otherwise al-
22 lowable deduction. Apportionable income of a taxpayer shall
23 not include or be measured by all or any part of the income
24 of any other corporation except as provided in section 209 of
25 this Act.

1 (b) ADJUSTMENT OF APPORTIONMENT FACTORS.—If
2 apportionable income includes income derived from the sales
3 of tangible personal property, the ultimate destination of
4 which is outside the United States, either the taxpayer or
5 the State may adjust denominators of the factors described
6 in sections 202 through 204 of this Act to include payrolls,
7 sales, and property attributable to such sales.

8 **SEC. 208. ALLOCABLE INCOME—DIVIDENDS.**

9 Dividends, other than dividends which constitute income
10 from sources outside the United States, received from cor-
11 porations in which the taxpayer owns less than 50 percent
12 of the voting stock are allocable to the State of commercial
13 domicile of such taxpayer. Dividends which constitute in-
14 come from sources without the United States as defined by
15 the Internal Revenue Code of 1954, as amended, and
16 dividends received from corporations in which the taxpayer
17 owns 50 percent or more of the voting stock shall not be
18 allocable to any State.

19 **SEC. 209. CONSOLIDATED APPORTIONABLE INCOME.**

20 (a) CONSOLIDATED APPORTIONABLE INCOME.—Ex-
21 cept as provided by subsection (b) if either a State or a
22 taxpayer establishes that a taxpayer has engaged in non-
23 arm's-length transactions, as defined in section 507, which
24 cause a material distortion of income apportioned to the State

1 the State may require or the taxpayer may elect to determine
2 apportionable income by reference to the consolidated appor-
3 tionable income and apportionment factors of all parties to the
4 non-arm's-length transactions. In no event shall this section
5 be construed to alter the effect of the provisions of this Act
6 relating to allocable income. For purposes of this Act, con-
7 solidated apportionable income is the sum of the apportionable
8 income of all corporations consolidated with all intercorporate
9 transactions eliminated.
10 (b) ADJUSTMENT OF INCOME.— A State or political
11 subdivision thereof may not require a corporation with a busi-
12 ness location in the State or political subdivision to combine
13 or consolidate, for the purpose of determining or measuring
14 any tax, its gross receipts, income, capital, or net worth with
15 the gross receipts, income, capital, or net worth of the
16 following:
17 (1) a corporation which is incorporated outside the
18 United States,
19 (2) any corporation, 50 percent or more of the
20 ordinary gross income of which is excludable under
21 section 207 (a) (1) of this Act, or
22 (3) excluded corporations.
23 However, a State or political subdivision may, upon a spe-
24 cific finding, adjust the income of a corporation to correct

1 any transaction with any other party consummated in the
2 manner of a non-arm's-length transaction.
3 (c) PERMITTED CONSOLIDATED INCOME.—Nothing
4 contained herein shall prevent any State from permitting by
5 statute or otherwise one or more affiliated companies as de-
6 fined in section 508 to elect to file a return based on consoli-
7 dated income.

8 TITLE III—SALES AND USE TAXES

9 **SEC. 301. REDUCTION OF MULTIPLE TAXATION.**

10 (a) LOCATION OF SALES.—A State or political subdivi-
11 sion thereof may impose a sales or use tax or require a seller
12 to collect a sales or use tax with respect to an interstate sale
13 of tangible personal property only if the destination of the
14 sale is—
15 (1) in that State, or
16 (2) in a contiguous State or political subdivision of
17 a contiguous State for which the tax is required to be
18 collected under reciprocal collection agreements.
19 (b) CREDIT FOR PRIOR TAXES.—The amount of any
20 use tax imposed with respect to tangible personal property
21 shall be reduced by the amount of any sales or use tax previ-
22 ously incurred and paid by a person with respect to the
23 property on account of liability to another State or political
24 subdivision thereof.

1 (c) REFUND.—A person who pays a use tax imposed
2 with respect to tangible personal property shall be entitled
3 to a refund from the State or political subdivision thereof im-
4 posing the tax, up to the amount of the tax so paid, for any
5 sales or use tax subsequently paid with respect to the same
6 property on account of prior liability to another State or
7 political subdivision thereof. For purposes of this subsection,
8 the person seeking the refund from a State or political
9 subdivision imposing the tax shall apply for the refund
10 within 1 year from the date of payment of the sales or use
11 tax to such other State or political subdivision.
12 (d) LIMITATION ON CREDIT FOR PRIOR TAXES.—
13 A credit or refund otherwise permitted under subsections
14 (b) and (c) shall not be allowed with respect to taxes which
15 are measured by periodic payments made under a lease to the
16 extent that the taxes imposed by the other State or political
17 subdivision thereof were also measured by periodic payments
18 made under a lease for a period prior to the possession, stor-
19 age, use, or other consumption of the property in the State or
20 political subdivision thereof imposing the tax.
21 (e) VEHICLES AND MOTOR FUELS.—
22 (1) VEHICLES.—Nothing in subsection (a) shall
23 affect the power of a State or political subdivision thereof
24 to impose or require the collection of a sales or use tax
25 with respect to vehicles that are registered in the State.

1 (2) FUELS.—Nothing in this section shall affect the
2 power of a State or political subdivision thereof to impose
3 or require the collection of a sales or use tax with respect
4 to motor fuels consumed in the State.

5 **SEC. 302. EXEMPTIONS FOR HOUSEHOLD GOODS, INCLUD-**
6 **ING VEHICLES, IN THE CASE OF PERSONS WHO**
7 **ESTABLISH RESIDENCE.**

8 No State or political subdivision thereof may impose a
9 sales tax, use tax, or other nonrecurring tax measured by
10 cost or value with respect to household goods, including
11 motor vehicles, brought into the State by a person who
12 establishes residence in that State if the goods were ac-
13 quired and used by that person 90 days or more before use
14 of the property in the State in which he establishes such
15 residence.

16 **SEC. 303. TREATMENT OF TRANSPORTATION CHARGES**
17 **WITH RESPECT TO INTERSTATE SALES.**

18 Where the freight charges or other charges for trans-
19 porting tangible personal property from the seller or supplier
20 directly to the purchaser incidental to an interstate sale are
21 separately stated in writing by the seller to the purchaser, to
22 the extent that such charges do not exceed a reasonable
23 charge for transportation by facilities of the seller or the
24 charge for the transportation by the carrier when the trans-
25 portation is by other than the seller's facilities, no State or

1 political subdivision may include such charges in the measure
2 of a sales or use tax imposed with respect to the sale or use
3 of the property.

4 **SEC. 304. REGISTRATION PROCEDURE.**

5 A person with a business location in a State and purchas-
6 ing goods in interstate commerce must obtain a registration
7 number from that State. Persons without a business location
8 in the State may rely upon such registration, as evidenced by
9 receiving the registration number from the buyer, in writing,
10 as conclusive authority for not charging and collecting a sales
11 or use tax.

12 **SEC. 305. LIABILITY OF SELLERS ON EXEMPT SALES.**

13 No seller shall be liable for the collection or payment of
14 a sales or use tax with respect to an interstate sale of tangible
15 personal property if the purchaser of such property furnishes
16 or has furnished to the seller a certificate or other written
17 form of evidence indicating the basis for exemption, or the
18 reason the seller is not required to pay or collect the tax.
19 Any such certificate or writing shall give the name and
20 address of the purchaser, his registration number, if any, and
21 shall be signed by the purchaser or his representative.

22 **SEC. 306. LOCAL SALES AND USE TAXES.**

23 (a) LIMITATION OF SELLER COLLECTION.—Notwith-

1 standing the provisions of section 101 (3) (C), no seller shall
2 be required by a State or political subdivision thereof—
3 (1) to collect a sales or use tax of a political sub-
4 division with respect to interstate sales, or
5 (2) to classify interstate sales for sales or use tax
6 purposes according to geographic areas of the State in
7 any manner,
8 except with respect to those interstate sales with destinations
9 in political subdivisions in which the seller has a business loca-
10 tion, or regularly makes deliveries other than by common
11 carrier or United States Postal Service.
12 (b) LOCAL TAXES TREATED AS STATE TAXES.—
13 Notwithstanding the limitations in subsection (a), to the
14 extent that State and any local sales and use taxes are
15 imposed in all geographic areas of a State upon like trans-
16 actions at the same combined State and local rate, are ad-
17 ministered by the State, and are otherwise applied
18 uniformly so that the seller is not required to classify inter-
19 state sales according to geographic areas of the State in
20 any manner whatsoever, such sales or use taxes, whether
21 imposed by the State or by political subdivisions, shall be
22 treated as State taxes for the purposes of this Act.

1 # TITLE IV—JURISDICTION
2 # OF FEDERAL COURTS

3 **SEC. 401. JUDICIAL REVIEW.**

4 Notwithstanding section 1251 (a) of title 28, United
5 States Code, the United States Court of Claims shall have
6 jurisdiction to review de novo any issues relating to a
7 dispute arising under this Act or under Public Law 86–272,
8 as amended. Within 90 days of the decision of a State ad-
9 ministrative body from which the only appeal is to a court,
10 any party to the determination may petition the Court
11 of Claims for a review de novo of any such issues. The
12 findings of fact by the State administrative body shall be
13 considered with other evidence of the facts. The judgment
14 of the Court of Claims shall be subject to review by the
15 Supreme Court of the United States as provided in section
16 1254 of title 28, United States Code, as amended.

17 **SEC. 402. EFFECT OF FEDERAL DETERMINATION.**

18 The determination of a dispute arising hereunder by
19 the Court of Claims shall be binding for the taxable years
20 involved on any State given notice or appearing as a
21 party, notwithstanding any prior determinations of the
22 courts or administrative bodies of that State completed after
23 notice to that State. No statute of limitations shall bar the
24 right of a State or a corporation to an amount of tax in-
25 creased or decreased in accordance with the determination,

1 provided action is begun within one year after the determi-
2 nation has become final.

3 # TITLE V—DEFINITIONS AND
4 # MISCELLANEOUS PROVISIONS

5 ## PART A—DEFINITIONS

6 **SEC. 501. NET INCOME TAX.**

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

12 **SEC. 502. GROSS RECEIPTS TAX.**

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

18 **SEC. 503. CAPITAL STOCK TAX; CAPITAL ACCOUNT TAX.**

19 (a) CAPITAL STOCK TAX.—A "capital stock tax" is
20 any tax measured in any way by the capital of a corporation.
21 (b) CAPITAL ACCOUNT TAX.—A "capital account
22 tax" is any capital stock tax measured by number of shares,
23 par or nominal value of shares, paid-in capital, or the like,
24 not including any tax the measure of which includes any
25 element of earned surplus.

1 **SEC. 504. SALES TAX.**

2 A "sales tax" is any tax imposed with respect to sales,
3 and measured by the sales price of tangible personal prop-
4 erty or services with respect thereto, which is required by
5 State law to be stated separately from the sales price by the
6 seller, or which is customarily stated separately from the
7 sales price.

8 **SEC. 505. USE TAX.**

9 A "use tax" is any nonrecurring tax, other than a sales
10 tax, which is imposed on or with respect to the exercise or
11 enjoyment of any right or power over tangible personal
12 property incident to the ownership of that property or the
13 leasing of that property from another, including any con-
14 sumption, keeping, retention, or other use of tangible
15 personal property.

16 **SEC. 506. EXCLUDED CORPORATION.**

17 An "excluded corporation" is any of the following:

18 (1) Any bank, trust company, savings bank, indus-
19 trial bank, land bank, safe deposit company, private
20 banker, small loan association, credit union, cooperative
21 bank, small loan company, sales finance company, in-
22 vestment company, any type of insurance company, or
23 any corporation which derives 90 percent or more of its
24 gross income from interest (including discount).

25 (2) Any corporation more than 50 percent of the

1 ordinary gross income of which for the taxable year is
2 derived from regularly carrying on any one or more of
3 the following business activities:
4 (A) the transportation for hire of property or
5 passengers, including the rendering by the trans-
6 porter of services incidental to such transportation;
7 or
8 (B) the sale of electrical energy, gas, or water.
9 **SEC. 507. ARM'S-LENGTH AND NON-ARM'S-LENGTH TRANS-**
10 **ACTIONS.**
11 An arm's-length transaction is a transaction between two
12 or more affiliated corporations consummated at a considera-
13 tion in an amount which would have been charged in an
14 independent transaction between two or more unrelated cor-
15 porations under similar circumstances considering all relevant
16 facts. A non-arm's-length transaction is a transaction between
17 two or more affiliated corporations consummated at a consid-
18 eration in an amount which is more or less than the amount
19 that would have been charged in an independent transaction
20 between two or more unrelated corporations under similar
21 circumstances considering all relevant facts.
22 **SEC. 508. AFFILIATED CORPORATIONS.**
23 Two or more corporations are "affiliated" if they are not
24 excluded corporations as defined in section 506 and are
25 members of the same group comprised of one or more cor-

1 porate members connected through stock ownership with a
2 common owner, which may be either corporate or noncor-
3 porate, in the following manner:
4 (1) 50 percent or more of the voting stock of each
5 member other than the common owner is owned directly
6 by one or more of the other members; and
7 (2) 50 percent or more of the voting stock of at
8 least one of the members other than the common owner
9 is owned directly by the common owner.
10 **SEC. 509. ORDINARY GROSS INCOME.**
11 The term "ordinary gross income" means gross income
12 as determined for the taxable year under the applicable pro-
13 visions of the Internal Revenue Code of 1954, except that
14 there shall be excluded therefrom—
15 (1) all gains and losses from the sale or other dis-
16 position of capital assets, and
17 (2) all gains and losses from the sale or other dis-
18 position of property of a character described in section
19 1231 (b) of the Internal Revenue Code of 1954 (deter-
20 mined without regard to holding period).
21 **SEC. 510. SALE.**
22 For the purposes of title III, the term "sale" shall be
23 deemed to include leases and rental payments under leases.
24 **SEC. 511. INTERSTATE SALE.**
25 An "interstate sale" is a sale in which the tangible per-

1 sonal property sold is shipped or delivered to the purchaser
2 in the State from a point outside that State.
3 **SEC. 512. DESTINATION.**
4 The destination of a sale is in the State or political sub-
5 division in which possession of the property is physically
6 transferred to the purchaser, or to which the property is
7 shipped by the seller to the purchaser, regardless of the free
8 on board point or other conditions of the sale.
9 **SEC. 513. BUSINESS LOCATION.**
10 A person shall be considered to have a business location
11 within a State only if that person—
12 (1) owns or leases real property within the State,
13 (2) has one or more employees located in the State,
14 (3) regularly maintains a stock of tangible personal
15 property in the State for sale in the ordinary course of
16 his business, or
17 (4) regularly leases to others tangible personal prop-
18 erty for use in the State.
19 For the purpose of paragraph (3), property which is on con-
20 signment in the hands of a consignee, and which is offered
21 for sale by the consignee on his own account, shall not be
22 considered as stock maintained by the consignor. If a person
23 has a business location in a State solely by reason of para-
24 graph (4), he shall be considered to have a business loca-
25 tion in the State only with respect to such leased property.

1 **SEC. 514. LOCATION OF PROPERTY.**

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

5 (b) MOVING PROPERTY.—Personal property which is
6 characteristically moving property, such as motor vehicles,
7 rolling stock, aircraft, vessels, mobile equipment, and the
8 like, shall be considered to be located in a State if—

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

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

14 If the operation of the property is not localized in any State
15 and there is no principal base of operations in any State
16 from which the property is regularly sent out, the property
17 shall not be considered to be located in any State for purposes
18 of inclusion in either the numerator or the denominator of the
19 property factor.

20 (c) MEANING OF TERMS.—

21 (1) LOCALIZATION OF OPERATIONS.—The opera-
22 tion of property shall be considered to be localized in a
23 State if during the taxable year it is operated entirely
24 within that State, or it is operated both within and

1 without the State but the operation without the State
2 is—
3 (A) occasional,
4 (B) incidental to its use in the transportation of
5 property or passengers from points within the State,
6 or
7 (C) incidental to its use in the production, con-
8 struction, or maintenance of other property located
9 within the State.
10 (2) BASE OF OPERATIONS.—The term "base of op-
11 erations", with respect to a corporation's moving prop-
12 erty means the premises at which any such property is
13 regularly maintained by the corporation or by some other
14 person; except that if the premises are maintained by an
15 employee of the corporation primarily as a dwelling place
16 they shall not be considered to constitute a base of
17 operations.
18 **SEC. 515. LOCATION OF EMPLOYEE.**
19 (a) IN GENERAL.—An employee shall be considered
20 to be located in a State if—
21 (1) the employee's service is performed entirely
22 within the State;
23 (2) the employee's service is performed both within
24 and without the State, but the service performed without

1 the State is incidental to the employee's service within
2 the State; or
3 (3) some of the service is performed in the State
4 and—
5 (A) the base of operations or, if there is no
6 base of operations, the place from which the service
7 is directed or controlled is in the State; or
8 (B) the base of operations or the place from
9 which the service is directed or controlled is not in
10 any State in which some part of the service is per-
11 formed, but the employee's residence is in the State.
12 (b) EMPLOYEE.—The term "employee" has the same
13 meaning as it has for purposes of Federal income tax with-
14 holding under chapter 24 of the Internal Revenue Code of
15 1954, as amended.
16 (c) CONTINUATION OF MINIMUM JURISDICTIONAL
17 STANDARD.—An employee shall not be considered to be
18 located in a State if his only business activities within such
19 State on behalf of his employer are any of the following:
20 (1) The solicitation of orders, for sales of tangible
21 personal property, which are sent outside the State for
22 approval or rejection and (if approved) are filled by
23 shipment or delivery from a point outside the State.
24 (2) The solicitation of orders in the name of or
25 for the benefit of a prospective customer of his employer,

1 if orders by such customer to such employer to enable
2 such customer to fill orders resulting from such solicita-
3 tion are orders described in paragraph (1).
4 (3) The installing or repairing of tangible personal
5 property which is the subject of interstate sale by the
6 employer, if such installing or repairing is incidental to
7 the sale.
8 This subsection shall not apply with respect to business ac-
9 tivities carried on by one or more employees within a State
10 if the employer (without regard to those employees) has a
11 business location in such State.

12 **SEC. 516. STATE.**

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

15 **SEC. 517. STATE LAW.**

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

21 **SEC. 518. TAXABLE YEAR.**

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

1 **SEC. 519. COMMERCIAL DOMICILE.**

2 "Commercial domicile" means the principal place from
3 which the trade or business of the taxpayer is directed or
4 managed.

5 **SEC. 520. DIVIDENDS.**

6 "Dividends" shall have the same meaning as that term
7 has under the Internal Revenue Code of 1954, as amended,
8 including any sum treated as a divendend under section 78 of
9 such Code.

10 **SEC. 521. UNITED STATES.**

11 The term "United States" wherever used in this Act
12 shall include only the States and the District of Columbia.

13 **SEC. 522. INCOME FROM SOURCES WITHOUT THE UNITED**
14 **STATES.**

15 Income from sources without the United States means
16 income from sources without the United States as defined by
17 the Internal Revenue Code of 1954, as amended, except that
18 section 638 of such Code shall not apply.

19 **SEC. 523. PERSON.**

20 The term "person" shall be construed to mean and
21 include an individual, a trust, estate, partnership, associa-
22 tion, company, or corporation.

23 **SEC. 524. TAXPAYER.**

24 The term "taxpayer" means any person subject to a
25 tax under the applicable State law.

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1 PART B—MISCELLANEOUS PROVISIONS

2 **SEC. 525. PERMISSIBLE FRANCHISE TAXES.**

3 The fact that a tax to which this Act applies is im-
4 posed by a State or political subdivision thereof in the
5 form of a franchise, privilege, or license tax shall not pre-
6 vent the imposition of the tax on a person engaged exclu-
7 sively in interstate commerce within the State; but such a
8 tax may be enforced against a person engaged exclusively
9 in interstate commerce within the State solely as a reve-
10 nue measure and not by ouster from the State or by crimi-
11 nal or other penalty for engaging in commerce within the
12 State without permission from the State.

13 **SEC. 526. PROHIBITION AGAINST GEOGRAPHICAL DIS-**
14 **CRIMINATION.**

15 (a) IN GENERAL.—No provisions of State law shall
16 make any person liable for a greater amount of sales or
17 use tax with respect to tangible personal property, by
18 virtue of the location of any occurrence in a State outside
19 the taxing State, than the amount of the tax for which such
20 person would otherwise be liable if such occurrence were
21 within the State. For purposes of this subsection, the term
22 "occurrence" includes incorporation, qualification to do
23 business, and the making of a tax payment, and includes
24 an activity of the taxpayer or of a person (including an

1 agency of a State or local government) receiving payments
2 from or making payments to the taxpayer.
3 (b) COMPUTATION OF TAX LIABILITY UNDER DIS-
4 CRIMINATORY LAWS.—When any State law is in conflict
5 with subsection (a), tax liability may be discharged in the
6 manner which would be provided under State law if the
7 occurrence in question were within the taxing State.
8 **SEC. 527. APPLICABILITY OF ACT.**
9 Nothing in this Act shall be considered—
10 (1) to repeal Public Law 86–272, as amended,
11 with respect to any person;
12 (2) to increase, decrease, or otherwise affect the
13 power of any State or political subdivision to impose
14 or assess a net income tax or a capital stock tax with
15 respect to an excluded corporation;
16 (3) to give any State or political subdivision the
17 power to impose a gross receipts tax with respect to a
18 sale of tangible personal property if the seller would
19 not be subject to the imposition of such a gross re-
20 ceipts tax without regard to the provisions of this Act;
21 or
22 (4) to prevent a State or political subdivision from
23 enacting legislation that would result in a lesser tax
24 liability than that provided by this Act.

1 **SEC. 528. PROHIBITION AGAINST OUT-OF-STATE AUDIT**
2 **CHARGES.**
3 No charge may be imposed by a State or political
4 subdivision thereof to cover any part of the cost of con-
5 ducting outside that State an audit for a tax to which this
6 Act applies including a net income tax imposed on an ex-
7 cluded corporation.
8 **SEC. 529. LIABILITY WITH RESPECT TO UNASSESSED**
9 **TAXES.**
10 (a) PERIODS ENDING PRIOR TO ENACTMENT DATE.—
11 No State or political subdivision thereof shall have the
12 power, after the date of the enactment of this Act, to assess
13 against any person any tax for any period ending on or
14 before such date in or for which that person became liable
15 for such tax if during such period the State or political
16 subdivision would not have had the power to assess such
17 tax had the provisions of title I of this Act been in effect
18 during such period.
19 (b) CERTAIN PRIOR ASSESSMENTS AND COLLECTIONS.—
20 The provisions of subsection (a) shall not be construed—
21 (1) to invalidate the collection of a tax prior to the
22 time assessment became barred under subsection (a), or
23 (2) to prohibit the collection of a tax at or after the

1 time assessment became barred under subsection (a), if
2 the tax was assessed prior to such time.

3 **SEC. 530. CAPITAL ACCOUNT TAXES ON DOMESTIC COR-**
4 **PORATIONS.**

5 The State in which a corporation is incorporated may
6 impose a capital account tax on the corporation without
7 division of capital, notwithstanding the jurisdictional stand-
8 ard and limitation on attribution otherwise imposed by this
9 Act.

10 **SEC. 531. EFFECTIVE DATES.**

11 (a) Except as provided in section 529, this Act shall
12 apply only with respect to taxable years beginning on or
13 after one year from the date of the enactment of this Act.
14 (b) Section 306 of this Act shall be effective with re-
15 spect to taxable periods beginning on or after July 1, 1978.

93D CONGRESS
1ST SESSION

S. 2092

IN THE SENATE OF THE UNITED STATES

JUNE 27 (legislative day, JUNE 25), 1973

Mr. MAGNUSON introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To authorize a compact between the several States relating to taxation of multistate taxpayers and to regulate and foster commerce among the States by providing a system for the taxation of interstate commerce.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

I—O
★(Star Print)

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1 TITLE I—CONSENT TO ENTER INTO COMPACT
2 AND CONFERRAL OF POWERS UPON COM-
3 PACT COMMISSION

4 **§ 101. Consent to compact**

5 Congress consents to any two or more States of the
6 United States to enter into the Multistate Tax Compact de-
7 scribed in section 102 of this Act. The consent granted herein
8 shall be retroactive to the date of entry into such compact
9 by any State if such date of entry is prior to the effective
10 date of this section.

11 **§ 102. Identification of compact**

12 The compact referred to in section 101 is the Multistate
13 Tax Compact which has been entered into by two or more
14 States prior to January 1, 1971, and which contains the
15 following in article I thereof:

16 "The purposes of this compact are to:

17 "1. Facilitate proper determination of State and local
18 tax liability of multistate taxpayers, including the equitable
19 apportionment of tax bases and settlement of apportionment
20 disputes.

1 "2. Promote uniformity or compatibility in significant
2 components of tax systems.

3 "3. Facilitate taxpayer convenience and compliance in
4 the filing of tax returns and in other phases of tax admin-
5 istration.

6 "4. Avoid duplicative taxation."

7 **§ 103. Limitation on certain compact provisions**

8 No corporation may make, with respect to any taxable
9 year in which it is taxable in more than one State for in-
10 come tax purposes within the meaning of section 301 (c)
11 of this Act, the election provided for in article III (1) to
12 apportion and allocate income in accordance with article
13 IV of the compact.

14 **§ 104. Additional powers**

15 In addition to the powers conferred upon the Multistate
16 Tax Commission by the compact consented to in section
17 101, the Commission shall have the power to adopt such
18 rules and regulations as it deems appropriate for the admin-
19 istration of titles II through V of this Act. The exercise of
20 the powers granted by this section shall be subject to the
21 following conditions:

22 (a) Any rule or regulation shall be adopted in accord-
23 ance with the procedures established in section 2 of article
24 VII of the compact: *Provided, however,* That the notice
25 required therein shall be given to each State.

1 (b) Any rule or regulation shall have the same force
2 and effect in a State as it would have if it were adopted by a
3 Federal administrative agency empowered to adopt a simi-
4 lar rule or regulation, unless within one hundred and eighty
5 days after the adoption thereof by the Multistate Tax Com-
6 mission it has been rejected by the State in a rule or regula-
7 tion adopted in accordance with the State's procedure for the
8 adoption of a rule or regulation pertaining to the same sub-
9 ject matter.

10 (c) No rule or regulation adopted pursuant to this sec-
11 tion shall be effective prior to one hundred and eighty days
12 after adoption of this Act.

13 (d) The bylaws of the Multistate Tax Commission,
14 established by article VI of the compact, shall contain:

15 (1) Procedures for States which have not adopted
16 the compact to become associate members of the Com-
17 mission, said procedures to be substantially the same as
18 those provided for in the bylaws in effect on January 1,
19 1971.

20 (2) Procedures for designation, by the Governor of
21 each associate member State, of the tax administrator
22 empowered to exercise voting rights on behalf of such
23 State.

24 (3) A provision granting to each associate member,
25 with respect to any Commission action taken pursuant to

1 this section, the same voting rights as are enjoyed by
2 regular members of the Commission.
3 (4) A provision that any action taken hereunder
4 must be approved both by a majority of the total number
5 of members and by those members representing a major-
6 ity of the total population of the member State as allowed
7 by the latest Federal census: *Provided, however,* That
8 "member" shall include both an associate member and a
9 regular member.
10 (5) A provision that the voting rights of associate
11 member States shall be subject to the associate members
12 having contributed to the Commission an amount to be
13 established by the Commission, such amount to be
14 no greater than the amount which would have been ap-
15 portioned to such State if all associate members were
16 regular members.

17 TITLE II—JURISDICTION TO TAX

18 **§ 201. Jurisdictional standards**

19 No State or political subdivision thereof shall have power
20 to require a person to collect and remit a sales or use tax
21 with respect to an interstate sale of tangible personal prop-
22 erty unless the person (1) has a business location in the
23 State; or (2) regularly makes deliveries in the State other
24 than by common carrier or United States mail; or (3) reg-
25 ularly engages in the State in solicitation of orders for the

1 sale of tangible personal property by means of salesmen,
2 solicitors, or representatives (unless such solicitation of or-
3 ders is carried on solely by direct mail or advertising by
4 means of newspapers, radio, or television).

5 A State or political subdivision shall have power, subject
6 to the limitations of section 405 of this Act, to require seller
7 collection of a sales or use tax with respect to an interstate
8 sale of tangible personal property, if it is not denied the
9 power to do so under the preceding sentence.

10 TITLE III—MAXIMUM INCOME ATTRIBUTABLE
11 TO TAXING JURISDICTION

12 **§ 301. Apportionment; taxable in a State; combined re-**
13 **porting**

14 (a) OPTIONAL THREE FACTOR FORMULA.—A State or
15 a political subdivision thereof may not impose for any tax-
16 able year on a corporation taxable in more than one State,
17 other than an excluded corporation, a net income tax meas-
18 ured by an amount of net income in excess of the amount
19 determined by (1) multiplying the corporation's apportion-
20 able income by an apportionment fraction, the numerator of
21 which is the sum of the property factor, the payroll factor,
22 and the sales factor, excluding those factors which have negli-
23 gible denominators and the denominator of which is three re-
24 duced by the number of factors which are excluded, and (2)

1 in the State of taxpayer's commercial domicile only, such
2 dividends as are assignable thereto under section 306 (b).
3 A negligible denominator is one which is less than 10
4 per centum of one-third of the corporation's net income.
5 (b) APPORTIONABLE INCOME.—For this purpose the
6 apportionable income to which the apportionment fraction
7 is applied shall be such corporation's net income for that
8 taxable year as determined under State law, with the ex-
9 ceptions provided for in section 306.
10 (c) TAXABLE IN MORE THAN ONE STATE; TAXABLE
11 IN A STATE.—For purposes of this title, a corporation is
12 taxable in more than one State if (1) in more than one
13 State it is subject to a net income tax, a franchise tax
14 measured by net income, a franchise tax for the privilege
15 of doing business, or a capital stock tax, or (2) more than
16 one State has jurisdiction to subject the corporation to a
17 net income tax regardless of whether, in fact, that State
18 does or does not.
19 For purposes of this title, a corporation is taxable in
20 a State if (1) in that State it is subject to a net income
21 tax, a franchise tax measured by net income, a franchise
22 tax for the privilege of doing business, or a capital stock
23 tax, or (2) that State has jurisdiction to subject the corpo-
24 ration to a net income tax regardless of whether, in fact, that
25 State does or does not.

1 Notwithstanding the statute of limitations in a State for
2 the filing of amended returns and claims for refunds, if it is
3 subsequently determined that a corporation is taxable in a
4 State for which a return was not originally filed, such corpo-
5 ration may file amended returns and claims for refunds in
6 any State to which sales have been assigned under the pro-
7 visions of section 304 (b) (2) of this Act, but only for the
8 purpose of revising the sales factor by reassigning such
9 sales.

10 (d) COMBINED REPORTING.—Any State may require
11 the apportioned income of a corporation to be determined by
12 reference to the combined income and apportionment fac-
13 tors of all corporations of the affiliated group of which the
14 corporation is a member. Any member of an affiliated group
15 may elect to determine its apportioned income for any State
16 by reference to the combined income and apportionment
17 factors of all corporations of the affiliated group.

18 **§ 302. Property factor**

19 (a) IN GENERAL.—The property factor is a fraction,
20 the numerator of which is the average value of the real and
21 tangible personal property which is located in a State and,
22 whether owned or rented, is used in that State by the cor-
23 poration and the denominator of which is the sum of the
24 corporation and the denominator of which is the sum of the

1 corporation's property factor numerators as determined un-
2 der this section for such year for all States in which the cor-
3 poration is taxable. The denominator of the property factor
4 shall not include the value of any property located in a State
5 in which the corporation is not taxable.
6 (b) VALUATION.—Property owned by the corporation
7 shall be valued at its original cost. Property leased to the
8 corporation shall be valued at eight times the gross rents pay-
9 able by the corporation during the taxable year without any
10 deduction for amounts received by the corporation from
11 subrentals.
12 The average value of property shall be determined by
13 averaging the values at the beginning and ending of the tax-
14 able year but the State tax administrator may require or
15 permit the averaging of monthly values during the taxable
16 period if reasonably required to reflect properly the average
17 value of the corporation's property.
18 **§303. Payroll factor**
19 (a) IN GENERAL.—The payroll factor is a fraction, the
20 numerator of which is the total amount paid in the State
21 during the taxable year by the corporation as compensation
22 and the denominator of which is the sum of the corporation's
23 payroll factor numerators as determined under this section for
24 such year for all States in which the corporation is taxable.
25 If an employee is located in any State in which the

1 corporation is not taxable, the compensation paid to that
2 employee shall not be included in either the numerator or the
3 denominator of the corporation's payroll factor for any State
4 or political subdivision.
5 (b) LOCATION OF COMPENSATION.—Compensation is
6 paid in the State if:
7 (1) the employee's service is performed entirely
8 within the State;
9 (2) the employee's service is performed both with-
10 in and without the State, but the service performed with-
11 out the State is incidental to the employee's service
12 within the State; or
13 (3) some of the employee's service is performed
14 in the State and (a) the base of operations or, if there
15 is no base of operations, the place from which the em-
16 ployee's service is directed or controlled is in the State,
17 or (b) the base of operations or the place from which
18 the service is directed or controlled is not in any State
19 in which some part of the service is performed, but the
20 employee's residence is in the State.
21 **§ 304. Sales factor**
22 (a) GENERAL.—The sales factor is a fraction, the nu-
23 merator of which is the sales of the corporation which are
24 located in the State during the tax year, and the denominator

1 of which is the total sales by the corporation everywhere
2 during the tax year.

3 (b) LOCATION OF SALES OF TANGIBLE PERSONAL
4 PROPERTY.—Sales of tangible personal property are in-
5 cluded in the numerator of a State if—

6 (1) the property is delivered or shipped to a pur-
7 chaser within the State, and the corporation is taxable
8 in the State, regardless of the f.o.b. point or other con-
9 ditions of the sale; or

10 (2) the property is shipped from an office, store,
11 warehouse, factory, or other place of storage in the State
12 and the property is delivered or shipped to a purchaser
13 within a State in which the corporation is not taxable,
14 or the purchaser is the United States Government and
15 the property is delivered or shipped to a place outside
16 the United States, including the District of Columbia.
17 Other than such sales to the United States Government,
18 sales of tangible personal property which are delivered
19 or shipped to a place outside the United States, includ-
20 ing the District of Columbia, are not included in the
21 numerator of a State.

22 (c) LOCATION OF CERTAIN OTHER SALES.—

23 (1) Sales of services shall be included in the numer-
24 ator of the State in which the service is performed.
25 Sales of services rendered in two or more States shall,

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1 for the purpose of the numerator of the sales factor, be
2 divided between those States in proportion to the direct
3 costs of performance incurred in each such State by the
4 taxpayer in rendering the services.
5 (2) Sales of real property, if the corporation is
6 engaged primarily in the business of selling real prop-
7 erty, are included in the numerator of the State in which
8 the property is located.
9 (3) Sales which consist of receipts from the rental
10 of tangible personal property shall be considered to be
11 located in the State in which the property is located.
12 (d) ALL OTHER SALES.—All gross receipts, other
13 than those described in subsections (b) and (c) of this
14 section, shall be excluded from both the numerator and the
15 denominator of the sales factor.
16 **§ 305. Local taxes**
17 The maximum income of a corporation attributable to a
18 political subdivision for tax purposes shall be determined
19 under this title in the same manner as though the political
20 subdivision were a State; except that the denominators of
21 the corporation's property factor, payroll factor, and sales
22 factor shall be the denominators applicable to all States and
23 political subdivisions. For this purpose the numerators of
24 the corporation's property factor, payroll factor, and sales

1 factor shall be determined by treating every reference to
2 a State as a reference to the political subdivision.

3 **§ 306. Exclusions from apportionable income**

4 (a) EXCLUSION OF INCOME CONSIDERED TO BE FOR-
5 EIGN SOURCE INCOME.—The apportionable income of a tax-
6 payer shall not include income described in section 951 (a)
7 (1) of the Internal Revenue Code.

8 (b) CORPORATE DIVIDENDS.—The apportionable in-
9 come of a taxpayer shall not include income derived from
10 dividends paid by a corporation in which taxpayer owns
11 at least 80 per centum of the voting stock; dividends other-
12 wise taxable shall be assigned to the State of taxpayer's
13 commercial domicile and may be subjected to a net income
14 tax only in such State; no State shall, by reason of not
15 including such dividends in apportionable income, make any
16 offsetting adjustment of an otherwise allowable deduction.

17 TITLE IV—SALES AND USE TAXES

18 **§ 401. Reduction of multiple taxation**

19 (a) LOCATION OF SALES.—A State or political sub-
20 division thereof may impose a sales tax or require a seller
21 to collect a sales or use tax with respect to an interstate
22 sale of tangible personal property only if the destination of
23 the sale is—

24 (1) in that State, or

25 (2) in a contiguous State or political subdivision

1 of a contiguous State for which the tax is required to
2 be collected under reciprocal collection agreements as
3 authorized under section 406.

4 (b) CREDIT FOR PRIOR TAXES.—The amount of any use
5 tax imposed with respect to tangible personal property shall
6 be reduced by the amount of any sales or use tax previously
7 incurred and paid by a person with respect to the property
8 on account of liability to another State or political subdivision
9 thereof.

10 (c) REFUND.—A person who pays a use tax imposed
11 with respect to tangible personal property shall be entitled
12 to a refund from the State or political subdivision thereof
13 imposing the tax, up to the amount of the tax so paid, for
14 any sales or use tax subsequently paid with respect to the
15 same property on account of prior liability to another State
16 or political subdivision thereof.

17 For purposes of this subsection, the person seeking the
18 refund from a State or political subdivision imposing the tax
19 shall apply for the refund within one year from the date of
20 payment of the sales or use tax to such other State or political
21 subdivision.

22 (d) LIMITATION ON CREDIT FOR PRIOR TAXES.—A
23 credit or refund otherwise permitted under subsections (b)
24 and (c) shall not be allowed with respect to taxes which are
25 measured by periodic payments made under a lease to the

1 extent that the taxes imposed by the other State or political
2 subdivision thereof were also measured by periodic payments
3 made under a lease for a period prior to the possession, stor-
4 age, use, or other consumption of the property in the State
5 or political subdivision thereof imposing the tax.
6 (e) VEHICLES AND MOTOR FUELS.—
7 (1) VEHICLES.—Nothing in subsection (a) shall
8 affect the power of a State or political subdivision thereof
9 to impose or require the collection of a sales or use tax
10 with respect to vehicles that are registered in the State.
11 (2) FUELS.—Nothing in this section shall affect
12 the power of a State or political subdivision thereof to
13 impose or require the collection of a sales or use tax
14 with respect to motor fuels consumed in the State.
15 **§ 402. Exemptions for household goods, including motor**
16 **vehicles, in the case of persons who establish**
17 **residence**
18 No State or political subdivision thereof may impose a
19 sales tax, use tax, or other nonrecurring tax measured by cost
20 or value with respect to household goods, including motor
21 vehicles, brought into the State by a person who establishes
22 residence in that State if the goods were acquired and used
23 by that person ninety days or more before use of the property
24 in the State in which he establishes such residence.

1 **§ 403. Treatment of transportation charges with respect**
2 **to interstate sales**
3 Where the freight charges or other charges for trans-
4 porting tangible personal property from the seller or supplier
5 directly to the purchaser incidental to an interstate sale are
6 separately stated in writing by the seller to the purchaser, to
7 the extent that such charges do not exceed a reasonable
8 charge for transportation by facilities of the seller or the
9 charge for the transportation by the carrier when the trans-
10 portation is by other than the seller's facilities, no State or
11 political subdivision may require the seller to include such
12 charges in the measure of a sales or use tax imposed and col-
13 lected by the seller with respect to the sale or use of the
14 property.
15 **§ 404. Liability of sellers on exempt sales**
16 No seller shall be liable for the collection or payment
17 of a sales or use tax with respect to an interstate sale of
18 tangible personal property if the purchaser of such property
19 furnishes or has furnished to the seller a certificate or other
20 written form of evidence indicating the basis for exemption,
21 or the reason the seller is not required to pay or collect the
22 tax. Any such certificate or writing shall give the name and
23 address of the purchaser, his registration number, if any,
24 and shall be signed by the purchaser or his representative.

1 § 405. Local sales and use taxes

2 No seller shall be required by a State or political sub-
3 division thereof to classify interstate sales for use tax col-
4 lection purposes according to geographic areas of the State
5 in any manner other than to account for interstate sales with
6 destinations in political subdivisions in which the seller (1)
7 has a business location; or (2) regularly makes deliveries
8 other than by common carrier or United States mail.

9 Where in all geographic areas of a State sales and use
10 taxes are imposed on like transactions at the same combined
11 State and local rate, are administered by the State, and are
12 otherwise applied uniformly so that a seller is not required
13 to classify interstate sales according to geographic areas of
14 the State in any manner whatsoever, such sales or use taxes,
15 whether imposed by the State or by political subdivisions,
16 shall be subject to the jurisdictional rule of section 201 of
17 this Act.

18 § 406. Reciprocal collection agreements

19 When authorized by State law, reciprocal agreements
20 may be made between two contiguous States for the purpose
21 of requiring a seller with a business location in one of the
22 States to collect applicable State use tax for, and to remit
23 that tax to, the other State into which the seller makes sales
24 of tangible personal property, even though he is otherwise
25 not subject to the jurisdiction of such other State under sec-
26 tion 201 of this Act.

1 PART A—DEFINITIONS

2 **§ 501. Net income tax**

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

8 **§ 502. Sales tax**

9 A "sales tax" is any tax imposed with respect to sales,
10 and measured by the sales price of tangible personal property
11 or services with respect thereto, which is required by State
12 law to be stated separately from the sales price by the seller,
13 or which is customarily stated separately from the sales price.

14 **§ 503. Use tax**

15 A "use tax" is any nonrecurring tax, other than a sales
16 tax, which is imposed on or with respect to the exercise or
17 enjoyment of any right or power over tangible personal prop-
18 erty incident to the ownership of that property or the leasing
19 of that property from another, including any consumption,
20 keeping, retention, or other use of tangible personal property.

21 **§ 504. Excluded corporation**

22 A financial organization or a public utility is an ex-
23 cluded corporation. "Financial organization" means any bank,
24 trust company, savings bank, industrial bank, land bank, safe
25 deposit company, private banker, savings and loan association,

1 credit union, cooperative bank, small loan company, sales
2 finance company, investment company, or any type of in-
3 surance company. "Public utility" means any business entity
4 (1) which owns or operates any plant, equipment, property,
5 franchise, or license for the transmission of communications,
6 transportation of goods or persons, except by pipeline, or the
7 production, transmission, sale, delivery, or furnishing of elec-
8 tricity, water, or steam; and (2) whose rates of charges for
9 goods or services have been established or approved by a
10 Federal, State, or local government or governmental agency.

11 **§505. Affiliated corporation**

12 (a) Two or more corporations are "affiliated" if they
13 are included corporations as defined herein and if they are
14 members of the same group comprised of one or more corpo-
15 rate members connected through stockownership with a com-
16 mon owner, which may be either corporate or noncorporate,
17 in the following manner:

18 (1) At least 80 per centum of the voting stock of
19 each member other than the common owner is owned
20 directly by one or more of the other members; and

21 (2) At least 80 per centum of the voting stock of at
22 least one of the members other than the common owner
23 is owned directly by the common owner.

24 The fact that a corporation is an "excluded corporation"
25 as defined in section 504 shall not be taken into account in

1 determining whether two or more other corporations are
2 "affiliated".
3 (b) The term "included corporation" means any corpo-
4 ration except—
5 (1) Excluded corporations as defined in section
6 504.
7 (2) Western Hemisphere Trade Corporations as
8 defined in section 921 of the Internal Revenue Code.
9 (3) Possessions companies as defined in section 931
10 of the Internal Revenue Code.
11 (4) Corporations entitled to the special deduction
12 for China Trade Act Corporations under section 941 of
13 the Internal Revenue Code.
14 (5) Corporations, substantially all of the income
15 of which is derived from sources without the United
16 States. For this purpose substantially all of the income
17 of a corporation shall be deemed to be derived from
18 sources without the United States if the sum of the ap-
19 portionment fractions of such corporation for all States
20 under title III of this Act, without the application of
21 section 304 (b) (2) thereof, averages less than one-tenth
22 (10 per centum) per year for the current year and the
23 two preceding years, or such lesser number of years as
24 the corporation was in existence. The United States, as

1 used in this paragraph, means the fifty States and the
2 District of Columbia.

3 **§ 506. Sale**

4 For the purpose of title IV only, the term "sale" shall
5 be deemed to include leases and rental payments under
6 leases.

7 **§ 507. Interstate sale**

8 An "interstate sale" is a sale in which the tangible per-
9 sonal property sold is shipped or delivered to the purchaser
10 in the State from a point outside that State.

11 **§ 508. Destination**

12 The destination of a sale is in the State or political sub-
13 division in which possession of the property is physically
14 transferred to the purchaser, or to which the property is
15 shipped to the purchaser, regardless of the free on board
16 point or other conditions of the sale.

17 **§ 509. Business location**

18 (a) GENERAL RULE.—A person shall be considered to
19 have a business location within a State only if that person—
20 (1) owns or leases real property within the State,
21 or
22 (2) has one or more employees located in the
23 State, or
24 (3) regularly maintains a stock of tangible per-
25 sonal property in the State for sale in the ordinary course
26 of his business, or

1 (4) regularly leases to others tangible personal
2 property for use in the State.
3 For the purpose of paragraph (3), property which is
4 on consignment in the hands of a consignee, and which is
5 offered for sale by the consignee on his own account, shall
6 not be considered as stock maintained by the consignor.
7 If a person has a business location in a State solely by
8 reason of paragraph (4), he shall be considered to have a
9 business location in the State only with respect to such
10 leased property.
11 **§ 510. Location of property**
12 (a) GENERAL RULE.—Except as otherwise provided
13 in this section, property shall be considered to be located
14 in a State if it is physically present in that State.
15 (b) MOVING PROPERTY.—Personal property which is
16 characteristically moving property, such as motor vehicles,
17 rolling stock, aircraft, vessels, mobile equipment, and the
18 like, shall be considered to be located in a State if—
19 (1) the operation of the property is localized in
20 that State, or
21 (2) the operation of the property is not localized
22 in any State but the principal base of operations from
23 which the property is regularly sent out is in that
24 State.
25 If the operation of the property is not localized in any State

1 and there is no principal base of operations in any State from
2 which the property is regularly sent out, the property shall
3 not be considered to be located in any State for purposes of
4 inclusion in either the numerator or the denominator of the
5 property factor.

6 (c) MEANING OF TERMS.—

7 (1) LOCALIZATION OF OPERATIONS.—The opera-
8 tion of property shall be considered to be localized in a
9 State if during the taxable year it is operated entirely
10 within that State, or it is operated both within and
11 without that State but the operation without the State
12 is—

13 (A) occasional, or

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

17 (C) incidental to its use in the production,
18 construction, or maintenance of other property lo-
19 cated within the State.

20 (2) BASE OF OPERATIONS.—The term "base of
21 operations", with respect to a corporation's moving
22 property means the premises at which any such prop-
23 erty is regularly maintained regardless of whether such
24 premises are maintained by the corporation or by some
25 other person; except that if the premises are maintained

1 by an employee of the corporation primarily as a dwell-
2 ing place they shall not be considered to constitute a
3 base of operations.

4 **§ 511. Location of employee**

5 An employee shall be considered to be located in a State
6 if—
7 (a) the employee's service is performed entirely
8 within the State;
9 (b) the employee's service is performed both within
10 and without the State, but the service performed with-
11 out the State is incidental to the employee's service with-
12 in the State; or
13 (c) some of the service is performed in the State
14 and (1) the base of operations or, if there is no base of
15 operations, the place from which the service is directed
16 or controlled is in the State, or (2) the base of opera-
17 tions or the place from which the service is directed or
18 controlled is not in any State in which some part of the
19 service is performed, but the employee's residence is in
20 the State.
21 The term "employee" has the same meaning as it has
22 for purposes of Federal income tax withholding under chap-
23 ter 24 of the Internal Revenue Code of 1954.

24 **§ 512. State**

25 The term "State" means the several States of the United

1 States and the District of Columbia: *Provided, however*, That
2 the term shall also include, for purposes of sections 302
3 through 304, the Commonwealth of Puerto Rico, any terri-
4 tory or possession of the United States, and any foreign coun-
5 try or political subdivision thereof.

6 **§ 513. State law**

7 References in this Act to "State Law," "the laws of the
8 State," and the like shall be deemed to include a State con-
9 stitution, and to include the statutes and other legislative acts,
10 judicial decisions, and administrative regulations and rulings
11 of a State and of any political subdivision.

12 **§ 514. Taxable year**

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

16 **§ 515. Compensation**

17 "Compensation" means wages, salaries, commissions, and
18 any other form of remuneration paid to employees for per-
19 sonal services.

20 **§ 516. Commercial domicile**

21 "Commercial domicile" means the principal place from
22 which the trade or business of the taxpayer is directed or
23 managed.

24 **§ 517. Dividends**

25 "Dividends" means distributions made in cash or prop-

1 erty from the earnings and profits of a corporation as earn-
2 ings and profits are defined for Federal tax purposes, but
3 net of any "deemed foreign tax paid" which may be re-
4 quired to be added for Federal income tax purposes under
5 section 902 of the Internal Revenue Code.

6 PART B—MISCELLANEOUS PROVISIONS

7 **§ 518. Permissible franchise taxes**

8 The fact that a tax to which this Act applies is imposed
9 by a State or political subdivision thereof in the form of a
10 franchise, privilege, or license tax shall not prevent the im-
11 position of the tax on a person engaged exclusively in inter-
12 state commerce within the State; but such a tax may be
13 enforced against a person engaged exclusively in interstate
14 commerce within the State solely as a revenue measure and
15 not by ouster from the State or by criminal or other penalty
16 for engaging in commerce within the State without permis-
17 sion from the State.

18 **§ 519. Prohibition against geographical discrimination**

19 (a) IN GENERAL.—No provision of State law shall make
20 any person liable for a greater amount of sales or use tax with
21 respect to tangible personal property, by virtue of the loca-
22 tion of any occurrence in a State outside the taxing State,
23 than the amount of the tax for which such person would
24 otherwise be liable if such occurrence were within the State
25 (subject to section 520). For purposes of this subsection, the

1 term "occurrence" includes incorporation, qualification to do
2 business, and the making of a taxpayment, and includes an
3 activity of the taxpayer or of a person (including an agency
4 of a State or local government) receiving payments from or
5 making payments to the taxpayer.
6 (b) COMPUTATION OF TAX LIABILITY UNDER DIS-
7 CRIMINATORY LAWS.—When any State law is in conflict
8 with subsection (a), tax liability may be discharged in the
9 manner which would be provided under State law if the oc-
10 currence in question were within the taxing State.
11 **§ 520. Applicability of Act**
12 Nothing in this Act shall be considered—
13 (a) to repeal Public Law 86–272 with respect to
14 any person; or
15 (b) to increase, decrease, or otherwise affect the
16 power of any State or political subdivision to impose
17 or assess a net income tax with respect to an excluded
18 corporation.
19 **§ 521. Prohibition against out-of-State audit charges**
20 No charge may be imposed by a State or political sub-
21 division thereof to cover any part of the cost of conducting
22 outside that State an audit for a tax to which this Act
23 applies, including a net income tax imposed on an excluded
24 corporation.

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1 **§ 522. Liability with respect to unassessed taxes**

2 (a) PERIODS ENDING PRIOR TO ENACTMENT DATE.—
3 No State or political subdivision thereof shall have the power,
4 after the date of the enactment of this Act, to assess against
5 any person any tax for any period ending on or before
6 such date in or for which that person became liable for
7 such tax if during such period the State or political sub-
8 division would not have had the power to assess such tax
9 had the provisions of title II of this Act been in effect
10 during such period.

11 (b) CERTAIN PRIOR ASSESSMENTS AND COLLEC-
12 TIONS.—The provisions of subsection (a) shall not be con-
13 strued—

14 (1) to invalidate the collection of a tax prior to
15 the time assessment became barred under subsection
16 (a), or

17 (2) to prohibit the collection of a tax at or after
18 the time assessment became barred under subsection
19 (a), if the tax was assessed prior to such time.

20 **§ 523. Effective dates**

21 (a) Except as provided in section 522, titles II and
22 III of this Act shall apply only with respect to taxable
23 years ending after the date of the enactment of this Act.

24 (b) Section 405 of this Act shall be effective with

1 respect to taxable periods beginning on or after July 1,
2 1976.
3 (c) The remaining provisions of this Act shall take
4 effect on the date of the enactment of this Act, unless a
5 specific date is provided for in any such provision.
6 **§ 524. Evaluation of State progress**
7 The Committee on the Judiciary of the House of
8 Representatives and the Committee on Finance of the
9 United States Senate, acting separately or jointly, or both,
10 or any duly authorized subcommittees thereof, shall for
11 five years following the enactment of this Act evaluate the
12 progress which the several States and their political subdivi-
13 sions are making in resolving the problems arising from
14 State taxation of interstate commerce and if, after five years
15 from the enactment of this Act, the States and their political
16 subdivisions have not made substantial progress in resolving
17 any such problem, shall propose such measures as are deter-
18 mined to be in the national interest.

93D CONGRESS
1ST SESSION

H. R. 2096

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 12, 1973

Read twice and referred to the Committee on Finance

AN ACT

To prohibit the imposition by the States of discriminatory burdens upon interstate commerce in wine, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 SECTION 1. (a) Congress finds that the imposition by
4 one State of State taxes, regulations, prohibitions, and re-
5 quirements which discriminate against wine produced outside
6 the State, and the imposition of unreasonable requirements as
7 conditions for shipment into and sale or distribution of wine
8 in a State, materially restrain, impair, and obstruct com-
9 merce among the several States.
10 (b) Congress declares that, in the exercise of the power

II

1 to regulate commerce among the several States granted to it
2 by article I, section 8, clause 3 of the United States Constitu-
3 tion, its purpose and intent in enacting this Act is to eliminate
4 the obstructions to the free flow of commerce in wine among
5 the several States resulting from acts of the States which
6 impose discriminatory and unreasonable burdens upon such
7 commerce.
8 SEC. 2. (a) Wherever the law of any State permits the
9 transportation or importation of wine into that State, such
10 State may not impose with respect to any wine produced out-
11 side the State, or from materials originating outside the State,
12 any tax, regulation, prohibition, or requirement which is not
13 equally applicable with respect to wine of the same class
14 (established under section 5041 (b) of the Internal Revenue
15 Code of 1954) (1) produced in, or from materials originating
16 in, the State imposing such tax, regulation, prohibition, or
17 requirement, or (2) produced outside the State, or produced
18 from products produced outside the State.
19 (b) A State which permits the sale of wine within the
20 State shall permit the transportation or importation of wine
21 of the same class (established under section 5041 (b) of the
22 Internal Revenue Code of 1954) produced outside the State,
23 or from materials originating outside the State, into such
24 State for sale therein upon terms and conditions equally
25 applicable to all wine of the same class (established under

1 section 5041 (b) of the Internal Revenue Code of 1954)
2 sold in the State.
3 SEC. 3. (a) Notwithstanding the provisions of section 2
4 of this Act, each State retains the right—
5 (1) to engage in the purchase, sale, or distribution
6 of wine; and
7 (2) to exercise discretion in the selection and list-
8 ing of wine to be purchased or sold by each such State.
9 (b) No State which exercises the rights set forth in
10 subsection (a) may impose with respect to wine of any class
11 (established under section 5041 (b) of the Internal Revenue
12 Code of 1954) any tax, regulation, license fee, prohibition
13 or markup, which discriminates against wine of such class
14 produced outside such State.
15 SEC. 4. Whenever any interested person has reason to
16 believe that any State has violated any of the provisions of
17 section 2 or 3 (b) of this Act, such person may file in a
18 district court of the United States of competent jurisdiction,
19 a civil action to enjoin the enforcement thereof. Such court
20 shall have jurisdiction to hear and determine such action,
21 and to enter therein such preliminary and permanent orders,
22 decrees, and judgments as it shall determine to be required
23 to prevent any violation of section 2 or 3 (b).
24 SEC. 5. As used in this Act—
25 (1) the term "State" means any State of the United

1 States, any political subdivision of any such State, any
2 department, agency, or instrumentality of one or more
3 such States or political subdivisions, and the Common-
4 wealth of Puerto Rico; and
5 (2) the term "person" means any individual and
6 any corporation, partnership, association, or other busi-
7 ness entity organized and existing under the law of the
8 United States or of any State.

Passed the House of Representatives September 11, 1973.

Attest: W. PAT JENNINGS,
Clerk.

Senator MONDALE. Our first witness, Senator Mathias, has long taken a special interest in this issue and is a sponsor of one of the chief proposals introduced in the Senate on this matter. He has long been pressing this committee to commence the hearings which we start today to try to come to grips with this problem.

Senator Mathias, we are pleased to have you testify today.

STATEMENT OF HON. CHARLES McC. MATHIAS JR., A U.S. SENATOR FROM THE STATE OF MARYLAND

Senator MATHIAS. Thank you very much.

As your staff has so thoughtfully notified us in this statement here on the desk, which is underlined in red, that we are not to read our statements but to submit them with a brief oral presentation, I will ask permission to submit my full statement.

Senator MONDALE. Certainly and I am sure it will be as impressive either way. The statement will appear in the record as if read.

Senator MATHIAS. As you suggest, this legislation has a long history. I was just sitting here thinking about the fact that in its present form the bill really is a result of an agreement reached by the late Senator Harry Byrd of Virginia, who was chairman of this committee, and Representative Emanuel Celler of New York, who was chairman of the House Judiciary Committee.

I am sure you remember the somewhat different philosophies of Senator Byrd and Chairman Celler. So, I think it is a matter of some singular importance that both of them agreed completely and totally on the necessity of this legislation. They felt the present situation was strangling the business community in America and that it needed some urgent attention.

The bill was a matter of some disputed jurisdiction originally. Senator Byrd agreed to assign the initial work of drafting the legislation to the House Judiciary Committee and Chairman Celler undertook that task, and it was performed under his leadership and direction. The principals who were immediately involved in the work were former Congressman Edward Lewis, and former Congressman William McCulloch of Ohio, and I mention their names particularly, because there have been objections from some State officials that this bill would, in some way, infringe upon States rights. In my entire period of service in the Congress, I can't think of two men who were more vigorously adamant in the protection of States rights and in the preservation of the maximum degree of local initiative than Edward Willis and Bill McCulloch. They were States rights men; yet they understood the necessity of this legislation, they understood very well how it would operate, and they understood very well that people would benefit from the bill and that the States would not suffer from the bill. After all, what is the purpose of the States but to serve the people.

I, myself, served on the committee in the other body. In 1964 we produced a four-volume report which is very exhaustive and I hasten to assure the chairman I won't attempt to quote at length from that four-volume report now. It is available, however, and I think it will be of some assistance to this committee.

The chairman has, himself, been a distinguished attorney general for the State of Minnesota, and I think understands the problems of the collection of State tax as well as any Member of the Senate. I had a somewhat similar experience as assistant attorney general of Maryland when I was given as a primary responsibility the collection of State taxes. I have tried to approach this bill from the point of view of that experience, and I feel that this bill is not going to prejudice States in the collection of their proper revenues and that, on the other hand, it is going to enormously relieve the businessmen of America of an arbitrary burden.

I feel we have created a paperwork jungle. We have created the necessity for the filing of numerous tax returns, forms, and information. It is not always accompanied by the obligation to pay a tax, but we have the necessity to carry out this endless internal requirement of paperwork and, therefore, actually, I think it poses an unreasonable and arbitrary task on American business.

While Europe is beginning to enjoy the benefit of a unified economic system, we are condoning the fragmentation of the great American market, which has played such an enormously important part in our development. I believe that this bill, which I wholeheartedly endorse and hope will be approved and reported favorably by this committee, will go a long way toward removing some of the artificial economic barriers that we have allowed to grow up and toward restoring the vigor of the great continental market which has been one of the unique strengths of the American economic system.

Thank you, Mr. Chairman.

Senator MONDALE. Thank you, Senator Mathias. As we begin these hearings one of the questions that arises is, Why the urgency for legislative action? We have at present a system, or lack of theory, whichever you want to call it that has been in existence for many, many years. It has been adjusted from time to time by Supreme Court decisions which give a new twist to existing law. Different States apparently try new policies from time to time, followed by, I gather, a great deal of informal unwritten accommodations. What would you say is the chief reason for the urgency today of changing that? I think I understand what you are saying but I would like you to emphasize why you think we should act?

Senator MATHIAS. Well, I think there are institutional reasons for urgency and individual reasons for urgency. Let me take the individual reasons first.

We have now got a fragmented kind of system where anyone who engages in any substantial interstate commerce whatever incurs various obligations to various taxing authorities. They may be States, they may be counties, they may be municipalities. The patchwork is now so varied that it is really impossible for a small businessman to find his way around the resulting jungle. So he incurs liabilities. He doesn't really know what they are. The liabilities may be merely to file an information request or a return or it may be to pay a tax. He may not be sure.

I asked a constituent of mine how he found his way around in this jungle and he said: "Well, I get these various requests for information and I don't have an in-house accountant and I don't have an in-house

lawyer so I put them all down in the bottom drawer of my file cabinet and when I can get to it, I will, but in the meantime, I hope none of them blows up on me."

Well, that is really as good an expression of the urgency as I can give you because liabilities which incur are beyond the ability of the average businessman to take care of and so they may "blow up" on him.

Senator MONDALE. You say, "blow up." In other words, it is your impression that in many cases interstate businesses cannot know what kind of tax liabilities are accruing.

Senator MATHIAS. That is exactly what I am saying.

Senator MONDALE. Is it because the system is vague?

Senator MATHIAS. It is vague, and it is confusing. The rates are different, the methods of assessment are different, the imposition of tax is different in different localities.

Senator MONDALE. Is it the complexity of the problem?

Senator MATHIAS. Yes, and, of course, that is what this bill aims at. This bill would provide uniformity so that a businessman who wants to do business across State lines, across county lines, or across municipal lines can, because of the uniformity of the system, understand the nature of his obligation and can discharge it.

Now, because State taxation on the scale that we are now paying is a fairly novel thing in America—and we are really talking about something which has really grown up in the last generation—State taxing authorities have not really reached the level of efficiency which I think they will reach and which they ought to reach. Nobody wants to deny the State taxes to which they are entitled, but with computerization, with better administrative methods, with better methods of detection, with better reporting, I think the State taxing authorities are going to be more and more efficient and the perplexing forms and so on, which the small businessman can't handle today and puts in his bottom drawer against the day when his accountant comes in or his lawyer comes in, will explode on him because the States are going to have means of following these cases more exactly. And as that happens, the burden on business increases, the frustration of the businessman increases and I think the unreasonable aspects of Government bears down more heavily on the average citizen.

Senator MONDALE. Well, thank you very much for a most useful statement and for placing this issue in perspective. I am most grateful for your appearing today.

Senator MATHIAS. Thank you, Mr. Chairman.

[The statement of Senator Mathias follows:]

TESTIMONY OF CHARLES McC. MATHIAS, JR., A U.S. SENATOR FROM THE STATE OF MARYLAND

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today on a subject I believe can be described as one of the more pressing areas of "tax reform" demanding congressional attention.

I commend the subcommittee for holding these hearings and hope they will result in the enactment this year of much needed remedial legislation.

I think it is fitting that these hearings are being held by a subcommittee of the Committee on Finance, for it was this committee which initiated the legislation which became the first enactment in this important area, the so-called stop-gap legislation of 1959 (Public Law 86-272).

Since coming to the Congress in 1961 I have consistently introduced interstate tax legislation. The latest version is S. 1245, the Interstate Taxation Act of 1973. Senators Ribicoff and Humphrey have joined me as cosponsors of S. 1245.

The magnitude of the problem has increased manyfold since that initial legislation. When I served on the House Special Subcommittee on State Taxation of Interstate Commerce, we issued a four-volume report at the end of 1964. We found at that time, for example, sales and use taxes were levied by approximately 2,300 State and local units. Since that time there has been about a 250 percent increase, Commerce Clearing House reports that today there are more than 8,000 entities which levy sales and use taxes. And there are 46 different state corporate income tax laws, plus other laws of general applicability, such as gross receipts and capital stock taxes. The problem of determining liability with this vast number of differing taxes appear almost insurmountable particularly for the small businessman.

We do not claim that S. 1245 is the perfect solution but believe it provides a more than adequate basis for the development of legislation which would be satisfactory to both the business community and State and local governments. Your hearing schedule is crowded, so I will not attempt to describe S. 1245 in detail, for I know you will hear much about it, both pro and con, during these hearings. I would submit for the record, however, a section-by-section analysis of S. 1245 and a copy of the remarks I made at the time S. 1245 was introduced.

The basic design of S. 1245 is to provide some certainty for the business community as to its liability for State and local taxes applicable to interstate business. I believe that its income tax provisions—for example, those applying to apportionment of income or capital—are perhaps less controversial than the sales and use tax provisions. S. 1245 makes concessions to the views of the States in the apportionment area when compared with earlier versions of the legislation, such as that which I introduced in the 91st and 92nd Congresses.

I believe the sales and use tax provisions of S. 1245, however, would provide the most substantial relief for small business. In general, if a company, large or small, has a business location in the State, then it would be liable for collection of sales and use taxes as well as the payment of income taxes. If the business did not have a business location as defined in S. 1245, an interstate seller would be able to rely on registration procedure as assurance that the business purchaser is liable for the payment of tax to the State in which he is located. Such a procedure would remove the liability for collection from the seller who makes only occasional sales, often with the cost of compliance exceeding the amount of tax due.

Having begun my government service at the State level, I am not unmindful of the needs of the States and localities for revenue. I think I have indicated this by my consistent support for revenue-sharing legislation. As I have said on a number of occasions we expect the States and localities to be responsible in their use of general revenue-sharing funds. But we must also expect them to act responsibly by breaking down tax barriers that impede the free flow of commerce among the 50 States. If we do not, then I fear that we face what a former Chairman of the House Judiciary Committee termed "balkanization" of the economy, incidentally, it was this House Committee on which I served which initiated legislation which passed the House by overwhelming majorities in 1968 and 1969.

Actually, I believe that a proper registration procedure with adequate reporting to the States would in the long run increase sales and use tax revenues. With the growth of sophisticated tax collection methods, State and local governments would for the first time be able to compile a record of total sales from out of State. Therefore, they would be able to collect the maximum revenues from taxpayers from within the State rather than rely on the present selective method of collection from out-of-State sellers, principally large firms.

Major business organizations who will be appearing later in these hearings have worked with me in developing S. 1245, I know they also have been trying to reach an accommodation with the States. Of course, the most desirable course of action would be reporting legislation that is 100 percent agreeable to all affected parties, I hope such an agreement can be reached. I think much progress has been made. If unanimity is impossible, I would urge the subcommittee to recommend legislation along the lines of S. 1245 at the earliest possible date so that the Senate can act on it in 1973.

If we delay much longer, I fear there will be an ultimate demand for Federal collection and distribution of most, if not all, state and local taxes. Existing laws have created a chaotic condition with widespread non-compliance due largely to lack of knowledge of liability, with always the possibility of a demand for years of back taxes plus penalties, Individual problems of businessmen have been described by their letters in support of this bill.

Perhaps the most succinct summary comes from a small businessman who wrote as follows:

> Even though it is our sincere intent to be a good corporate citizen, I know that we are in violation of some taxing legislation at some governmental level, but I don't know which one, where it is, or the extent of our liability. In some cases, the penalties for late filing or non-compliance are staggering.
>
> On the other hand, the cost of locating each taxing authority, filing, keeping up to date with the rules, regulations and rates, plus finding any new taxing authorities is even more costly.

I have a few more illustrations of the type of problems being faced on a day to day basis by those who operate in interstate commerce, but in the interest of time I will not read them but ask that they be included as part of my testimony.

". . . we have not had a sale in California since 1967 and we have not had a sale in Arkansas since 1968, yet we must still file an annual Sales Tax report with California and submit monthly reports to Arkansas; we have had no employees in Alabama since 1968, yet we must still file an Employers Quarterly Tax Withholding report; we have had no fuel purchases nor trucks in Nebraska since 1970, yet we must file a monthly report indicating zero activity."

". . . we are a small company employing 55 people . . . Sales are made to all types of businesses, schools, hospitals and government agencies in all 50 states through manufacturers representatives. . . .

"We have no property or employees at any location other than in * * * . . . As a practical matter we now have three people in our accounting department who probably spend as much time accumulating the information necessary for tax returns and preparing tax returns as they spend on the accounting necessary for the operation of our business. . .

"Our principal concern at this time is the State of * * *. We were first contacted by the State of * * * in September of 1963. We did not apply for a sales tax permit because it appeared that there would be some Federal regulation to regulate interstate taxation . . . The Tax Commission did send an auditor in March of 1971 and I point out that this was nearly eight years after the first contact. We cooperated with the auditor and before he left he informed us that we would receive a determination of the tax due for the years prior to 1971 . . .

"The * * * tax people let the problem drag seven and one half years before the first audit. Over two years have passed between this audit and a date when we can expect a determination of tax for prior years. The prospects are that because of the delay the accumulated interest and penalty will exceed the tax . . .

"We are aware that if we receive a * * * sales tax permit we will have to make regular returns—the worst part of which is that these sales will have to be reported by counties and special tax districts with special assessments for some of the tax districts. The auditor suggested that we might make use of a computer for this detailed accounting. We don't need a computer to run our business but it isn't hard to see where it would be useful for tax accounting. We are also mindful of the fact that there are 44 other states collecting sales and use taxes as well as innumerable counties, cities, and special tax districts."

"We are a small company, less than 50 employees . . .

"We do business in all 50 states . . .

"Most of our dealers do not buy from us daily or weekly. Many of them purchase only two, three or four times per year. According to individual State law some of these sales should be taxable, others are not. In some states a particular type of sale is taxable, in another state it is not.

"Then there is the constant bickering with each State about income tax. Some say we owe it if we have a desk and phone in their state. Some base it on whether our sales representatives are local or out of state."

"In an attempt to determine what our tax status is in other states, we wrote exactly the same letter to 43 states, outlining the way we do business and inquiring if any of their state tax laws applied to us. After 60 days, we have received only 31 replies, of which only 5 gave an unqualified yes, that we were liable for collecting sales and use taxes, and 1 a probable yes. Seven gave an unqualified no, 2 a probable no, and 6 advised us to consult a private attorney. The remainder gave various indefinite answers or sent copies of their tax laws with no comments."

"The awareness of an unknown tax liability has plagued us for some time. We have subscribed to state tax services and tried in many ways to determine our tax liabilities accurately. However, from time to time we are confronted with a liability from some town or subdivision concerning a tax liability we knew nothing about.

"We have also discovered that the contents of local tax laws are not clear, leaving a great deal of discretion to the administrators which can change as administrators are replaced.

"We had been advised by our auditing firm and our own tax people that we were not liable for the business and occupation tax in the State of * * *. However, due to some insignificant technicality we were found liable and had to pay taxes for five years retroactive to 1966. During this investigation we also discovered that any local municipality could also tag on a piggyback tax if they so desired.

"In some areas . . . local taxation has made us raise our eyebrows and consider whether or not we wish to continue to sell in the area."

[From the Congressional Record, Mar. 15, 1973]

By Mr. MATHIAS (for himself and Mr. RIBICOFF):

S. 1245. A bill to regulate and foster commerce among the States by providing a system for the taxation of interstate commerce. Referred to the Committee on Finance.

THE INTERSTATE TAXATION ACT

Mr. MATHIAS. Mr. President, I am introducing the Interstate Taxation Act of 1973. I am pleased that the senior Senator from Connecticut (Mr. RIBICOFF) is joining me in this effort. Our bill is a revised version of legislation that we introduced in the 92d Congress, and prior legislation that I introduced in the 91st Congress as a Member of the Senate and even prior to that time during my service in the House of Representatives.

On October 11, 1972, I introduced S. 4080, a version of this legislation which made major concessions to the States and localities which have opposed earlier versions and asked for comments after it had been studied by those who would be affected by its provisions. I have received many such comments, and the bill I am introducing today contains revisions reflecting some of these suggestions.

The Interstate Taxation Act has the support of a substantial segment of the business community. I have received the expert help of tax technicians drawn from the National Association of Manufacturers, Council of State Chambers of Commerce, the National Association of Wholesalers-Distributors, and other organizations. This bill also has the endorsement of many other single product or service business associations.

The revisions are primarily in the direction of additional concessions to the States and localities. Perhaps the major change from S. 4080 involves a major simplification of the provision relating to consolidated returns and combined reporting.

As did S. 4080, this new version embodies some of the concepts, particularly those relating to sales and use taxes of S. 3333 introduced in the 92d Congress by the chairman of the Committee on Commerce, the distinguished senior Senator from Washington (Mr. MAGNUSON).

Mr. President, in both the 90th and 91st Congress, the House passed by overwhelming majorities State taxation legislation similar in its thrusts to that which I am introducing today. Since that time, the workload of the Committee on Finance has been such that it has not even been able to hold public hearings on the subject. I am most pleased that the chairman of the Committee on Finance, the distinguished senior Senator from Louisiana (Mr. LONG) told the Louisiana Association of Tax Administrators late last year that—

"It is likely that time can be found in 1973 to undertake . . . public hearings."

I am also pleased that the committee has created a subcommittee to deal with pressing problems such as that addressed by the Interstate Taxation Act of 1973. The subcommittee, the Subcommittee on State Taxation of Interstate Commerce, is chaired by the distinguished Senator from Minnesota (Mr. MONDALE) and is privileged to have the Senator from Wyoming (Mr. HANSEN) as the ranking minority member.

Mr. President, as I have indicated on past occasions, now that we have accomplished a fundamental and far-reaching change in Federal-State fiscal relationships, it becomes even more urgent that we turn our attention to legislation designed to bring order into the present chaotic system of taxing interstate commerce by State and local governments. We expect the States and localities to be responsible in their use of Federal revenue-sharing funds, but we must also ask

that they act responsibly in breaking down tax barriers that impede the free flow of commerce between the 50 States. I am particularly pleased that the distinguished chairman of the Committee on Finance (Mr. LONG) in the speech I just referred to indicated that with the enactment of the revenue-sharing bill, Public Law 95-512—

"The arguments against an interstate tax bill of some sort have been weakened."

The Interstate Taxation Act of 1973 has substantial support in the business and industrial community. It meets many of the earlier objections of the States, and I believe provides an adequate base along with other State taxation bills certain to be introduced for the earliest possible consideration by the Committee on Finance.

I urge the distinguished chairman of the Subcommittee of State Taxation of Interstate Commerce to schedule public hearings as soon as possible, hopefully before the Committee on Finance is confronted with major legislation coming from the House.

Mr. President, I ask unanimous consent that a copy and explanation of my bill be printed in the RECORD at this point.

There being no objection, the bill and explanation were ordered to be printed in the RECORD, as follows:[1]

EXPLANATION OF MAJOR PROVISIONS OF S. 1245, THE INTERSTATE TAXATION ACT OF 1973

S. 1245 is a revision of S. 4080 introduced in the 92nd Congress in October of 1972. S. 4080 incorporated features of a number of bills that had been introduced over a period of time. Many of its provisions were supported by a significant portion of the business community and a number of State tax officials. The revisions in S. 4080 contained in this new bill primarily implement a further meeting of minds between the affected business taxpayer groups and key State officials

TITLE I—JURISDICTION TO TAX

SECTION 101. UNIFORM JURISDICTIONAL STANDARDS

This section aims to provide protection for the business that is selling in interstate commerce from being liable for payment or collection of taxes in States where that business has no business location while at the same time preserving the legitimate interest of the States in collecting all taxes to which they are entitled.

The present sales and use tax jurisdictions would be preserved for the States by codifying (with an exception benefiting primarily small business) the present law as enunciated in the Supreme Court cases of *Scripto, Inc.* v. *Carson,* 362 U.S. 107 (1960) and *National Bellas Hess, Inc.* v. *Department of Revenue of the State of Illinois,* 386 U.S. 753 (1967).

The bill would afford relief from sales tax liability for businesses without a business location in the State—that is, generally medium and small businesses wholesalers and small manufacturers—through a registration number procedure.

The seller, without a business location in a State, would be able to rely on a sales and use tax registration number procedure, prescribed in Section 304, as assurance that the *business* buying the product would assume liability for payment of any sales or use tax that may be due. "Business location," which is defined in Section 513, generally means owning or leasing real property within the State, or having one or more employees located in the State, or regularly maintaining a stock of tangible personal property in the State for sale in the ordinary course of business. Since most of the larger corporations would tend to have "business locations" in States in which they are making interstate sales, their tax liability would not be greatly affected by this registration number procedure. Rather the registration number procedure would tend to benefit primarily the smaller businesses—the type of business that the House Judiciary Subcommittee on State Taxation of Interstate Commerce found to be in widespread noncompliance, through lack of knowledge, inability to comply, etc., with sales and use tax payments on interstate sales. In that the procedure clarifies liability for payment of sales and use taxes, it should be helpful to States in actually collecting the taxes that are not being collected now, as well as relieving small business from potential liability that hangs over their heads.

[1] The bill is reprinted at p. 6.

Section 101 also provides for a "business location" jurisdictional test for imposing a corporate net income tax, a gross receipts tax or capital stock tax on a corporation. The reason for this provision is well stated in the December 1971 Report of the Committee on Interstate Taxation of the New York Bar Association. The report states:

"In our Committee's judgment, the policy of requiring a corporation to contribute to the support of the government of each State providing a market for its goods or services is outweighed by the policy of freeing multistate business firms from the onerous administrative burdens of keeping records and filing tax reports for a multiplicity of States and localties with which their economic contacts are relatively small. In our view, the governmental services furnished by a State to an enterprise having no permanent establishment within that State's borders are not likely to be sufficiently substantial to justify the imposition of income tax compliance burdens on such an enterprise. This judgment leads us to support the "business location" test set forth in Clause (1) in Section 101 of the Rodino Bill as affording an appropriate means of alleviating the compliance problem."

TITLE II—MAXIMUM INCOME OR CAPITAL ATTRIBUTABLE TO TAX JURISDICTION

SECTIONS 201-206 OPTIONAL THREE-FACTOR FORMULA

The bill provides an optional Three-Factor Formula (property, payroll, and sales) for apportionment of income or capital of interstate corporations. This is the most widely used formula and has been recommended by the Commissioners on Uniform State Laws in the Uniform Division of Income Tax Purposes Act (UDITPA). A taxpayer would still have the right to use a different apportionment formula that may be provided for by State law, but the Three-Factor Formula and other provisions of Title II serve as a maximum.

The bill adopts the approach of the so-called "Ad Hoc" bill, S. 3333, of the 92nd Congress, to apportion all income in the tax base except portfolio dividends which would be allocated to commercial domicile. Foreign source income generally and intercorporate dividends would be excluded both from allocable and apportionable income. This will clear up the confusion that has developed in the application of UDITPA between "business" income that is apportionable among the states by the use of the Three-Factor Formula and "non-business" income which is allocable to a specific State.

The shift in this bill to placing greater emphasis on apportioning income among the States by formula, as opposed to allocating that income to specific States by situs, constitutes a major concession by the business community to those States that have been advocating this approach. There has been a developing trend among the States to support apportioning income among the States by the Three-factor Formula rather than allocating by situs. Business generally in the past has proposed clarifying the confusion in UDITPA between apportionable "business" income and allocable "non-business" income by specifying what types of income should be apportioned and what types should be allocated.

SECTION 204. SALES FACTOR—"THROWBACK RULE"

The bill assigns sales by destination in a State as the simplest, most equitable attribution procedure. It gives due weight to the role of the market in the overall production of income or capital and is one that many businesses and States have learned to live with and prefer. The so-called "throwback" provision, found in the Uniform Act (UDITPA), is not included in the sales factor. The "throwback rule" provides that in the case of sales to the United States Government and when the taxpayer is not taxable in the State of the purchaser, the sale will be recaptured or "thrown back" to the State of the origin of the sale.

It would appear more equitable and appropriate that the receipts factor include sales on a straight destination basis since the purpose and intent of the apportionment formula is to arrive at a reasonable basis for assigning some part of the corporation's total income to a particular State based on the activity performed in that State. Therefore, in attempting to measure this activity, the guidelines should be focused on what is being done in the State—and not what the taxpayer is *not* doing in some other State. In utilizing the receipts factor, it is recognized that part of the income or capital is attributable to the selling activity in the market State and, therefore, any change from a straight destination test results in attributing a smaller part of the total income or capital to the selling activity than

would be the case by utilizing a straight destination test. The market oriented States must rely largely on the sales factor to have a share of major multistate business assigned to them. Other States that are relatively less market oriented have property and payroll factors, as well as sales, to increase their share of the taxable income or capital. The justice of this concept has been recognized by a number of major States, including some that are not market oriented States, which have deleted the "throwback" provision in enacting the Uniform Act. These States have recognized that recapture involves an administrative complexity that may cost more than the tax difference. The House Judiciary Subcommittee on State Taxation of Interstate Commerce on page 244, Volume 1 of their report, stated that:

"It should also be observed that the existing throwback rules add to the complexity of the system even if their applicability is clear. When a throwback rule applies, it will normally require the taxpayer to develop data in addition to that needed to comply with the primary division-of-income rules of the taxing State. When a destination State requires that certain sales be thrown back to the State of origin, for example, the taxpayer is required to determine the point of origin of each transaction subject to the throwback. The development of such information may materially increase the burden of compliance."

SECTION 207. APPORTIONABLE INCOME

Corporations necessarily have, in addition to their regular business income, income which is not earned in the course of their regular trade or business. To the extent that such income is not earned in the United States, it is not properly apportionable by formula to the various States. Section 207(a) insures that only income earned in the United States will be apportioned among the States by formula.

The Section 207(a) provision that apportionable income for a corporation shall not be determined by reference to the income of any other corporation needs to be related to Section 209 on "Consolidated Apportionable Income" which provides for determining apportionable income for affiliated groups of companies under certain circumstances.

Additional language has been added to Section 520 to make it clear that a State cannot properly include foreign taxes deemed to be paid which are treated as dividends for Federal income tax purposes as part of the State tax base. This is meant to clear up a confusion that has developed in some States that have attempted to follow the Federal tax base without recognizing that the "gross-up" of foreign taxes required by Federal law is simply a device used in connection with the application of the foreign tax credit which then eliminates such taxes from the Federal base. Since States do not have a foreign tax credit, failure to permit an adjustment for the gross-up results in a State attempting to impose a tax on fictitious income to which it has no legitimate claim. Most recently this has been a problem in the State of Illinois.

The alternative Apportionment Election permitted by Section 208(b) of S. 4080 has been deleted from this bill. This provision would have allowed a taxpayer to elect to include in apportionable income gains, profits, and income derived from the sale of personal property without the United States. The deletion of this provision constitutes a further concession to the State tax collector viewpoint that generally objects to the taxpayer being given elections which it is assumed would be exercised to benefit the taxpayer at the expense of the State.

Section 207(b) on "Adjustment of Apportionment Factors" accomplishes the same purpose as Section 208(c)(2) of S. 4080. It provides for adjustment of the denominators of the apportionment factors to include payrolls, sales, and property that are attributable to the sale of tangible personal property, the ultimate destination of which is outside the United States, because the income derived from the sale is included in apportionable income. The income from such a sale would be included in apportionable income when it is not "income from sources without the United States" as defined in Section 862 of the Internal Revenue Code because the sale takes place, or the title passes, in this country and the property is then shipped outside of the country. The adjustment of the denominators of the factors is made necessary because Sections 202–204 define the denominators as including *only* property, payroll, sales *within* the United States, but such sales may involve property, payroll, and sales located outside of the United States. To properly apportion income it is essential that the apportionment factors reflect values directly related to the specific income to be apportioned.

SECTION 208. ALLOCABLE INCOME—DIVIDENDS

Dividends, except dividends from affiliates, are allocable to the State of commercial domicile. Dividends received from an affiliated corporation in which the taxpayer owns 50% or more of the voting stock and income from sources outside the United States generally are excluded both from apportionable and allocable income and so would not be in the tax base. These exclusions from apportionable income are provided for in the Section 207 definition of "apportionable income."

Section 208 has strong support from business and many States.

Since a State should be attempting to tax only income derived from sources in that State, it would seem obvious that the States should not be taxing income earned overseas, but this is precisely what some States are attempting to do. In fact, some States are attempting to go beyond commonly accepted worldwide concepts of taxing international income.

Section 207 provides that corporate dividends are to be excluded from income apportioned among the States by formula unless dealing in securities is the taxpayer's principal business. Section 208 then provides for allocation of dividends, except dividends from affiliates, to the State of commercial domicile. This type of allocation is in accordance with intent of the Uniform Act (UDITPA) but Congressional action is made necessary by a September 10, 1971, recommendation by the Multistate Tax Commission (MTC) to the States for regulations that would apportion dividend income. The regulations which the MTC proposes to change basically were worked out after much effort by the Committee on Uniform Income Tax Regulations of the National Association of Tax Administrators (NATA). The regulations as recommended by NATA have been adopted by California, Oregon, and Kentucky. The regulations as proposed by NATA would generally allocate dividends to the State of commercial domicile which is a clear cut way of handling the problem in accordance with the intent of the uniform law (UDITPA). Only a minority of the States have enacted the Multistate Tax Compact. Therefore even if all the member States adopted this proposed regulation, which seems unlikely, many States are likely to continue to follow their present practices. This means that States that tax dividends of companies with a commercial domicile in the State will continue to do so. Other States that adopt the Multistate Tax Commission (MTC) regulation will be apportioning the *same* dividend income by formula among the States. The result will be increased *double* taxation.

Most States and the Federal government have long recognized that intercorporate dividends should not be treated as income subject to full taxation. Some States allow a 100% exclusion for intercorporate dividends, while others follow the Federal practice of an 85% exclusion (a 100% exclusion is permitted by the Internal Revenue Code for dividends from affiliates under certain circumstances). It is likely, however, that if the MTC regulation referred to above is adopted by Compact member States, there will be a great temptation for these States to subject such income to taxation even though they have no legitimate claim on it. The result will be increased multiple taxation.

Business generally takes the position that no dividends should be taxed since the income from which the dividends are paid has already been taxed. Very few States include all dividends in the tax base. Many States include dividends only to the extent that they are included in Federal taxable income. To the extent dividends are taxable, they are generally allocated to the State of commercial domicile, as provided for in Section 207.

SECTION 209. CONSOLIDATED APPORTIONABLE INCOME

If it is established that two or more affiliated companies have engaged in non-arm's-length transactions which cause a material distortion of income apportioned by a State, the State may require, or the taxpayer may elect to determine, apportioned income by consolidating the income of parties to the non-arm's-length transactions. "Non-arm's-length transactions" and "affiliated corporations" are defined in Sections 507 and 508.

This provision on consolidated returns (Section 209(a)) is a revision of the proposal contained in Section 210(a) of S. 4080 of last session.

Section 209(b) provides that a State or political subdivision may not require and the taxpayer may not elect a consolidation that includes a corporation incorporated outside the United States, or any corporation 50 percent or more of the ordinary gross income of which is excludable under Section 207(a)(1),

or an excluded corporation. Section 207(a)(1) excludes income from sources without the United States. Section 509 defines "ordinary gross income" and Section 506 defines "excluded corporation." Section 208 allocates portfolio dividends to the State of commercial domicile and excludes from the tax base dividends from affiliates and from foreign sources outside the United States.

If affiliated corporations engage in non-arm's-length transaction, it is the intent of this section, and Sections 507 and 508, that all such affiliated corporations, whether or not each engages in non-arm's-length transactions with each of the others, may be required or permitted under appropriate circumstances to determine maximum amount of income attributable to a taxing jurisdiction by reference to a consolidated apportionable income on a consistent basis and so that neither more nor less than 100% of their consolidated apportionable income will be subjected to tax. In order to achieve this result, each such affiliated corporation will multiply the aggregate apportionable income of all such affiliated corporations (after elimination of all intercorporate transaction) by an apportionment fraction which is the average of the corporation's property, payroll and sales factors, except that the denominator of each factor shall be the total of the same factor for all such affiliated corporations with all intercorporate transactions eliminated. If a corporation falls within the scope of subsection (b)(1), (2), or (3) so that its income would not be included in consolidated apportionable income for the purpose of determining the maximum tax of an affiliated corporation, it should not be required or permitted to compute its apportionable income under this section.

The provisions on combined reporting and consolidated returns should help avoid situations where companies are "whipsawed" between conflicting approaches of different States and subjected to double or multiple taxation on the same income. This sometimes results in more than 100% of a company's income being subjected to State taxation.

The need for these provisions is illustrated by two cases involving the Kennecott Copper Corporation. The States of California and Utah have both held that Kennecott and its affiliates are unitary.

California rules that Kennecott must file a combined report. (*Chass Brass and Copper Company* v. *Franchise Tax Board*, 7 Cal. App. 3d 99, 86 Cal. Rptr. 350, *appeal dismissed and cert. denied*, 400 US 961 (1970)). Utah, on the other hand, refused to permit Kennecott to file a consolidated return, even though its law authorizes such a return, but instead imposed a separate accounting approach on the parent organization and required separate taxation of its affiliates (*Kennecott Copper Corporation, et al.* v. *State Tax Commission of Utah*, unreported decision of the Utah Supreme Court, Case No. 12498, filed January 24, 1972. Appeal dismissed by the Supreme Court of the United States, November 6, 1972.) Both California and Utah acted in a manner so as to maximize the tax owed to each State. The result is that Kennecott is being subjected to taxation on considerably more than 100% of its income. The California case also illustrates how that State uses its combined reporting requirements to subject foreign source income from overseas investment to taxation even though the foreign affiliates involved have no situs or business activity in the State.

The refusal of the Supreme Court to hear the Kennecott California and Utah appeals emphasizes the need for Congressional action to rectify the situation.

TITLE III—SALES AND USE TAXES

This title generally follows S. 3333 with the addition of the registration requirement referred to above in connection with Section 101. This includes the provisions (Section 306) prohibiting political subdivisions from imposing the obligation on the seller to collect tax on an interstate sale unless (1) the seller has a business location or makes regular deliveries into the subdivision, or (2) the local tax is imposed in all geographic areas of the State on like transactions at the same combined State and local rate, administered by the State, and uniformly applied so that a seller would not be required to classify interstate sales according to geographic areas of the State. (This section would not be effective until July 1, 1977.) The other provisions in this title primarily codify existing law and are generally considered acceptable to the States.

TITLE IV—JURISDICTION OF FEDERAL COURTS

This title would give jurisdiction to the Federal Court of Claims to hear appeals upon the application of provisions of the Act, after Senate administrative decisions are final and the only appeal is to court. The Court of Claims uses Commissioners to hear cases throughout the country. The Court of Claims also have authority

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to sit as a panel of judges in different parts of the country. The objective of this title is to have a single Federal court that could develop expertise in the area of interstate taxation and provide for uniform application of the Federal law in a manner that would not be possible through use of State or Federal District Courts.

INTERSTATE TAXATION ACT

Mr. RIBICOFF. Mr. President, I am pleased to join with the distinguished Senator from Maryland (Mr. MATHIAS) in introducing the Interstate Taxation Act.

This bill is designed to bring order to the present chaotic system of taxing interstate commerce. Almost 200 years after the founding of this Nation businesses still face serious impediments to the free flow of commerce.

The growth of our society has placed increasing demands on our States and local governments. Population expansion, particularly in our cities and towns, has burdened local jurisdictions with demands for increased public services—in the form of schools, roads, sewers, fire, and police protection. State and local governments, in meeting these demands have had to open new sources of revenues including income, sales, and use taxes. The resulting wide proliferation of State and local taxation programs have increased the difficulties of conducting an interstate business—particularly if the concern is small or medium sized.

A recent study by a House Judiciary Committee subcommittee revealed a staggering number of jurisdictions taxing interstate commerce. There were in effect on a State level, 38 different sets of corporate income tax laws, 39 sales and use tax systems, 37 capital stock tax laws, and eight different sets of State gross receipts tax laws. The local tax picture was even more staggering—with more than 2,300 cities, counties, parishes, towns, and villages imposing sales and use taxes on interstate commerce, more than 1,000 local governments imposing gross receipts taxes, and more than 100 local governments imposing full fledged corporate income taxes.

Today the numbers are even higher and the problems they create more exasperating.

I have received pleas for action from Connecticut businesses of all sizes. Products manufactured in my State travel all over the country. But the present system of State taxation is so unwieldly, so cumbersome, that many companies, particularly smaller ones, simply do not have the ability to meet the taxing requirements of all the jurisdictions in which their goods are sold. One Connecticut businessman told of having to spend several hundred dollars in order to meet a tax bill amounting to only a few dollars. Individuals face many of the same problems. It is imperative that these companies and private citizens be given relief and allowed free access to a single national market.

I have introduced legislation to solve this problem in the 90th, 91st, and 92d Congresses. Unfortunately the Senate has never taken action. I am hopeful that with the establishment in the Senate Finance Committee of a Subcommittee on Interstate Taxation we will finally enact the necessary corrective legislation. The Mathias-Ribicoff Interstate Taxation Act of 1973, a revised version of our previous efforts, will be a major step toward eliminating the present confusion and allowing our Nation's businesses free and easy access to all markets.

Senator MONDALE. Our next witness is Mr. Leonard E. Kust, a member of the Taxation Committee, chamber of commerce, accompanied by Robert R. Statham, taxation and finance manager, U.S. Chamber of Commerce,

We are pleased to have you both here this morning.

STATEMENT OF LEONARD E. KUST, MEMBER, TAXATION COMMITTEE, CHAMBER OF COMMERCE OF THE UNITED STATES, ACCOMPANIED BY ROBERT R. STATHAM, TAXATION AND FINANCE MANAGER, U.S. CHAMBER OF COMMERCE

Mr. KUST. Thank you, Mr. Chairman. My name is Leonard Kust, and I am a partner in the New York City law firm of Cadwalader, Wickersham & Taft.

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Prior to 1971, I was vice president and general tax counsel of Westinghouse Electric Corp. and head of its tax department, and I am appearing on behalf of the Chamber of Commerce of the United States, as a member of its Taxation Committee, and as chairman of its Subcommittee on Taxation of Interstate Commerce today.

I am accompanied, as you noted, by Robert Statham, who is the taxation and finance manager of the national chamber.

In keeping with your instructions, Senator, I propose simply to summarize a longer statement which has already been submitted to the subcommittee.

Senator MONDALE. If it is all right, Mr. Kust, we will place your full statement in the record as though read, and you can emphasize the points you think we ought to keep uppermost in mind here.

Mr. KUST. Thank you. This is what I propose to do.

The national chamber is grateful for this opportunity to express its views on proposals regarding State taxation of interstate commerce. The chamber has had an intensive interest in the problems, and I commend the subcommittee for holding these hearings and enabling the business community to express its conviction that action by Congress to adopt legislation in this area is essential.

Advances in communication and transportation in this country have given impetus to a national economy in which large segments of American business are operating in interstate commerce, and our institutional structures beginning with the Constitution have encouraged the growth of such a national economy.

Most large- and medium-sized businesses find their commercial activities necessarily extend across State lines.

Many retail establishments find that customers are requiring delivery of merchandise in other States. Even small manufacturers are doing business in large numbers of States. And as business extends its sales into other States, liability for taxes in those States follow, but the rules under which interstate businesses are subject to the tax in various States have been an exception to the institutional encouragement of the national economy. Such rules are, as the chairman has noted, multiple and often vague. Many of the rules must be extracted from court decisions rather than from statutory law or from regulations.

Frequently, it is the small businessman who is hardest hit. Desiring to expand his commercial activities into other States, he often finds his greatest obstacle is tax compliance.

Senator MONDALE. In your judgment, are the complexities and difficulties of that problem a significant barrier to the expansion of interstate commerce?

Mr. KUST. It is difficult to say that it actually impedes interstate commerce, Senator.

Senator MONDALE. I don't mean in a legal sense; I mean as a practical matter.

Mr. KUST. But as a practical matter, it is an exceedingly heavy burden. It is not only the complexity but the multiplicity that is the problem; that is, there are 50 States and many political subdivisions and simply coping with the need for information to comply in the absence of uniformity, well, it is just a formidable task for many small businesses. And indeed, if a small business

attempted to comply in every respect with the requirements, it might well forestall some expansion of small business. But as the subcommittee of the House in its findings noted, there is substantial noncompliance.

Senator MONDALE. What do you mean by that?

Mr. KUST. Well, lack of knowledge of what the requirements are. They simply do not know there is an obligation, and they go on with their business. I don't think there was any finding—at least it is not my experience—that there is deliberate noncompliance. I think it is simply inability to comply in all respects with all of the rules.

The small businessman has to know the tax laws of each State; all of the jurisdictions in which he sells products, if he is to comply in all respects. And as I have stated, it is not just the States that have income, gross receipts, and sales taxes, but many local jurisdictions as well.

For the businessman, large or small, operating in a large number of States and their many subdivisions, the problem of tax compliance can approach the impossible. Not only do the tax laws differ from State to State, but in some cases from locality to locality. Vague provisions in the applicable laws, uncertain interpretations, unwritten local practices, and other obstacles can make the businessman's tax compliance problem so formidable that, as I have noted, it is impossible to fully comply.

In the case of large business, such as I was associated with, I think every effort is made at full compliance, but it requires a substantial staff of experts in taxation, accountants and lawyers, and complicated computer programs to attempt really fully to comply with all of the laws.

Senator MONDALE. Has it been your experience that some of these State or local tax systems are really disguised trade barriers?

Mr. KUST. I don't believe that they are designed as trade barriers, but I think in some measure that they do act as trade barriers, although they may well be defended as attempts to equalize tax burden between in-State and out-of-State business. The in-State business enjoys the advantage of being at home and, therefore, knowing what the rules are. The out-of-State business that operates not only in a home State but many other States, suffers the additional burden of compliance with the different tax structures of the States and the localities in which he does business other than his own home State.

Senator MONDALE. Well, do you fear that establishment of your uniform jurisdictional standards might create tax exemptions or tax rules which would provide interstate business a competitive advantage over intrastate business?

Mr. KUST. This is a possibility if the jurisdictional threshold is too high. However, I think that the need for congressional action is, in part, to permit a much lower level of jurisdictional presence. If the rules under which the taxation was imposed were uniform, I believe that a much lower jurisdictional threshold would be acceptable to the business community. But absent the uniform rules, a jurisdictional standard of some significance is needed to protect intrastate business from the burdens of compliance.

Senator MONDALE. Would you favor separate congressional consideration of State corporate income taxes and State sales and use

taxes? For example, acting first in this session on a sales and use tax bill with later consideration of income taxes, or do you think they should, of necessity, be treated together?

Mr. KUST. Well, there is nothing of necessity that compels treating them together but, as a practical matter, and having lived with 16 years of consideration by the Congress of the problem of intrastate business, I am reluctant to agree that there be a separation because I am afraid that if there is action taken in the one area before it is taken in the other—in other words, without it being taken in all areas, that may well unnecessarily defer action in the remaining area.

Senator MONDALE. What is the area of greatest concern? Is it the sales and use tax question that causes the most difficulty? Or would you say the greatest difficulty is in another area?

Mr. KUST. I think I would have to say that the greatest threat of actual trade barriers to interstate business is the proliferation of local sales, use, and income taxes. And, of course, more in the area of sales and use taxes than in income taxes. But the imposition by local governments of these taxes which, under present law, can be imposed on any business that is engaged anywhere in the State in an activity which meets the jurisdictional standard even though not so engaged in the local subdivision imposing the tax is, I think, the greatest burden on interstate commerce.

Senator MONDALE. Can you give me an example?

Mr. KUST. Excuse me?

Senator MONDALE. Could you give me an example of a specific local tax problem this legislation which you recommend is designed to deal with and how it would deal with it so I can get the picture in a specific instance of how this legislation would deal with a specific sales and use tax problem.

Mr. KUST. Well, several of the bills deal with the problem of local political subdivisions' jurisdiction to impose taxes. Now, S. 1245 would——

Senator MONDALE. And you support that?

Mr. KUST. Excuse me?

Senator MONDALE. The chamber supports that?

Mr. KUST. Yes, we do.

Senator MONDALE. Supports the views and the concepts in it?

Mr. KUST. That is right.

S. 1245 deals or attempts to deal with the problem by imposing upon local subdivisions a jurisdictional standard with respect to sales and use taxes that is based on business location, requiring that there be within the local subdivision a business location for it; that is——

Senator MONDALE. So that is the old concept, in other words, of business contacts?

Mr. KUST. That is right. There has to be either property in the local subdivision or an employee or a stock of goods in the local subdivision.

Senator MONDALE. So, if a business solicits by mail, there wouldn't be sufficient legal contact?

Mr. KUST. That is right. If all there is, is solicitation by mail, under S. 1245 neither the State nor a political subdivision would have jurisdiction to tax.

Senator MONDALE. Now if they have a traveling salesman in the State, would there be sufficient contract?

Mr. KUST. In a State?

Senator MONDALE. Yes.

Mr. KUST. There would be sufficient contact under the bill to impose a State tax, but not a political subdivision tax.

Senator MONDALE. What kind of contact is needed for the imposition of sales and use taxes by a local government?

Mr. KUST. Well, local governments, to have jurisdiction under S. 1245—and this is also incorporated in S. 2092, which is the so-called ad hoc committee bill—to impose the obligation to collect use taxes, the interstate seller must within that local jurisdiction have a business location which is more than mail solicitation or an employee who is merely soliciting within the political subdivision.

Senator MONDALE. You need an office, in other words?

Mr. KUST. Not necessarily an office but an office certainly would do it. The business location required is defined in terms of property in the political subdivision or an employee in the political subdivision, which means he is resident there and not directed from any place outside. Business location is a specific definition, which is a higher standard than the standard which would be imposed on the State itself.

Senator MONDALE. I regret I have to leave at this point but Senator Hansen has arrived.

Senator HANSEN. I might add, Mr. Chairman, I have just come from the floor and, as you know, we have a three-ring circus going on over there. We have an executive session at the Interior Committee, we are discussing the pension reform legislation on the floor, we have these hearings, and I wanted to participate in some unanimous-consent agreements in connection with the pension reform bill.

Senator MONDALE. Thank you very much.

Senator HANSEN. I am sorry I didn't get to hear your statement. If you have any further observations to make, you may proceed.

Mr. KUST. I was in the process, Senator Hansen, of summarizing the statement and the chairman had asked some questions. If I may, I would like to conclude and to finish the summary of the full statement, which has been submitted for the record.

Senator HANSEN. I am informed that we are trying to observe some time limitations in order that all witnesses may testify. With the understanding that you may submit whatever concluding written statements you wish for inclusion in the record as though they were delivered orally, would that be satisfactory with you?

Mr. KUST. Yes, if I can just make a concluding statement?

Senator HANSEN. All right.

Mr. KUST. The statement which we submit sets forth the positions that are preferred by the national chamber with respect to congressional action. However, I want to make it clear on behalf of the chamber that it is prepared to accept a reasonable compromise between the positions that are preferred and those that may be necessary in order to get the approval and endorsement of the State tax administrators.

The ad hoc committee bill which is S. 2092, represents an effort to formulate a compromise between the views of business and the views of the State administrators. The national chamber, while it prefers S. 1245, nevertheless, has by action of its board of directors indicated that it would approve something like S. 2092 if it receives significant

support from State administrators. It is our belief that the differences between the business community and between the State administrators are no longer so great that some accommodation cannot, in fact, be worked out. I think we have been unduly preoccupied with several points of conflict and have tended to overlook that there is indeed a substantial base of agreement as to what congressional action should be and we hope that this subcommittee will serve to add that last bit of encouragement to the effort to bring about an accommodation which will, in fact, succeed.

Thank you very much.

Senator HANSEN. Thank you very much, Mr. Kust.

If you have any further information you would like to have included in the record, you may submit it and it will be made as part of the record.

Mr. KUST. I do have two articles, which I have written in the past, which try to outline the areas of agreement and the remaining areas of disagreement. I would like to submit those for the record.

Senator HANSEN. Without objection, they will be included.

Thank you very much, Mr. Kust.

[The statement and articles of Mr. Kust follow:]

STATEMENT OF LEONARD E. KUST, MEMBER, TAXATION COMMITTEE, U.S. CHAMBER OF COMMERCE

SUMMARY

The National Chamber favors the enactment by the Congress of legislation which will:

1. Establish a uniform jurisdictional standard for the imposition of taxes by the states on interstate business,
2. Promote uniformity in the division among the states of interstate business income and in the tax base for income tax purposes, and
3. Promote uniformity in definitions of common terms and common standards used by the states in the imposition of the obligation on interstate sellers to collect sales and use taxes.

Except as it is prepared to support a genuine compromise solution joined in by the state tax administrators, it is the position of the Chamber that the legislation embodied in H.R. 977, introduced in the House by Representative Peter W. Rodino, Jr., should be enacted by the Congress with certain modifications. The Chamber supports the use of a three-factor formula rather than the two-factor formula set forth in H.R. 977. It prefers the use of a sales factor in the formula on a destination basis without the so-called "throw-back" rule. The Chamber is opposed to the use of foreign source income in the apportionable income base. It believes consolidation at the discretion of state tax administrators should not be permitted unless the state can show that there are intercompany transactions which are not reasonably the same as if they were at arm's length prices or charges. It is also opposed to the taxation of intercompany dividends.

S. 1245, introduced by Senators Charles McC. Mathias and Abraham Ribicoff, generally embodies the views and concepts supported by the National Chamber. It is the Chamber's view that enactment of S. 1245 would provide a solution for most of the problems set forth in the House Subcommittee study.

There are sufficient areas of agreement between the state tax administrators and the business community to make the time ripe for development of a solution that would be acceptable to both sides. The Chamber urges the Subcommittee to grasp this opportunity to add its encouragement and influence to the development of legislation which will facilitate the free flow of commerce between the states.

STATEMENT

My name is Leonard E. Kust. I am a partner in the New York City law firm of Cadwalader, Wickersham & Taft. I am appearing in behalf of the Chamber of Commerce of the United States as a member of its Taxation Committee and Chairman of its Subcommittee on State Taxation of Interstate Commerce. I am ac-

companied by Robert R. Statham, Taxation & Finance Manager of the National Chamber.

Mr. Chairman, the National Chamber is grateful for this opportunity to express its views on proposals regarding state taxation of interstate commerce. For years the National Chamber has advocated action by the Congress, under the Interstate Commerce Clause of the Federal Constitution, that would establish uniform jurisdictional standards for the imposition of taxes by the states upon interstate business, promote uniformity in the division among the states of interstate business income and in the tax base for income tax purposes, and promote uniformity in definitions of common terms and common standards used by the states in the imposition of the obligation on interstate sellers to collect sales and use taxes. S. 1245 generally embodies the views and concepts supported by the National Chamber. However, the National Chamber is on record as willing to cooperate in achieving a compromise solution by endorsing the Ad Hoc Committee effort, if it received significant support from the state tax administrators.

I should like to commend the Subcommittee for holding these hearings and enabling the business community to express the need for prompt action by the Congress to adopt legislation in this area.

Advances in communication and transportation in this country have brought us to a point where a huge segment of American business is operating in interstate commerce. Most large and medium size businesses find that their commercial activities necessarily extend across state lines. Many retail establishments find that customers are requesting deliveries of merchandise to other states. Even small manufacturers are doing business in large numbers of states. As business extends its sales into other states, liability for taxes in those states follows. But the rules under which interstate businesses are subject to the taxes of the various states are voluminous and often vague. Many of the rules must be extracted from court decisions rather than from statutory law or regulations.

Frequently it is the small businessman who is hardest hit. Desiring to expand his commercial activities into other states, he often finds his greatest obstacle is tax compliance. He must know the tax laws of each jurisdiction in which he sells his product. Not only do states have income, gross receipts and sales taxes, but so do local jurisdictions. Often he finds he must file income tax returns and remit sales taxes not only in many states, but in many more local jurisdictions as well. Currently over 4,100 local jurisdictions have sales taxes and over 3,400 have income taxes.

For the businessman, large or small, operating in a large number of states and their many subdivisions, the problems of tax compliance can approach the impossible. Not only do the tax laws differ from state to state, but in some cases, from locality to locality. Vague provisions in the applicable laws, uncertain interpretations, unwritten local practices, and other obstacles can make the businessman's tax compliance problems a nightmare.

To illustrate what I am talking about, if the volumes of state tax reporters provided by one of the national tax services and needed by a business operating in fifty states to determine its tax liabilities were piled one on top of the other, they would reach to a height of over twenty feet.

The problem is not new. Almost six decades ago, in 1917, Professor T. S. Adams of Yale University, delivering a paper on business taxation before the 11th Annual Conference of the National Tax Association, called for a uniform rule for dividing income among the states for tax purposes. He said:

> Eventually the difficult problem of allocation will have to be solved more scientifically. What is most needed is a uniform rule. Just what rule shall be selected is less important than the general adoption of the same rule by competing jurisdictions. Eventually the federal government (through the Interstate Commerce Commission or the Federal Trade Commission or both) should lay down general rules for this important department of American business. An equally efficacious remedy would be found in the adoption of some common rule by the Congress of States whose organization has just been effected; or by the passage, voluntarily, of uniform legislation upon this subject by the several state legislatures.

Subsequently efforts were made to solve the problem. But it was not until 1957 that any real hope for a solution became apparent. In 1957, the National Conference of Commissioners on Uniform State Laws adopted the Uniform Division of Income for Tax Purposes Act (UDITPA). It was hoped at the time that all the states would adopt the uniform act and thereby provide consistency in the allocation and apportionment of business income. Instead, ultimately many states adopted only portions of the uniform law, but few adopted it completely.

In 1959, the United States Supreme Court found itself confronted with a series of cases involving net income taxes on businesses operating across state lines. Prior to 1959, there was a commonly held view that a state could not impose an income tax on a nondomiciliary engaged solely in interstate commerce in that state. Businessmen were shocked by the Supreme Court decision handed down in *Northwestern States Portland Cement Company v. Minnesota* 358 U.S. 450 (1959) and *Williams v. Stockham Valves and Fittings* 358 U.S. 450 (1959), in which the Court concluded that income from the interstate operations of an out-of-state corporation having an adequate nexus of activity within the state could be subjected to state taxation if the levy were not discriminatory and if it were properly apportioned. While the taxpayer maintained an office in the state in each of the foregoing cases, shortly after those decisions, the Supreme Court refused to grant certiorari in the case of *International Shoe Co. v. Fontenot* 359 U.S. 984 (1959), in which the only activity of an out-of-state business was solicitation of orders.

The *Northwestern* decision and the failure of the Supreme Court to grant certiorari in the *International Shoe* case set off a demand for Congressional action that resulted in the enactment of P.L. 86-272. The new enactment not only precluded a state from imposing an income tax upon a business in which the only activity within that state involved soliciting orders, but it also provided that the House Judiciary Committee and the Senate Finance Committee should make a study of the state taxation of income derived from interstate commerce.

Within a matter of months after P.L. 86-272 became law, the Supreme Court handed down *Scripto v. Carson* 362 U.S. 207 (1960), confronting business with a problem in the sales and use tax area similar to that presented in the *Northwestern* case regarding net income taxes. Although legislation was proposed, Congress resisted passing remedial legislation and instead extended the study to be made regarding income taxes to include matters pertaining to taxation of interstate commerce by the states and their political subdivisions.

A Special Congressional Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives was formed to carry out the study. The Subcommittee held hearings in 1961 on the income tax, and in 1962 on the sales tax. The first witness at the 1961 hearings appeared on behalf of the Chamber of Commerce of the United States. Our witness said:

> We believe that there is a strong national interest which transcends such interests but which is compatible with the best interests of both the States and interstate business alike. This national interest calls for the development of a system of State taxation of interstate commerce which will accomplish three objectives. First, it should result in the smallest economic burden on interstate business. Second, it should produce in each State the most efficient and least costly system of tax administration and compliance. Third, it should maintain and improve tax morality in both the area of administration and the area of compliance.

By 1965, the most extensive study of state taxation of interstate commerce ever undertaken was concluded by the Subcommittee. The four-volume study prepared by the Subcommittee and its staff was an outstanding achievement. In addition to the study, two volumes of hearings held in 1961 and 1962, and ultimately two volumes of hearings held in 1966, were published by the Subcommittee. All in all, the hearings, factual information and conclusions gathered by the Subcommittee and made available to the public, covered over 5,300 pages. The study itself covered 2,000 pages.

The Subcommittee's study had this comment on how it found the system of state taxation of interstate commerce to be operating:

> It has been found that the present system of State taxation as it affects interstate commerce works badly for both business and the States. It has also been found that the major problems encountered are not those of any one of the taxes studied but rather are common to all of them. This is not surprising in that all of these problems reflect the pervasive conflict between the approach to the taxation of interstate companies as it appears in State and local law, and the practical difficulties of realistic compliance expectations and effective enforcement. Increasingly the States, reinforced by judicial sanction, have broadened the spread of tax obligations of multistate sellers. As the principle of taxation by the State of the market has been accepted, the law has prescribed substantially nationwide responsibility for more and more companies. The expanding spread of tax obligations has not, however, been accompanied by the development of an approach by the

States which would allow these companies to take a national view of their tax obligations. The result is a pattern of State and local taxation which cannot be made to operate efficiently and equitably when applied to those companies whose activities bring them into contact with many States. (House Report No. 952, Vol. 4, p. 1127, 89th Cong., 1st Session (1965).)

In October of 1965, H.R. 11798 was introduced by Representative Edwin E. Willis reflecting the initial recommendations of the Subcommittee, based on the study. Hearings were held starting in January, 1966, and concluding in April, 1966. Literally hundreds of businessmen, state and local governmental officials, and academicians took part in those hearings.

At the 1966 hearings it became obvious that major revisions were needed in H.R. 11798 if the legislation were to be workable in solving the problems of state taxation of interstate commerce. In our testimony for the Chamber in 1966, we said:

> These hearings have already revealed strongly divergent views. Any solution of the problems involved in state taxation of interstate business must strive to reconcile these divergent views. It should not be acceptable to this Subcommittee that no action be taken. It must, however, also be clear that a solution which might commend itself it we were confronted with the problem *de novo*, i.e., if we were erecting our Federal Republic anew with a clean slate before us, may be unacceptable in the context of the present circumstances of our existing governmental institutions.
>
> A solution must be sought which, given the present state of affairs, will reasonably attain the purpose of relieving interstate business of avoidable burdens and enlist the support, or at least minimize the opposition, of those who will be affected: business, large as well as small, and state and local governments and their tax administrators.

The bill was overhauled, and a bill with a substantially curtailed impact was introduced in 1966 by Representative Willis. With the support of the business community, that bill has passed the House twice—once under the sponsorship of Mr. Willis, and later under the sponsorship of Representative Peter W. Rodino, Jr., who succeeded Mr. Willis as Subcommittee Chairman. The bill was introduced in the House this year as H.R. 977. The support of the Willis-Rodino bill by much of business was qualified. It was viewed as inadequate but was supported on the assumption that perfecting amendments would be made in the course of legislative action.

The principal opponents of the legislation have been the state tax administrators. As a result efforts were made to work out compromise legislation acceptable to the business community and to the tax administrators. I served as co-chairman of what became known as the "Ad Hoc Committee" of businessmen and tax administrators, which did draft a compromise bill. In 1970, the National Chamber's Board of Directors offered to accept the compromise bill drafted by the Ad Hoc Committee, if the state tax administrators would also accept the compromise version. The bill as subsequently revised by the Ad Hoc Committee was introduced last year by Senator Warren G. Magnuson as S. 3333 and again this year as S. 2092.

Pending legislation

Except as it is prepared to support a genuine compromise solution joined in by state tax administrators, it is the position of the National Chamber that the legislation embodied in H.R. 977, introduced in the House by Representative Rodino, should be enacted by the Congress with certain modifications. We support the use of a three-factor formula rather than the two-factor formula set forth in H.R. 977. We prefer the use of a sales factor in the formula on a destination basis without the so-called "throw-back" rule. We are opposed to the use of foreign source income in the apportionable income base. We believe consolidation at the discretion of state tax administrators should not be permitted unless the state can show that there are intercompany transactions which are not reasonably the same as if they were at arm's length prices or charges. We are also opposed to the taxation of intercompany dividends.

S. 1245, introduced by Senators Charles McC. Mathias, Jr., and Abraham Ribicoff, generally embodies the views and concepts supported by the National Chamber and recommendations in our original testimony before the House Subcommittee in 1966. In our view, enactment of S. 1245 would provide a solution for most of the problems set forth in the House Subcommittee study.

Federal guidelines

The National Chamber favors the enactment by the Congress of legislation which will:

1. Establish a uniform jurisdictional standard for the imposition of taxes by the states on interstate business,
2. Promote uniformity in the division among the states of interstate business income and in the tax base for income tax purposes, and
3. Promote uniformity in definitions of common terms and common standards used by the states in the imposition of the obligation on interstate sellers to collect sales and use taxes.

There were those who argued in 1966 that it was possible for the states to form a compact to solve the many problems inherent in state taxation of interstate commerce. However, seven years later it is clear that Congressional action is needed to solve a problem that cannot be solved in the foreseeable future by a compact of the states. In spite of efforts since 1966 to form such a compact, only two-fifths of the states are members—and the compact itself is of questionable legality.

Federal administration

The administration of state tax laws, including federal standards that are adopted, should, as far as possible, be left to the states; and where other administrative action is required, it should be achieved, if possible, through interstate rather than through federal administrative action. The need for Congressional action derives from the desirability of promoting interstate commerce by eliminating the duplication of taxes and reducing the compliance costs of an interstate business subject to the tax laws of the several states in which it does business. We are concerned that in achieving this purpose every effort should be made to preserve the independence of the states. We opposed federal administration in 1966, and we continue to do so.

Jurisdiction

We believe there is a need to eliminate uncertainty in determining whether there is sufficient nexus to require compliance with state and local tax laws. At the Subcommittee hearings in 1966, with respect to jurisdiction, we called for the business location test as thereafter set forth in the Rodino bill. We also asked that the jurisdictional standard for sales and use taxes be enlarged to include household deliveries, and this is also in the Rodino legislation.

Since 1966, there has been an increase in the number of local jurisdictions with sales and income taxes. Currently over 4,100 localities have their own sales taxes, and over 3,400 localities have their own income taxes. There are over 80,000 local governmental units in the United States. The potential for an ever increasing number of localities with their own sales and income taxes makes jurisdictional standards more necessary than ever before. For a business—large or small—that must file tax returns and remit taxes in a multiplicity of local jurisdictions, the problem is indeed an acute one.

Apportionment formula

The apportionment formula for the division of income should include the three factors of sales, payroll, and property. This formula, used by most of the states, is contained in the Uniform Division of Income for Tax Purposes Act drafted by the National Conference of Commissioners on Uniform State Laws. And, as may be seen from reviewing the 1966 House hearings, most of the business representatives preferred the three-factor formula over the two-factor formula. It is apparent that the state tax administrators generally favor the use of the three factors to determine how much income should be attributed to each state in which the taxpayer does business for income tax purposes.

The sales factor should be on a destination basis, thereby recognizing that the taxpayer is operating in the market state and that a portion of the taxpayer's income should be attributed to the market state. The numerator should consist, without exception, of sales of products delivered in or shipped into the taxing jurisdiction. The denominator should consist of total sales, without any exclusions.

The determination of the sales factor on a destination basis would greatly simplify compliance. Compliance with sales and use tax laws already requires recording all sales having their destination in the state. There is little additional burden involved in incorporating into the procedure a totaling of all sales having their destination in the state for purposes of the income tax apportionment formula, provided that the definition of destination is the same for both taxes.

Foreign source income

We are opposed to either the apportionment or the allocation of foreign source income among the states for income tax purposes. It has been the policy of the Federal Government, through the federal tax laws and treaties with other nations, to avoid double taxation. It is the most practical approach as well as in the best interests of the nation, for an international policy to be left to the Federal Government, not the states.

Consolidation

We agree with Section 209 in S. 1245. This provision requires proof of related taxpayers engaging in non-arm's length dealings which cause a material distortion of income in order for a state to require, or for a taxpayer to elect that a consolidated return be filed. Consolidation at the discretion of state tax administrators should not be permitted unless the state can show intercompany transactions which are not reasonably the same as if they were at arm's length.

Much of the problem has centered around the unitary business doctrine, which ignores the corporation as a separate legal entity and instead seeks to treat affiliates as an economic unit. While the concept may appear to be workable in theory, it frequently suffers in practical application. The only justification for consolidation is that transactions among the members of an affiliated group may not be on terms which would prevail if the transactions were between independent businesses. However, this does not justify indiscriminate consolidation at the discretion of tax administrators.

It is very difficult to provide uniform and practical tests for determining whether consolidation should be required or permitted. Up to this time only a few states have sought to require consolidation under the unitary business doctrine. While we recognize there are instances where the doctrine should apply, we believe that it is a discretionary and imprecise remedy. It is our view that consolidation should be imposed by the states only if it can be established that there has been non-arm's length dealing between the related companies, or if the taxpayer establishes that a clear reflection of income requires it.

Dividends

It has been the general practice of most states not to tax intercorporate dividends. It has also been the general practice to assign corporate dividends to the state of commercial domicile. An effort to tax the dividends received from affiliates would be a substantial change from the practice in most of the states and would result in the double taxation of income on which federal and state income taxes or foreign taxes have already been levied. The proper alternative would be to exclude dividend income, thereby avoiding double taxation. Certainly the exclusion should not be less than the 85% provided under the federal income tax law.

Conclusion

Mr. Chairman, we hope that you and your Subcommittee will take a leadership role in working out a solution to this complex problem. Such a solution could encourage a greater flow of commerce between the states and help to preserve the great "American Common Market."

I have presented in behalf of the National Chamber its carefully considered views as to appropriate, indeed, necessary actions by the Congress to regulate state taxation of interstate business. While the National Chamber has its preferred prescriptions for such action by the Congress, it is receptive within reasonable bounds to alternatives. Reasonable compromise in the interest of promoting Congressional action is desirable and called for at this juncture. The National Chamber is on record as willing to cooperate in achieving a compromise solution by endorsing the Ad Hoc Committee effort at such a compromise, if it received significant support from state administrators which, up to now, has not been notably evident.

We are aware that new efforts are under way to forge a new compromise departing from the Ad Hoc Committee proposal mostly in eschewing any administrative provisions, and thus taking no position with respect to the Multistate Tax Compact and its Commission. The National Chamber has encouraged and is willing to cooperate in this new effort and, within reasonable bounds, to endorse the end result.

There are sufficient areas of agreement between the tax administrators and the business community to make the time ripe for development of a solution that would be acceptable to both sides. The climate for compromise and the prospects

and promise for statesmanship have never been better. We urge the Subcommittee to grasp this opportunity to add its encouragement and influence to the development of legislation which will facilitate the free flow of commerce between the states.

[From the Tax Executive, April 1973]

STATE TAXATION OF INTERSTATE BUSINESS—AN OBDURATE ISSUE[1]

(By Leonard E. Kust)[2]

If you are familiar with my past involvement in efforts to resolve the problems and the conflicts in state taxation of interstate business or have yourself been involved as long as I, you will surely agree if I begin by observing that time passes but does not heal. This is not only an observation but a plea for reconciliation to nullify the observation.

A simple roll call of the events of the past 16 years quickly delineates the problems, the conflicts, the fruitless efforts at solutions and the present confusion.

The central problem is inherent in our federal system, the success of which depends on a reasonable accommodation between the sovereign powers of the states and the national interest as defined in the Constitution. Specifically with respect to interstate business, the powers of the states to tax such business is subject to the national interest in promoting an open economy as embodied in the commerce clause.

In spite of the clear power of Congress to implement the commerce clause in this area and the plea addressed by members of the Supreme Court in several cases to Congress to act, the task of accommodating the power of states to tax interstate business to the national interest was left to the fragmentary and uncoordinated process of case by case decisions by the courts.

Finally, in 1957 the National Commissioners on Uniform State Laws adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), and therewith began 16 years of history which almost at once rendered this pioneering effort inadequate if not largely irrelevant. UDITPA had not been adopted by any state when the Supreme Court decisions in the *Stockham Valves* and *Northwestern Cement* cases in 1959 (358 U.S. 450) centered attention on the question of minimum connection as a basis for jurisdiction and UDITPA does not deal with jurisdiction. Prior to those decisions, a foreign corporation engaged solely in interstate activity in a state that had been held not to be subject to a tax measured by net income imposed by such state on the privilege of doing business therein (*Spector Motor Service v. O'Connor*, 340 U.S. 602 (1951)). Under those decisions, however, a tax imposed directly on the net income of such a business was permissible "provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same" (358 U.S. 450 (1959) at 452).

Alarmed by the exposure to state taxation of income from interstate commerce and the uncertainty of the minimum nexus in the absence of which protection still existed, the business community quickly prevailed upon Congress to take action and within seven months P.L. 86–272 was enacted denying to a state the power to impose a net income tax on an interstate business if the only activity within such state was solicitation. Recognizing that more comprehensive legislation required careful consideration, Congress in P.L. 86–272 called on the House Judiciary and the Senate Finance Committees to make a thorough study and to recommend legislation with respect to all of the problems involved, including apportionment of income. When the Supreme Court decided the *Scripto* case in 1960 (362 U.S. 207), the impact of sales and use tax collection on interstate commerce was added to the investigation.

Against this setting let me simply recall the intervening events in the droning drama that comes to no end and leaves us where we are today. The mere recital without elaboration conjures up vividly the conflicts and contending views and leaves space to identify the areas of substantial consensus as well as the areas of conflict and to appraise the possibilities of reconciliation and prospective action.

The lists of events following P.L. 86–272, unhappily, begins with the legislative proposal, based on the disastrously misconceived conclusions of an elaborate

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[1] Based on a paper presented at the TEI-Loyola-Tulane-LSUNO State and Local Tax Course, January 1973.

[2] Mr. Kust is a partner in the law firm of Cadwalader, Wickersham & Taft, New York, and is a past president of Tax Executives Institute.

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four-year long study by the Willis Subcommittee and embodied in H.R. 11798, which persuaded few but alarmed many, particularly the State tax administrators. This was followed by the drastically truncated measure directed primarily to small business, beginning as the Willis Bill and continuing as the Rodino Bill, which, although thrice enacted by the House has died in three successive sessions of Congress but arises, Phoenix-like, to be introduced again. There is the Multistate Tax Compact promoted by State tax administrators as the alternative to federal legislation. There is the *National Bellas Hess* case (386 U.S. 753 (1967)). There is the unredeemed promise of Senate Finance Committee hearings. There are the first Ad Hoc Committee proposal, the Multistate Tax Commission "Plan," the second Ad Hoc Committee proposal and the Council of State Chambers' COST proposal. There are the competing legislative bills embracing, besides the Rodino Bill (H.R. 1538), the Ribicoff-Mathias Bill (S. 317), the Talcott-Tunney Bill (H.R. 4267), the two Magnuson Bills (S. 1883 and S. 3333) and the Mathias Bill (S. 4080). And, finally, there are the court decisions interpreting P.L. 86–272, the most notable of which are the *Smith, Kline & French* (241 Ore. 50, 403 P. 2d 375 (1965)), *Clairol* (57 N.J. 199, 270 A. 2d 702 (1970) appeal dismissed, 402 U.S. 902 (1971)) and *Heublein* (Dec. 18, 1972) cases, the last of which was just decided last December 18th by the Supreme Court.

There has been plenty of movement; the question is whether it has been forward. The portent of these tangled events is not easy to read. But let us try to divine some meaning from the confused history and venture some views as to where it will or at least should lead.

GENERAL AREAS OF CONSENSUS

The recitation of the recent history of State taxation of interstate business reflects mostly conflict and competing views but there are substantial areas of consensus. It is important not to lose sight of this, for if the differences are to be composed, we shall have to build on the areas of consensus.

There is substantial agreement that there should be a uniform formula for the division of interstate business income among the states and that the collection of sales and use taxes by interstate business should be governed by uniform standards.

Although the agreement is less general, it is also broadly agreed that there should be uniform minimum jurisdictional standards for the imposition of an income tax and for the collection of a use tax by interstate business and possibly also for the imposition of capital and gross receipts taxes on such business.

There is accordingly substantial agreement as to the basic elements of needed action. But there is not the same agreement as to means for translating the agreed on general concepts into the needed action nor as to the specifics of such action; indeed, there are some means and some specifics as to which there is only stalemated and unyielding disagreement.

GENERAL AREAS OF CONFLICT

Having identified the general areas of substantial agreement, let us identify the conflicts as to general concepts that hold little promise of resolution and then consider the specifics with respect to which there is substantial agreement or with respect to which conflict has frustrated the achievement of progress.

First of all, the Rodino Bill, limited to small business and providing a "business location" jurisdictional standard and a two-factor apportionment formula for income has only limited support from business and has been adamantly opposed by the states. It has had the general support of the business community in the past only as a basis of action by the House to permit corrective and enlarging amendments in the Senate. But this has become a worn and tired formula and one wonders whether it will be repeated in this session of Congress.

It seems equally clear that the Multistate Tax Compact cannot carry the day as a self-sufficient solution. Its legal status without Congressional approval remains untested and with business opposition to it as the whole solution, it is unlikely that it will be sufficiently accepted by the large industrial states to work effectively.

It is less clear but probably also true that federal legislation alone, without giving to the states a continuing lead role by way of a modified Multistate Tax Compact, has little chance of being enacted because of state opposition.

This seems to leave only one promising course of action, but we will deal with this later, turning first to the specific areas of agreement or conflict.

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SPECIFIC AREAS OF AGREEMENT OR CONFLICT

Jurisdiction

The problem of the minimum connection required to justify imposition of tax on an interstate business remains as one of the most difficult problems in the accommodation of state and local governments' power to tax to the national interest in an open economy. It is not just a question of equality between instate and out-of-state business but a question of the deterrence to out-of-state business when the connection with a state or locality is too thin to justify compliance with state and local tax laws by the out-of-state business. This is, of course, primarily a problem of small, expanding business. But this is at the heart of a growing national economy and the encouragement of economic competition. It is also evident that the burden of compliance arises primarily from disparate rules for the determination of income, the apportionment of income, and the obligation to collect use taxes. If the rules were uniform among the states, jurisdictional protection from any state in which there are customers might well prove to be unnecessary, at least with respect to state level taxes.

The proliferation of the imposition of income and use taxes by local governments, however, is another matter. This can be as burdensome to large business as to small, considering that there are some 80,000 local governments. With respect to such taxes, there should be a substantial minimum connection with the taxing jurisdiction.

In spite of the fact that concern about jurisdictional overreach by the states initiated the recent history and remains the prime concern of small business, there has developed far more agreement than may at first be evident.

With respect to income taxes, the Ad Hoc Committee proposal, introduced in the last session of Congress by Senator Magnuson as S. 3333, and the Multistate Tax Commission Plan, both accept P.L. 86–272 as sufficient while the Rodino Bill, the Ribicoff-Mathias Bill and the COST proposal, introduced at the end of the last session of Congress by Senator Mathias as S. 4080, embrace a "business location" concept. But on close examination, how much difference is there between P.L. 86–272 and "business location?" The latter is a more precise and elaborate definition but solicitation by an employee in the state would alone be sufficient in certain circumstances to confer jurisdiction except as solicitation is rendered insufficient by incorporation of the language of P.L. 86–272 in the definition of "location of an employee." Thus, the minimum connection in both comes to the same thing and by virtue of the same language except for the additional exclusion under the business location standard of installation or repair incidental to an interstate sale, which is important but not a likely matter of critical disagreement.

With respect to the power of state and local governments to impose the obligation on interstate business to collect sales or use taxes, there is substantial agreement in all of the proposals and bills except the Rodino and Ribicoff Bills. The latter bills would impose the business location standard modified only by regular household deliveries. All other bills and proposals would codify the *Scripto* and *National Bellas Hess* case law extending the jurisdictional reach of states to cover regular solicitation in the state by an employee or representative (*Scripto*), but not solicitation solely by mail, radio or television (*National Bellas Hess*). The jurisdiction of local governments, however, would extend beyond the business location test only to regular household deliveries under the Ad Hoc Committee bill, the Multistate Tax Commission Plan and the COST bill, as under the Rodino and Ribicoff Bills.

Thus, again, except for lingering small business interest in the higher state level limitation in the Rodino Bill, there is general agreement as to sales and use tax jurisdiction. It would appear that the far greatest importance of effective limitation of potentially 80,000 local governments requiring collection of their separate sales and use taxes will persuade small business to join in the general consensus.

The sales factor

There is no significant controversy with respect to the use or definition of the property and payroll factors of the income apportionment formula. All the conflict centers on the sales factor, first as to whether it should be used and second as to its content. The Rodino and Ribicoff Bills continue to incorporate the two factor formula, omitting sales, which first appeared in H.R. 11798. However, the momentum of support for the two factor formula is waning and was never sufficient to overcome the adamant state opposition. All the other pending proposals employ a three factor formula, including a sales factor on a destination basis.

But disagreement persists with respect to the so-called "throwback" rule, under which sales to customers in a state lacking jurisdiction to tax the seller are as-

signed to the state of origin. UDITPA, the Multistate Tax Compact and the Multistate Tax Commission's Plan all incorporate the "throw-back" rule. The Ad Hoc Committee Bill (S. 3333) modifies the rule by making it inapplicable to export sales, other than to the U.S. Government, and the COST bill eliminates the "throwback" rule completely.

There is more theoretical fervor than there is practical significance in the disagreement and an accommodation along the lines of the Ad Hoc Committee proposal should be acceptable.

Dividends

There is substantial agreement that the business/nonbusiness income distinction embodies in UDITPA should be avoided and that all income should be apportioned under the formula, with the exception of dividends with respect to which there is strong disagreement.

The Multistate Tax Commission in its regulations and in its Plan would include dividends in apportionable income. The Ad Hoc Committee bill would eliminate from the tax base dividends from 80% owned affiliates and would allocate all other dividends to the commercial domicile of the recipient. The COST bill follows the Ad Hoc proposal but reduces ownership of affiliates to 50%.

The general practice among the states is not to tax intercorporate dividends, but a few states vigorously disagree. It would seem that the taxation of intercorporate dividends is undoubted double taxation which should certainly not be extended beyond the 15% included in income under the Internal Revenue Code.

The treatment of dividends clearly is one of the most sensitive and important remaining controversies. Failure to resolve it may well stand in the way of the needed accommodation.

Combined or consolidated returns

The treatment of dividends is a sensitive and important issue but the combination or consolidation of related corporations where one is subject to the jurisdiction of the state but the other is not is the more notorious and apparently irreconcilable. controversy. Arcane distinctions are drawn between combination and consolidation but for brevity we shall use consolidation as comprehensive.

The storm center of the controversy is the premise, aside from a common ownership, on which consolidation should rest. There are strong advocates of the "unitary business" doctrine among state tax administrators but most administrators appear to be indifferent. On the other hand, business generally strongly adheres to the view that consolidation should be imposed by states only if there has been non-arm's length dealing between the related companies.

Reflecting the controversy, the Ribicoff Bill prohibits consolidation and substitutes reallocation in accordance with the principles of Section 482 of the Internal Revenue Code. The first Ad Hoc Committee bill employed a series of rebuttable presumptions permitting or forbidding consolidation of 80% affiliates, keyed to the volume of intercompany transactions. The Multistate Tax Commission Plan would permit either the state or the taxpayer to elect to consolidate with all 80% affiliates and this was adopted in the second Ad Hoc Committee proposal with the exclusion, however, of affiliates substantially all of the income of which is from foreign sources. The COST bill, on the other hand, permits consolidation only if the state establishes non-arm's length dealing or if the taxpayer establishes that clear reflection of income requires it.

The disparities in the proposals are obviously wide and fundamental but, curiously, the resolution of the conflict may not be as remote as it appears, as I shall explain presently.

Regulations and appellate procedures

There are two other specifics over which there is no express general agreement: regulations and appellate procedures. The Multistate Tax Compact provides for the formulation by the Commission of purely advisory regulations while the first Ad Hoc Committee proposal would have conferred on the Multistate Tax Commission the power to promulgate mandatory regulations on nonmembers as well as members of the compact. The second Ad Hoc Committee proposal retreated to advisory regulations which would be adopted only by the action of all states, whether or not members of the compact, and which would not be binding on a state if it took positive administrative action within 180 days rejecting the regulation. None of the other bills or proposals, other than the first Magnuson consent bill, endorse the Multistate Tax Compact or provide for regulations.

With respect to appeals the Multistate Tax Compact provides for arbitration, the first Ad Hoc Committee proposal provided for an appellate procedure within the Multistate Tax Commission from which there was an appeal to the Federal Courts of Appeal, but the second Ad Hoc Committee proposal abandoned all appellate procedure, leaving the resolution of controversies to present state administrative and judicial remedies. The COST proposal does not provide for any administrative procedures but would confer jurisdiction on the Court of Claims to review *de novo* final state administrative determinations involving application of the federal legislation.

These are interesting proposals and alternatives for regulations and appeals but they do not represent crucial differences that cannot be dealt with in the context of general agreement with respect to the rest of the legislative package.

THE NEED FOR RECONCILIATION

Having traversed the sixteen years of recent history, where do we stand today? It is my reading of the mood of Congress, particularly of the Finance Committee, that it is waiting for the contending parties to compose their differences. The Congress does not intend to act as arbiter and unless state administrators and business are prepared to give substantial support to one of the existing proposals or a new accommodation it will not act. This is now more likely than ever to be true since Congress will be preoccupied with its constitutional confrontation with the executive. Therefore, unless the past 16 years of effort, contention and substantial accommodation are to come to naught, a final effort to resolve remaining differences must be made.

A SOLUTION TO RESOLVE THE REMAINING CONFLICTS

Since neither Federal legislation alone nor the Multistate Tax Compact alone seem capable of commanding sufficient support to provide a solution, the Ad Hoc Committee conception of a combination of the two with appropriate modifications provides the only real promise of reconciliation. It makes sense and deserves support. I do not, however, foreclose; indeed, I encourage, the substitution of a new and broader accord between business and tax administrators, if one can be forged. There is promise of this in the discussions under progress between COST and the Executive Committee of the National Association of Tax Administrators (NATA). One can only hope that the promise will come to an early fruition, since the remaining differences are no longer really so very great, except for some partisans who continue to insist on their own special interest or point of view.

With respect to jurisdiction the existing proposals are not substantively very different with respect to income taxes, and although I would prefer the business location test to simple continuation of P.L. 86-272, I think we should recongize that the business location test would not have resolved beforehand the litigation in the *Clairol* and *Heublein* cases with respect to the meaning of solicitation under P.L. 86-272. With respect to sales and use tax collection, I believe small business should yield to the more general consensus as to state jurisdiction in order to achieve limitations on the potentially far more burdensome obligation of collecting local government taxes.

The treatment of dividends and consolidation of related companies are the two remaining significant obstacles to general consensus. Again it seems to me that the Ad Hoc Committee proposals are reasonable accommodations. I do not like the elective consolidation by either the state or the taxpayer, since it lacks any rationale except expediency, but it seems to be the only solution that can possibly achieve substantial support from both states and business. The proposal originated with the Multistate Tax Commission Plan and therefore has state support and despite the COST bill's adherence to the arm's-length standard, I have reason to believe that the business community can and would accept the dual elective standard, if affiliates, substantially all of the income of which is from foreign sources, are excluded.

A final effort at accommodation must be made and it must be made during this session of Congress or I fear that all reasonable hope of useful action to bring order and balance into the chaos of state and local taxation of interstate business will be spent, perhaps irrevocably.

AN OPTIMISTIC OUTLOOK

But I remain optimistic. The not uncommon history of apparently intractable controversies is that they pass from unyielding hostility to grudging recognition of merit in opposing views and gradually to reconciling compromise.

But an acceptable issue out of our difficulties is by no means assured. One must plead for statesmanship on the part of both tax administrators and business representatives. The Ad Hoc Committee conception of a combination of federal legislative standards and the Multistate Tax Compact is a new venture in federalism and, perhaps with some further adjustment, deserves support. But any other solution with substantial backing by business and state tax administrators, such as the developing COST-NATA accord, deserves encouragement and support. If we persist in unyielding disagreement, the opportunity for creative statecraft may irretrievably pass, risking to unpredictable future pressures the fashioning of perhaps some drastic solution.

[From the Tax Executive, January 1971]

A New Venture in Federalism—Toward a Solution to State Taxation of Multistate Business [1]

(By Leonard E. Kust)[2]

I. INTRODUCTION

My title—"A New Venture in Federalism" possibly conjures up something far more exciting than my subject. But the obdurate problems involved in state taxation of interstate business require new perspectives and some venturesomeness in statecraft and I will stand by my title, trusting that my subject will at least be challenging if not exactly exciting.

New initiatives are needed to break the sterile impasse with which we have been confronted. All proffered solutions have been rejected.

The present impasse is, of course, part of the historic confrontation between state and national government in a federal system. The problems of state taxation of multistate business arise naturally from a nationwide economy functioning within a federal system. Solutions, on the other hand, necessarily impair in some measure the autonomy of the states.

In spite of this historic context, we must not permit an overweening emphasis on the conflict between "states' rights" and "national supremacy" deflect us from the search for a reasonable accommodation.

Reviewing the history of the controversy, I believe we have passed well beyond a simplistic confrontation between state and national government.

Ever since Chief Justice Marshall in *Brown* v. *Maryland* [3] declared the obvious, it has remained persuasive that state taxation can impede interstate commerce in violation of the Constitution. Yet as some 300 decisions of the Supreme Court [4] since attest, the judicial process is not a satisfactory instrument for reconciling the sovereign power of states to impose taxes to the needs of a national economy contemplated by the commerce clause of the Constitution.

Recognizing that the taxing power is the most jealously guarded power of soverignty, it is unfortunate indeed that the first full scale and considered attempt of Congress to exercise its constitutional power to regulate state taxation of interstate commerce should have unnecessarily exacerbated the inherent conflict between state and national government.

Yet H.R. 11798, the result in 1965 of five years of preparatory work by the Subcommittee of the House Judiciary Committee, could not have been better calculated to alarm the states and give credence to a claim of invasion of "states' rights." The drastic departure from prevailing state practice in presenting a two-factor apportionment formula for income taxes and the provision for substantial federal administration provided a momentum for state resistance which has since blocked any reasonable action.

Withdrawal by Congress since to consideration of such modest and really inadequate measures as the Rodino Bill (H.R. 7906) has convinced everyone, I believe, that no undue invasion of "states' rights" is threatened. Reasonable restraints on state taxing power in the interest of freer interstate commerce is now largely accepted on all sides. The quarrel is over what is reasonable and how it should be implemented.

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[1] This article is based on a talk delivered by Mr. Kust at the TEI Annual Conference in New YorkCity.
[2] Leonard E. Kust is a partner with the firm Cadwalader, Wickersham & Taft in New York. Mr. Kust holds the degrees of Ph.B. from the University of Wisconsin and J.D. from Harvard Law School He was formerly Vice President and General Tax Counsel of Westinghouse Electric Corporation. He is past President of Tax Executives Institute and Tax Institute of America.
[3] 25 U.S. (12 Wheat.) 419 (1827).
[4] *Northwestern States Portland Cement Co.* v. *Minnesota*, 348 U.S. 450 at 457, 458 (1959).

Against this background, let me give you my appraisal of where matters stand and what the prospects are.

II. POSSIBLE SOLUTIONS IN PROCESS

There are presently in process several initiatives in varying degree of implementation and with varying promise of providing reasonable solutions to the problems of state taxation of multistate business.

A. *Uniform Acts.* Since 1890 the National Conference of Commissioners on Uniform State Laws has promoted uniformity in state legislation on subjects where diversity of treatment is an interstate evil.

A National Tax Association Committee issued a report in 1919 urging States to utilize a simple uniform tax on income and in 1921 set forth the model acts which had been drafted pursuant to the 1919 study. Although the NTA persisted in its advocacy of a uniform law, nothing concrete ensued until 1957 when the present Uniform Division of Income for Tax Purposes Act, referred to by the acronym UDITPA, was drafted and approved by the National Commissioners on Uniform State Laws and was in the same year endorsed by the American Bar Association.[5]

After years of standing as the only solution being advocated with respect to the problems of state taxation of interstate business, no sooner had the proposal begun to be implemented then it began to be viewed as inadequate. The Supreme Court decisions in the *Stockham Valve and Northwestern Cement* cases[6] in 1959 centered attention on the question of jurisdiction. UDITPA does not deal with jurisdiction. Mr. Justice Frankfurter in his dissent in the aforementioned cases urged Congress to act. The business community organized an urgent demand on Congress and Congress, though it had never theretofore recognized any obligation or power in the area, promptly enacted Public Law 86-272 in 1959 delimiting the power of states to impose an income tax on interstate business corporations and calling on the House Judiciary and Senate Finance Committees to make a thorough study and recommend legislation with respect to all of the problems involved, including apportionment of income. When the Supreme Court decided the *Scripto* case[7] in 1960, the impact of sales and use taxes on interstate commerce was by amendment of P.L. 86-272 added to the investigation.[8]

Overtaken by these developments UDITPA has languished. Although efforts continue to have it enacted by state legislatures and some progress continues, the uniform act is now generally viewed as guidance and as a prototype for incorporation in other broader solutions.

But aside from the roll of events, does UDITPA deserve its apparent fate? I believe it has served a laudable and perhaps indispensable purpose in crystallizing thinking about the standards to be incorporated in a uniform apportionment formula, but both its scope and its approach are, I think, clearly inadequate to the needs.

Uniform acts are rarely adopted by all states. Only 25 states and the District of Columbia have adopted UDITPA.[9] Usually some deviating amendments are made by state legislatures, as has happened with respect to UDITPA. Some lack of uniformity may be tolerable with respect to other uniform laws but with respect to UDITPA deviation means a potential duplication of tax burden.

Moreover, as already noted, UDITPA does not deal with jurisdiction. It does not deal with the determination of the income base; it does not deal with the treatment of related taxpayers; and it does not deal with taxes other than the income tax. Finally, the uniform law approach cannot provide machinery for uniform administrative and judicial interpretation which can over time create wide diversity.

I think we can conclude that the uniform law approach will not serve to solve the problems of state taxation of multistate business.

B. *Federal Legislation.* Congressional action and the prospect of additional Congressional action have drained the uniform act approach of vitality. But while federal legislation has distinct advantages over uniform laws, what are the real prospects for effective federal legislation and how would it be implemented?

The prospects are at best uncertain. After its disastrous first proposal for Congressional action incorporated in H.R. 11798, the House Judiciary Subcommittee offered a drastically truncated measure directed primarily to small business.

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[5] H.Rep. 1480, 88th Cong., 2d Sess., Vol. 1, pp. 129, et seq. (Willis Subcommittee Report)

[6] *Supra*, 358 U.S. 450 (1959).

[7] *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

[8] P.L. 87-17; H.Rep. 1480, supra, p. 9.

[9] Alabama, Alaska, Arkansas, California, Colorado, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Missouri, Montana, Nebraska, New Mexico, North Dakota, New Hampshire, Oklahoma, Oregon, South Carolina, Washington, North Carolina, Utah, Virginia.

It has been twice passed by the House in spite of adamant opposition by state tax administrators. Now known as the Rodino Bill (H.R. 7906) and pending before the Senate Finance Committee, it is in threat of becoming a casualty a second time as time is running out in this Session of Congress.

Why after so many years and so much effort and such clear need is Congressional action again about to abort?

There is a complex of reasons. There is still a residue of resistance based on the notion that any action represents Congressional interference with states' rights. There is disagreement between business and state tax administrators; there is disagreement among business groups; there is disagreement among tax administrators; and there is reluctance on the part of Congress, particularly the Senate Finance Committee on which all these disagreements have come to bear, to act arbiter and impose a solution. My reading of the mood of the Finance Committee is quite frankly that it is waiting for the contending parties to compose their differences.

Overhanging the troubled attempts to solve the problems through federal legislation are some nagging questions if we are to enlarge the narrow scope of the Rodino Bill. How far can the scope be broadened and made effective without provision for administrative and judicial interpretation in a manner which will preserve uniformity? Is federal administration avoidable and if not how can present state opposition be overcome? Is a multistate tax compact an alternative to federal legislation?

C. *The Multistate Tax Compact.* The Multistate Tax Compact was conceived in 1966, and has been promoted as an alternative to federal legislation. It incorporates UDITPA, it provides some sales and use tax standards, it provides for advisory administrative regulations and it provides an arbitration procedure. It is thus clearly superior to the uniform law approach. But it still suffers from some of the defects of a uniform act and encounters some special problems of its own.

In 4 years the Compact has been adopted by only 20 states [10] and has been adopted by none of the major Eastern seaboard industrial states. It has succeeded in getting associate membership from 13 states, including important industrial states, but clearly the prospect of getting broad enough participation to make the compact a self-sufficient solution to the problems of state taxation of multistate business is doubtful.

Moreover, the Compact does not deal with the issues of jurisdiction and its provisions for administrative interpretation are weak. It has no provisions for judicial review. While the contrary is argued, it may well be invalid without Congressional consent. Its enlargement and amendment to meet changing needs would involve cumbersome individual member state legislative approval and if Congressional consent is required, repeated Congressional approval. Facing all of these problems and the present reluctance of additional states to adopt it, the Compact approach also appears unlikely to provide an adequate solution to state taxation of multistate business. It has, nevertheless, served as a rallying point for state tax administrators in their effort to forestall federal legislation, and they have had bills introduced to give Congressional assent to the Compact.

III. AN INNOVATION IN STATECRAFT—FEDERAL LEGISLATION ADMINISTERED UNDER A MULTISTATE COMPACT

All of the apparently available avenues to solution of the problems of state taxation of interstate business seem to be seriously flawed. How, then, do we proceed?

Obviously some innovative, reconciling initiative is needed. Fortunately this initiative has been launched, not as a selfconscious exercise in creative statecraft, but intuitively, forced by the logic of the circumstances. It has emerged from the chrysalis of pressure for solution through federal ligislation and the counterpressure for solution through a multistate compact. Neither pressure or solution appears sufficient in itself, but an amalgamation of the two approaches may well be the reconciling, innovative answer.

The Bill drafted by the Ad Hoc Committee on Taxation of Interstate Business offers such an answer. I had the privilege of serving as Co-Chairman of this Committee. As you know, the Committee was a volunteer and self-appointed group of state tax administrators and business representatives who subscribed to the view that reconciliation of the positions of business and state tax administrators was necessary and were willing to devote effort to that end.

[10] Multistate Tax Newsletter No. 22, July, 1970.

While palpable hostility between the business and state representatives at the outset threatened the joint enterprise, this gradually gave way to respectful regard for opposing views. Total reconciliation was not achieved but a wide area of accord was defined and, remarkably, from the beginning there was consensus that the solutions to the problems of multistate taxation of interstate business should be implemented through a merger of the compact approach with federal legislation.

I am convinced that, consciously or unconsciously, this was genuinely inovative and regardless of the fact that the Committee's recommendations were not unanimous or whether we individually, on study and reflection, agree with all the details of the Committee's proposals, the larger thrust of the Committee's effort is sound and offers the best and most hopeful solution to the problems of state taxation of multistate business.

A. *The Ad Hoc Committee Proposal.* A brief description of the main provisions of the Ad Hoc Committee's proposal will, I trust, serve to justify this conviction. The fundamental, creative conception is, of course, the merger of the multistate tax compact approach and the federal legislation approach.

Under this conception, federal legislation would provide jurisdictional standards, a uniform apportionment formula for income and capital stock taxes, standards for consolidation or combination of affiliated corporations for income tax purposes, standards for sales and use taxes, and procedures for the settlement of disputes, with the Multistate Tax Compact providing the means for administration of the federal legislation.

Such a structure would provide flexibility for adjustment and evolution to improve the system for taxation of interstate business. With the Multistate Tax Compact providing only the administrative machinery under which the States would act cooperatively to administer federal standards, and not itself containing substantive standards, there should be little or no need for future amendments of the Compact. This is desirable since, as already noted, amendment of an interstat compact involves procedures which it would be difficult to make responsive to changing needs and developing thinking with respect to standards for taxation of interstate business. On the other hand, with the Multistate Tax Commission under the Compact acting as the administrative agency it could implement and modify, within the limits of permissible administrative interpretation, the legislative standards under federal law, and when the need for changes exceeded the bounds of permissible administrative interpretation the Commission could seek amendments to the federal legislation, a far more responsive procedure than amendment of an interstate compact. Moreover, under the Committee structure of the Multistate Tax Compact any proposal for amendment of the federal legislation will have been preceded by extensive discussions between state administrators and business representatives and will presumably, therefore, be presented to Congress with a substantial consensus of support.

Time does not permit discussion of the specifics of the standards to be provided by federal legislation or the specifics of the powers of administration delegated to the Multistate Tax Commission. Some are freighted with controversy and the Committee sought to limit itself only to the most pressing problems rather than to deal with all the problems that might arise in the areas which were included in its proposal. The Committee deemed it more important to take an initial step, but a sound one, which would lay the groundwork for perfecting amendments as experience pointed the way.

While the Committee conceived its approach under the compulsion of existential pressures, unaware of historical precedents and unsure of its constitutional propriety, its conception, one finds on research, is not wholly unprecedented and is, with little doubt, wholly constitutional, the latter having been confirmed by competent outside legal counsel during the course of the Committee's deliberations.

B. *Precedents.* In a landmark article in 1925,[11] Mr. Justice Frankfurter, then Professor of Law at Harvard Law School, and James Landis, then his research associate and later Dean of the Law School, analyzed the compact clause of the Constitution and urged a more imaginative use of this clause in dealing with problems requiring interstate adjustments within our federal system. They cited this approach as preservative of the legal autonomy of the states rather than reducing them to departments or mere administrative divisions of the central government. Although acknowledging that the compact clause had its origin in the boundary disputes pending at the time the Constitution was framed and adopted, they traced its gradual application in other areas and argued that the

[11] Frankfurter & Landis, THE COMPACT CLAUSE OF THE CONSTITUTION—A STUDY IN INTERSTATE ADJUSTMENTS, 34 Yale Law Journal 685 (1925).

pressure of modern interstate problems has revealed the rich potentialities of the device. They specifically called attention to its usefulness with respect to interstate conflicts in taxation. The following quotation sounds remarkably current:

> ". . . no one can scan the flood of cases dealing with 'jurisdiction' to tax, rules for apportionment and the like, without realizing that the opportunities for taxation open to the States against common resources might find a more economic and more effective solution through negotiation than through litigation. At all events, in view of the growing burden upon time and feelings, as well as the cost in money due to the conflicts and confusion arising from the administration of independent systems of State taxation, the possibilities of amelioration and economy realizable through an alert use of the Compact Clause call for more intensive study, as part of a disciplined attack upon the entire tax problem."

This early recognition of the usefulness of the compact clause in interstate taxation has been validated by time, but as we have learned a simple resort to the compact clause is not enough. A more alert and imaginative use is needed. The Ad Hoc Committee's proposal for federal legislation of uniform standards administered under a multistate compact is such a use.

But even this conception is not wholly unprecedented. In an article in 1936,[12] Professor Stevens of Cornell Law School proposed the adoption of uniform corporation laws through a combination of federal legislation and an interstate compact. He suggested federal legislation authorizing an interstate compact to set up an interstate commission on corporation law which would draft and approve uniform corporation law provisions for adoption by member states. But more critically for our purposes, he also suggested that in order to make the compact approach effective the federal legislation should prohibit the conduct of interstate commerce by corporations not formed under an act embodying the uniform law. He had no doubt as to the constitutionality of such a combination of federal regulation of interstate commerce with an interstate compact.[13]

Similarly, there also appears to be ample authority under several Supreme Court decisions [14] to support the administrative and judicial appeal procedures envisioned by the Ad Hoc Committee's proposal.

IV. INTERNATIONAL IMPLICATIONS OF THE AD HOC COMMITTEE'S PROPOSAL

There is more than a federal and interstate dimension to the Ad Hoc Committee's proposal which heightens my interest. The parallel between our interstate problems and the problems of international taxation of multinational business is inescapable. If we can resolve through federal legislation and a multistate compact the problem of interstate taxation, why should not this serve as a prototype for resolution of the problems of international taxation of multinational business through a multilateral treaty? The obstacles may seem insurmountable but the power of the example will be there and as pressure for solutions mounts with the accelerating growth of multinational business, international machinery may well be implemented to parallel our example. It is clearly in the interest of business not only to solve our domestic problems but to grasp the opportunity through a successful domestic solution to provide a compelling international example. The time may not be so far off when a burgeoning multinational business will require new initiatives to deal with the international implications, including taxes. The impending seriousness of this is attested in the recent testimony on multinational corporations last December and May before the Subcommittee on Foreign Economic Policy of the Joint Economic Committee.

V. PLEA FOR STATESMANSHIP

I am convinced that nothing less than a new venture in federalism such as the merger of the Multistate Tax Compact and federal legislation will resolve the differences between business and state tax administrators over solutions to the problems of state taxation of interstate business. To me this venture beckons as a challenge to statecraft. It calls for a kind of statesmanship that has not always been abundantly present in the debates on the subject heretofore. But I am optimistic. The not uncommon history of apparently intractible controversies

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[12] Stevens, UNIFORM CORPORATION LAWS THROUGH INTERSTATE COMPACTS AND FEDERAL LEGISLATION, 34 Michigan Law Rev. 1063 (1936)

[13] See also Holcombe, THE STATES AS AGENTS OF THE NATION, 3 SELECTED ESSAYS ON CONSTITUTIONAL LAW, 1187 (1938).

[14] *Petty v. Tennessee-Missouri Bridge Comm.*, 359 U.S. 275 (1959); *Parden v. Terminal Railway of the Alabama State Docks Department*, 377 U.S. 184 (1964); *Tobin v. U.S.*, 306 F(2) 270 (D.C. Cir. 1962), Cert. den., 371 U.S. 902 (1963).

is that they pass from unyielding hostility to grudging recognition of merit in opposing views and gradually to reconciling compromise. I think the multistate business tax controversy is running this course and we may well be entering the last stage of reconciling compromise.

But an acceptable issue out of our difficulties is by no means assured. One must plead for dedication to making our federal system work and for some sustained statesmanship on the part of both tax administrators and business representatives.

I have dealt only with the larger issues but there are specifics which must be incorporated in any solution and my experience on the Ad Hoc Committee makes it only too clear that unyielding adherence to a preferred view with respect to important specifics can destroy the promise of the joint venture.

Aside from its central conception, the genius of the Ad Hoc Committee's proposal, if it merits so laudatory a description, is its spirit of accommodation. There is danger that it may not be considered in the same spirit by contending business groups and state tax administrators now reviewing it.

I do not mean to suggest that the Ad Hoc Committee's proposal must be accepted intact or all will fall. But in seeking adjustments in the proposal let us not rekindle the old hostilities and resume the old intransigent stands.

I question whether either of the opposing views in the major specific controversies, such as over use tax jurisdiction and the consolidation of related companies, can wholly prevail. And if we persist in unyielding disagreement, the opportunity for creative statecraft may irrevocably pass, risking to unpredictable future pressures the fashioning of perhaps some drastic solution.

Senator HANSEN. The next witness is the Honorable Kenneth Back, president, National Association of Tax Administrators, accompanied by Charles F. Conlon, executive secretary, N.A.T.A.

You may be seated and you may proceed.

STATEMENT OF KENNETH BACK, PRESIDENT, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, ACCOMPANIED BY CHARLES F. CONLON, EXECUTIVE SECRETARY

Mr. BACK. Thank you, Mr. Chairman.

My name is Kenneth Back and I am Director of the Department of Finance and Revenue, District of Columbia, and president of the National Association of Tax Administrators. I have with me Mr. Conlon who is executive secretary of the association.

I present this statement on behalf of the executive committee of this Association of Tax Administrators. I have submitted a statement for the record and I would request that it be made a part of the record and I will attempt to summarize it here.

Senator HANSEN. Without objection, it will be placed in the record.

Mr. BACK. The views expressed in this statement, which has been submitted for the record, faithfully reflect the general position of State tax administrators in respect to substantially similar bills introduced in earlier Congresses. In addition, tax administrators who have their individual views on some of the points discussed here will communicate them directly to the committee.

Congressional concern with the general problem of State and local taxation of interstate business dates back many years. Following some Supreme Court income tax decisions, Congress enacted Public Law 86–272. At that time, Congress also authorized and called for a study of the matter. That study was primarily based on data available during the period of 1959–60. In the meantime, in the way of remedial action to deal with bona fide complaints, much has been done and achieved by the concerted action of the States themselves.

Moreover, as Senator Murphy pointed out, when he introduced S. 3368 in the 91st Congress, there have also been a number of signifi-

cant sales and use tax developments, the practical effect of which has been to render irrelevant much of the previous testimony in support of Federal legislation. This is particularly true, for example, of the extended testimony dealing with catalog and mail order sales, which the U.S. Supreme Court has determined do not subject a business to a State's taxing jurisdiction.

While there was much disagreement with the study of the House Judiciary Committee at the time the study was completed, we would be the first ones to say that the study spurred the States to take action for uniformity.

The steps that States have taken to eliminate unduly burdensome requirements are spelled out in detail in the formal statement I have presented for the record. Let me just summarize them here by saying that they involve a corporation income tax base tied to the Internal Revenue Code as a starting point; the adoption of a standard apportionment and allocation formula; credit for sales taxes paid to another State; the use of exemption or resale certificates to relieve vendors of tax liability; their elimination of charges for out-of-State sales, income, and tax audits; the elimination of sales or use taxes or household goods brought into a State by new residents; expended filing periods for sales tax vendors with low sales volume and the negotiation of an interstate tax compact.

On the whole, these accomplishments are impressive and suggest that the program recommended by the tax administrators will be adopted by all of the States and there is, accordingly, no real need for further action by the Congress at this time.

We would have serious objections to some provisions in many of the bills that are pending before the Congress. I won't identify any particular bill but just mention some of the principal parts of the bills we would find most objectionable.

These would be the use of a two-factor apportionment ceiling various restrictions on State power to require a consolidated tax return where such a return is necessary to determine accurately the income of a corporation with a business location in the State; prohibitions on the taxation of intercorporate dividends; and the exclusion of foreign source income, including dividend income in a manner that effectively prohibits a State from requiring a consolidated return be filed in those cases where, in the tax administrator's opinion, such a return is necessary to determine accurately the income of a corporation with a business location in the State. We would object to the provision in one of the bills—I believe it is S. 1245—that the Federal courts be used for de novo proceedings on State and local taxes. We would also oppose the conferral on any organization or association of the power to make rules and regulations binding on all States. We would be most reluctant to see the elimination of the *Scripto-General Trading* rule in the sales and use tax field and the inauguration of registration number procedures as a substitute for vendor collection.

There are some of the provisions which would be most objectionable in our opinion to the majority of the States.

I would go further, Mr. Chairman, and say if Federal legislation is to be adopted, we would like to recommend some of the principles to be observed in such a bill. The first principle would be to incorporate into each title dealing with a specific tax the definitions appropriate to the concept of that tax and thus avoid some of the misunderstandings

caused by the use of common definitions in pending bills. In other words, the jurisdictional standards set forth in Public Law 86-272, in our opinion, simply will not work in the sales tax field.

No. 2, in the corporation income and capital stock tax fields, we would recommend:

(*a*) Include leased-out income-producing personal property as a jurisdictional element—some of the bills do and some of them do not carry this—and,

(*b*) Make the jurisdictional provisions and the division of income provisions applicable to all corporations covered by the bill, provided, though, that the three-factor formula is substituted for the present two-factor formula in the apportionment ceiling provision in some of the bills. It should be noted that a substantial number of State tax officials would favor the application of the formula to the entire net income of a corporation, and,

(*c*) Let the tax base be determined according to State law—and I am referring to income taxes now—and let existing law be governing with respect to the requirement for a combined or consolidated return of affiliated taxpayers where such a return would be necessary in order to determine accurately the income earned in a State, and,

(*d*) Allow a reasonable leadtime before any legislation is operative.

The executive committee of NATA has gone one step further in its efforts to provide affirmative solutions in the income tax field. In preparation for these hearings, the executive committee directed that a special study be organized for the purposes of preparing a draft bill dealing specifically, with corporation income and capital stock taxes.

This study group under the chairmanship of Owen L. Clark, has been working on such a draft bill. Although the study group has worked diligently on this project, it simply has not been feasible to complete the draft for the executive committee in time for consideration prior to this hearing. Mr. Clark will, however, describe for the special subcommittee on State taxation of interstate commerce the progress made thus far and the prospects for completing the draft in the near future for consideration by the executive committee of NATA, and by the tax departments of the several States and, as I said, this will be completed in the near future and presumably at that time, if one can be agreed upon by the States, we would make such a submission for consideration.

In the sales and use tax field, most of the provisions of S. 282 and H.R. 1453, are generally recommended as acceptable standards if Federal legislation is to be enacted in the sales tax field. Either could be incorporated as a single title in the omnibus bill. This would insure:

(*a*) The retention of the General Trading Scripto standard for the collection of use taxes; and,

(*b*) A conventional definition of a use tax, that is, one that is complementary to a general tax; and,

(*c*) The retention of the authority for interstate sales tax agreements; and,

(*d*) A practical definition of an "interstate sale." S. 282 and H.R. 1453, also include a number of sales and use tax remedial provisions that appear in other bills pending before the Congress. However, as to two of these, the good faith test for a resale certificate and the exclusion of delivery charges from the measure of the tax, there are substantial differences.

As to local taxes, the executive committee members would recommend that any action in connection with local sales taxes, as contained in most of the bills, would be postponed for 5 years to give the States an opportunity to get their house in order.

The members of the executive committee would also support sales and use tax provisions permitting the advance collection of the tax from wholesalers in those States that favor such an approach.

At the roundtable hearing in this room a few weeks ago, there was a proposal laid out on the table by Mr. Traigle, collector of revenue for the State of Louisiana. Our association has not had time to study this proposal prior to these hearings. I spoke with Mr. Traigle and when he testifies, I assume he may further elaborate on his proposal, but the executive committee of this association has not had an opportunity to take a position on this proposal and on its workability.

The CHAIRMAN. You are aware of what that proposal does?

Mr. BACK. Yes; we are familiar with the proposal. We would assume it probably needs some revisions here and there but that it may work. We don't know. We really haven't had a chance to study it.

The CHAIRMAN. What I understand that proposal would do is instead of having 10,000 or more different rates, there would be just 50 separate rates to contend with, so you would just see what the total State tax was in that State and, if you paid that, that is all the businessman would need to worry about. It seems to me that would help you meet your problem. It might not be perfect but it is better that what you have now.

Mr. BACK. I think that is right, Senator Long. I think our main concern would be from an enforcement point of view.

The CHAIRMAN. Yes.

Mr. BACK. But the principle and idea sounds great, to me, personally, but I think we would want to look at it from the point of view of how can we enforce it and this I don't think has been resolved yet.

Getting back to the statement, the members of the executive committee, also, generally recommend that enforcement powers be spelled out in the provisions of several pending bills which authorizes the use of the interstate sales and use tax collection agreements.

Let me summarize the statement this way: A Federal bill incorporating these amendments and those proposed amendments, that will be recommended in the draft bill now under consideration by the special study group in NATA would provide standards and guidelines for State and local taxation that would assure a reasonable degree of certainty for the taxpayer while, at the same time, avoiding any wholesale disruption of State administrative procedures and enforcement methods and the sharp adverse revenue impact which some of the pending proposals would entail. To a considerable degree, a bill drafted along the lines recommended would, in effect, codify the standards and principles that have been sanctioned by the courts over the years.

I will end my formal statement there and try to answer any questions that you may have.

Senator HANSEN. What steps do States usually take to inform all companies doing business within their State that they might be liable for income or sales taxes and how do they insure compliance?

Mr. BACK. I can't speak for all of the States. I think enforcement and information procedures will vary. I just can't speak for the States in this regard. I am not that familiar with all of their procedures, Mr. Chairman.

Mr. CONLON. If I may, may I comment?

Senator HANSEN. Fine.

Mr. CONLON. I——

Mr. BACK. This is Mr. Conlon who is accompanying me here as our executive secretary.

Mr. CONLON. The States make efforts to furnish the commercial law reporters with information with respect to regulations, copies of forms and the like in the same way generally as the Internal Revenue Service does. There is a greater concentration of there efforts, of course, within the State than there is outside. Unless you do have ready access to the commercial reporting services, Senator, you simply would have to get in contact directly with the State tax agency.

Senator HANSEN. One further question: How have States acted on their own initiative to provide uniform collection of these taxes, that is, sales and use taxes at the State level?

Mr. CONLON. Well, do you mean with respect to the kind of reporting and return procedures that the States use, sir?

Senator HANSEN. Well, whatever it may be. I would certainly assume that those two facets would be included.

Mr. CONLON. Most of the States imposing sales and use taxes have a standard registration procedure under which any vendor, who makes sales of tangible personal property in the jurisdiction, must get a permit and make a return within the time specified. Some of the returns are monthly, some of them are bimonthly, some of them are quarterly. These returns differ in form but, in general, they are somewhat similar in that they require a statement of the gross receipts from the sale of tangible personal property, a specification of the exemptions and the amount of exempt items sold and a totaling up of the tax liability. There are some differences among the States in the detail in which the report must be made, but, in general, that is the kind of procedure which the States ordinarily use.

Senator HANSEN. More specifically, Mr. Conlon, in those States where separate entities of government exist, whether it is county government, city, or whatever it may be and they impose taxes on their own initiative, what efforts do you know of that might have been taken by States to achieve uniformity in this situation?

Mr. CONLON. Well, I think the most notable and most successful one is the plan followed in a number of States, for example, in California and Illinois among others, whereby local government authority to impose a sales tax is conditioned on the use of a standard tax base and some sort of limitation on the rate; together with State administration of both the State and local tax. This is not the case in all States. There are States, as Senator Long has indicated, where local governments may independently adopt their own taxes and their own tax rates. Also, these taxes are enforced independently so that a vendor doing business in 15 different localities in the State must make some 15 tax returns.

Senator HANSEN. Do you consider this to be a political problem that the States can resolve on their own initiative?

Mr. CONLON. I will answer it this way: In many States this problem has been resolved by the use of the State-administered, State-local sales tax which I have just described. Now, what kind of incentive you need to spur such action in other States, I just don't know. It is mostly, I think, a matter of local autonomy. Local governments wish to enforce the type of tax they like and collect it in the way they like.

The CHAIRMAN. I understand that the National Association of Tax Administrators has been working with representatives of business in an effort to work out some sort of accommodation on interstate tax legislation. Can you tell me what progress has been made and what prospects there seem to be?

Mr. BACK. Yes, Mr. Chairman. We have been working very closely with business. The entire Executive Committee of NATA has had numerous meetings with the business group known as the COST group, and I think considerable progress has been made. I don't know whether it will be possible for every single issue to be resolved to everybody's satisfaction or not. I doubt it but, as Mr. Kust said awhile ago, I think we are a thousand times closer together than we are apart, and I am very hopeful that, if all parties will continue to give a little and take a little, that if Federal legislation is to be that we can have a bill that will substantially satisfy most people.

The CHAIRMAN. Thank you very much. We appreciate your statement.

[The statement of Mr. Back follows:]

TESTIMONY OF KENNETH BACK, PRESIDENT, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

SUMMARY

In the years since the Special Subcommittee of the House issued its report, the State tax departments have undertaken and have largely accomplished the adoption of remedial programs affecting the administration of income, capital stock, gross receipts and sales and use taxes affecting interstate commerce.

The scope of the remedial program suggested and the high degree of acceptance it has received indicate that there no longer is any real need for Congressional legislation.

The tax commissioners of many of the states have expressed their strong opposition to specifically identified provisions in pending bills, the purpose of which are principally to reduce tax liability rather than to reduce compliance burdens.

Lest it appear that the views of state tax officials are negative in respect to proposed legislation, it should be pointed out:

1. If Federal legislation is to be enacted in the sales and use fields, the provisions of the CRANSTON-TUNNEY bill are much more acceptable to state tax administrators than those in the other interstate taxation bills.
2. Specific suggestions for the corporation income tax field have been submitted.
3. A special NATA study group under the chairmanship of Owen L. Clarke is working on a draft bill in the corporation and capital stock tax field. Mr. Clarke will report directly to the Subcommittee on the status of this project.

STATEMENT

I am Kenneth Back, Director of the Department of Finance and Revenue District of Columbia, and President of the National Association of Tax Administrators. I present this statement on behalf of the Executive Committee of this Association.

The views expressed here faithfully reflect the general position of state tax administrators in respect to substantially similar bills introduced in earlier Congresses. In addition, tax administrators who have their individual views on some of the points discussed here will communicate them directly to the Committee.

Congressional concern with the general problem of state and local taxation of interstate business dates back to the *Northwestern Portland Cement* and *Stockham Valves* cases in the income tax field (1959) and the *Scripto* case in the sales and use tax field (1960). Following the income tax decisions, Congress enacted P.L. 86-272 which specified the activities that an out-of-state business could conduct without being exposed to state to local income taxes. Congress also called for a study of the taxation of interstate business, which was subsequently conducted by the Special Subcommittee on State Taxation of Interstate Commerce of the House Judiciary Committee. Twice the House has passed a bill which would restrict state and local taxation of interstate commerce. There has been no corresponding action in the Senate, nor until now even any hearings on the subject.

The basic research involved in the special study, on which the House Judiciary Committee recommendations were founded, dates back to the 1959-1960 tax year. In the meantime, much in the way of remedial action to deal with bona fide complaints has been achieved by the concerted action of the states themselves. Moreover, as Senator Murphy pointed out when he introduced S. 3368 in the 91st Congress, there have also been a number of significant sales and use tax developments, the practical effect of which has been to render irrelevant much of the previous testimony in support of federal legislation. This is particularly true, for example, of the extended testimony dealing with catalog and mail order sales, which the United States Supreme Court has now determined do not subject a business to a state's taxing jurisdiction.

RECENT DEVELOPMENTS

Although some aspects of the Special Subcommittee's findings have been sharply criticized, there is no question that the Subcommittee's work and reports spurred the states to review their tax statutes and their administrative procedures in respect to the taxation of interstate business. As a result of this review the states have, in the past several years, taken many steps to improve the situation through the elimination of practices deemed to be inequitable or unduly burdensome as applied to interstate commerce and by the enactment of statutory provisions designed to provide uniform procedures and to reduce the cost of complying with state tax laws.

The basic program along those lines was set forth in the statement of policy adopted at the special meeting of the National Association of Tax Administrators, held in Chicago, January 13-14, 1966.

The record of achievement in the implementation of that program is exemplified by the situation which exists today:

1. *Corporation Income Tax Base.* Forty states have adopted the federal tax base as the starting point for determining taxable income for state corporation income tax purposes or by administrative practice follow the federal statute for all practical purposes. (This standard, incidentally, is not required in any of the interstate taxation bills pending before the Congress.)
2. *Standard Apportionment Formula.* Twenty-nine states and the District of Columbia have adopted, verbatim or with some modifications, the Uniform Division of Income for Tax Purposes Act promulgated by the National Conference of Commissioners on Uniform State Laws. All but two states imposing corporation income taxes use a three-factor formula. Bills are pending in other states to conform these three-factor formulas to the NCCUSL Act. In addition, the National Association of Tax Administrators has proposed a series of regulations to implement the NCCUSL Act and is working on additional regulations.
3. *Optional Low Rate Tax on Gross Sales.* The policy statement endorsed the proposal of a provision in an income tax law under which a taxpayer whose only activities within a state consist of sales might elect to pay a lower rate tax on gross sales in lieu of the tax on net income. While this provision is included in the compact mentioned below, it has not been widely adopted on a unilateral basis probably because, as a practical matter, a taxpayer whose activities were qualified for the gross sales election would also be protected by P.L. 86-272 and thus not subject to tax at all.
4. *Credit for Sales or Use Tax Paid to Another State.* Sales and use taxes are imposed in 45 states and the District of Columbia. In all but one of these states, a credit is allowed for a sales or use tax paid to another state. However in two of these states, the credit is limited to contractors' equipment, tools and machinery and in another the credit is allowed only if the purchase was made in a state which had enacted the Multistate Tax Compact.

5. *Exemption and Resale Certificates.* All the states imposing sales and use taxes provided by statute or regulation that where a vendor has received and accepted a resale certificate in good faith, he shall be relieved of responsibility for sales tax on such a transaction unless it is obvious that the property involved is not being acquired for resale.

6. *Discrimination against Interstate Transactions.* In the few instances where such discriminations were cited, for example, the denial of a trade-in allowance on local sales, these have now been completely eliminated. In four states there are still differences in the treatment of transportation charges on intrastate and interstate sales under some circumstances. For all practical purposes, however, these differences are nominal or technical rather than substantial.

7. *Charges for Expense of Out-of-State Audits.* The few states which formerly required the taxpayer to reimburse the tax department for the cost of sending an auditor to the taxpayer's out-of-state location to make a sales or use tax or corporation income tax audit have repealed this requirement.

8. *Taxation of Household Goods of New Residents.* So far as can be determined, no state actually imposes a use tax on household goods brought into a state after first use in another state by new residents.

9. *Extended Filing Period.* Where the interstate vendor's sales within a state are minimal, all but a few states grant the taxpayer permission to file returns less frequently than the ordinary monthly or quarterly requirement.

10. *Interstate Tax Compact.* The policy statement also requested Congress to authorize the negotiation of an Interstate Compact through which the states might carry out the program outlined above. Although the requested consent has not yet been forthcoming, the Multistate Tax Compact creating a Multistate Tax Commission has been drafted and has been adopted and become effective in 21 states. At the same time, the states generally have proceeded to implement the suggested program by amendment of their own tax laws and regulations independently of the compact with the result that practically all the changes enumerated above represent specific state legislative recognition of these problems and unilateral action to remedy them.

On the whole, these accomplishments are impressive and suggest that the program recommended by the tax administrators will be adopted by all the states and there is, accordingly, no real need for further action by the Congress.

SPECIFIC OBJECTIONS TO PENDING PROPOSALS

Aside from the conviction that further federal legislation is unnecessary, the Executive Committee of NATA would single out a number of specific provisions or omissions in some of the bills presently pending. These provisions or omissions are unduly restrictive or unfair; or disruptive of well established and accepted procedures. In the corporation income and capital stock fields, these objections include:

1. The failure to include the presence of leased-out income-producing personal property within a state as a basis for tax jurisdiction.
2. The use of a two-factor apportionment ceiling.
3. Various restrictions on state power to require a consolidated tax return where such a return is necessary to determine accurately the income of a corporation with a business location in the state.
4. Prohibitions on the taxation of intercorporate dividends.
5. The exclusion of foreign source income including dividend income in a manner that effectively prohibits a state from requiring a consolidated return be filed in those cases where, in the tax administrator's opinion, such a return is necessary to determine accurately the income of a corporation with a business location in the state.
6. Provision for federal rules and regulations and the use of federal courts for de novo proceedings involving state and local tax determinations.

Additionally, many state tax departments have expressed their strong opposition to Congressional legislation conferring on any organization or association the authority to promulgate rules and regulations that would be binding on all states.

In the sales and use tax fields, the Executive Committee of NATA identifies the following provisions that, almost without exception, have been strongly opposed by the state tax departments:

1. The imposition of the P.L. 86-272 standard governing the requirement for the collection of use taxes instead of the *General Trading* and *Scripto* rules now sanctioned by the courts.

This change in the jurisdictional standard would give out-of-state vendors a substantial and unfair competitive advantage over local merchants. The local merchant must collect the tax from his customer. The out-of-state vendor would also have a serious adverse effect on state sales and use tax revenues and on sales and use tax administrative procedures and costs. Most state tax officials would characterize the issue here as the most important by far of all the interstate taxation proposals involved in pending bills.

2. The inauguration of registration number procedures as a substitute for vendor collection. Such procedure would have all the disadvantages of the P.L. 86-272 standard; in addition it would require the registration of many businesses not now engaged in the sale of tangible personal property. Instead of looking to relatively few vendors for the tax, the state tax departments would have to collect taxes as best they could from a relatively large number of buyers.

3. The limitation on the imposition of a use tax except on a person who has a dwelling place or place of business in the taxing state. This proposal involves a major change in the universally accepted concept of a use tax.

4. The definition of a use tax is so broad that it covers cigarette and alcoholic beverage taxes whereas the sales tax provisions of the bills do not apply to such special taxes.

5. The definition of an interstate sale and particularly the highly artificial subdefinition of the origin of a sale.

6. Unwarranted limitations on local sales and use tax jurisdiction.

A number of states object also to the exclusion of delivery charges from the measure of the tax imposed with respect to a sales or use tax on an interstate sale.

Restrictions on the imposition of gross receipts taxes affect only a small number of states, but they are likewise strongly opposed by the states concerned.

In the personal income tax field, the Executive Committee of NATA recognizes state opposition to those restrictions which were tacked on to the original Willis bill in 1968 by a floor amendment because:

1. These personal income tax restrictions were added to the bills without a Committee hearing. The states have never had an opportunity to demonstrate that the standards incorporated by the floor amendment are neither practicable, reasonable nor equitable.

2. These restrictions would prohibit the taxation of income other than earned income derived from sources within a state, unless the recipient were also domiciled in the state. Income from income-producing property located within a state and owned by a nondomiciled person would thus be exempt from taxation in the state where the property is located.

3. These personal income tax amendments would substitute domicile for actual residence as the primary test of income tax liability contrary to the practice in many states.

ALTERNATIVE PROGRAM

While the progress achieved in the past few years argues strongly that there is no need for any further federal legislation and especially any legislation with the many objectionable features just enumerated, nevertheless, the possibility that an interstate taxation bill might pass both houses of Congress must be considered. In that event, the members of the Executive Committee of NATA are substantially agreed that any such legislation should reflect the following recommendations:

1. Incorporate into each title dealing with a specific tax, the definitions appropriate to the concepts of that tax and thus avoid some of the misunderstandings caused by the use of common definitions in pending bills.

2. In the corporation income and capital stock tax fields:

(a) include leased-out income-producing personal property as a jurisdictional element;

(b) make the jurisdictional provisions and the divivion of income provisions applicable to all corporations covered by the bill provided, though, that the three-factor formula is substituted for the present two-factor formula in the apportionment ceiling provision. It should be noted that a substantial number of state tax officials would favor the application of the formula to the entire net income of a corporation;

(c) let the tax base be determined according to state law and let existing law be governing with respect to the requirement for a combined or consolidated return of affiliated taxpayers where such a return would

be necessary in order to determine accurately the income earned in a state; and

(d) allow a reasonable lead time before any legislation is operative.

The recommendation in subparagraph (c) above is based on the premise that no satisfactory and practical standards relative to combined or consolidated returns have yet been formulated and it would be premature to do other than to maintain the status quo until satisfactory standards are worked out.

The Executive Committee of NATA has gone one step further in its efforts to provide affirmative solutions in the income tax field. In preparation for these hearings, the Executive Committee directed that a special study group be organized for the purpose of preparing a draft bill dealing specifically with corporation income and capital stock taxes.

This study group under the chairmanship of Owen L. Clarke has been working on such a draft bill. Although the study group has worked diligently on this project, it simply has not been feasible to complete the draft for the Executive Committee in time for consideration prior to this hearing. Mr. Clarke will, however, describe for the Special Subcommittee on State Taxation of Interstate Commerce the progress made thus far and the prospects for completing the draft in the near future for consideration by the Executive Committee of NATA and by the tax departments of the several states.

3. In the sales and use tax field, most of the provisions of S. 282 and H.R. 1453 are generally recommended as acceptable standard. Either could be incorporated as a single title in an omnibus bill. This would insure:

(a) the retention of the *General Trading-Scripto* standard for the collection of use taxes;

(b) a conventional definition of a use tax, that is, one which is complementary to a general tax;

(c) the retention of the authority for interstate sales tax collections agreements; and

(d) a practical definition of an "interstate sale".

S. 282 and H.R. 1453 also include a number of sales and use tax remedial provisions that appear in other bills pending before the Congress. However, as to two of these—the good faith test for a resale certificate and the exclusion of delivery charges from the measure of the tax—there are substantial differences of opinion.

As to local sales taxes, the Executive Committee members are aware of the fact nonuniform local sales taxes cause some serious problems of compliance for interstate vendors. They strongly recommend that if stricter jurisdictional standards are imposed in respect to these taxes, the effective date of these standards be postponed for a period of five years in order to mitigate the immediate impact of such restrictions and to permit the adoption of alternative methods for the collection of such local taxes within the rules provided.

The members of the Executive Committee would also support sales and use tax provisions permitting the advance collection of the tax from wholesalers in those states that favor such an approach.

It has very recently been proposed that any vendor selling tangible personal property in interstate commerce be required to collect applicable sales or use taxes (including a standardized local sales or use tax rate) on all such sales unless the buyer furnishes a resale or exemption certificate. The tax thus collected would be remitted by the vendor to the tax department in the buyer's state. The Executive Committee of NATA has considered this proposal but has not had time to study it carefully and examine its implications from the standpoint of administrative and compliance problems. Concededly, this elimination of any jurisdictional restriction on the collection of sales and use taxes would increase state sales and use tax collections. However, consideration needs to be given to enforcement and compliance requirements before a definite recommendation is forthcoming. Up to this point, the Executive Committee and NATA itself has extended its support only to those sellers with activities in the taxing state or who would be subject to the interstate tax collection agreements authorized by the CRANSTON-TUNNEY bill.

4. The members of the Executive Committee also generally recommend that enforcement powers be spelled out in the provision in several of pending bills which authorizes the use of the interstate sales and use tax collection agreements.

5. Gross receipts taxes. In view of the fact that problems in the gross receipts tax field are of special concern to only a small number of states, the tax com-

missioners leave any specific recommendations in respect to these taxes to the states affected. However, they strongly support the application to the gross receipts tax of the same principles implicit in the destination basis of sales and use tax collection authority and the use of a destination basis in the sales tax factor of the corporation income tax formula.

SUMMARY

A federal bill incorporating these amendments and those recommended in the draft bill now under consideration by the special study group in NATA would provide standards and guidelines for state and local taxation that would assure a reasonable degree of certainty for the taxpayer while at the same time avoiding any wholesale disruption of state administrative procedures and enforcement methods and the sharp adverse revenue impact which some of the pending proposals would entail. To a considerable degree, a bill drafted along the lines recommended would, in effect, codify the standards and principles that have been sanctioned by the courts over the years.

In closing, however, the Executive Committee of the National Association of Tax Administrators would again emphasize the point that the record of the states, in implementing their own program, demonstrates convincingly that *federal legislation is not really necessary* and that it might be a wise decision for the Congress to leave this matter to the states so long as it can be shown that *the states are genuinely responsive,* as has been the case here.

The CHAIRMAN. We will next hear from Eugene F. Corrigan, executive director, Multistate Tax Commission, accompanied by the Honorable Byron L. Dorgan, tax commissioner of the State of North Dakota.

STATEMENT OF BYRON L. DORGAN, CHAIRMAN, MULTISTATE TAX COMMISSION AND TAX COMMISSIONER OF THE STATE OF NORTH DAKOTA

Mr. DORGAN. Thank you. My name is Byron L. Dorgan, and I am tax commissioner for North Dakota, which is an elective position encompassing the enforcement and administration of State tax laws. I am also chairman of the Multistate Tax Commission, which has been formed to work toward uniformity of tax laws, and to cooperatively and jointly enforce our State tax laws with respect to the interstate businesses.

I want to state three things today to the subcommittee in the strongest terms I know how, both from my position of State tax commissioner of North Dakota, and representing a consensus of the members of the Multistate Tax Commission; that is, the regular members of the Multistate Tax Commission.

No. 1. Federal intervention in the area of State taxation of interstate business is both unwelcome and unneeded, with one possible exception, and that exception is in the sales and use tax area embodied in the principles of the proposals submitted by Mr. Traigle of Louisiana. I think that proposal has some merit in the sense that, No. 1, it would improve the effectiveness of the States in getting full accountability in the sales and use tax area, while, No. 2, it would greatly simplify compliance problems with respect to the small interstate seller. The full accountability feature of that bill is both meritorious and important. Other than that, we do oppose Federal intervention in the area of taxation of interstate business.

The second point: we vigorously oppose Senate bill 1245, which I think masquerades as a respectable approach to solving some of these problems; but I also think that it is a giant tax giveaway scheme benefiting the largest business interests of the country.

And No. 3. The Multistate Tax Compact in my opinion and in the opinion of the regular members, deserves congressional blessing; and we ask you to pass a consent bill to let the States resolve their own problems.

I must say that the States have worked very hard in the last 8 to 10 years to solve their own problems. The compact itself, since Congress last dealt with this problem, has been enacted by 21 State legislatures; and it is no small task getting the States to act in unison. Senators Hansen, Packwood, and Bentsen know, of course, that Wyoming, Oregon, and Texas are members of the compact. Indeed, I believe that you, Senator Hansen, were largely instrumental in achieving its enactment in Wyoming while you were Governor there. Those 21 include the Legislature of the State of Wyoming, the Legislature of the State of Oregon, the Legislature of the State of Texas. The Legislature of the State of Minnesota has the compact bill before it with Governor Anderson's support, and with bipartisan support among the legislators. It is likely that the compact bill will be enacted in January of next year in Minnesota. As you know, Senator Long, Louisiana is an associate member of the Multistate Tax Commission.

I would like to comment on those three points briefly. The first point is with respect to Federal legislation, which we oppose. The exception to that is in the sales and use tax area. It has always been a sophisticated political technique to rock the boat and then try to convince everyone that there is a storm at sea. I think that that is exactly what is happening in this area. I suspect that you will hear testimony from certain witnesses citing double taxation and unusual and unjust compliance burdens that businessmen face. Those will then represent that this clearly spells the need for Federal intervention.

I think that both of these claims are largely myths. In fact, in most cases I think that the multistate business is paying much less than its fair share of taxes. It would be interesting to me, and I am sure to you, to take the State tax returns filed by the 500 largest corporations of this country, lay them around the table and lay bare the myth of double taxation; because I believe it really is a myth.

I think that auditing done by my State and by many of your States, and by the Multistate Tax Commission as well, has proved beyond a doubt that interstate sellers who are competing against the one-State seller are making more money, paying less taxes, and screaming the loudest about these problems.

Let me say, that simply because certain economic interests might represent double taxation and nonuniformity to you to be a fact, does not make it a fact at all. The fact is that during the past 5 to 8 years, there has been more uniformity in the area of taxation of interstate business than there has been ever before in the history of this country; and that is a fact. I think the States have made tremendous progress, that they are doing a good job and that they can, will, and should manage their own affairs.

The second point I made was with respect to Senate bill 1245. I said it masquerades as a respectable attempt to solve the problems. I don't think it solves them at all. It represents to me the old cake and crumbs theory where the larger economic interests get the cake and the smaller economic interests get the crumbs. I think that it is unfair and unwarranted; and I think that you should turn that proposal aside.

As elected officials we all have as part of our constituencies the small businessman, the one-State seller. I think that it is unfortunate that a bill like S. 1245 and even some of the practices of the States today would allow an interstate seller to come into Wyoming or North Dakota or Louisiana and compete with our one-State seller and compete in a way that they would pay less taxes than a one-State seller. If a Colorado businessman wants to do business in Wyoming and compete with the Main Street businessman in Cheyenne, then that businessman has every obligation to comply with and pay the same State taxes that your Cheyenne businessman is being asked to pay. That is the very least we can ask and it means full accountability; and no one should object to full accountability.

The last point I made was with respect to congressional consent for the multistate tax compact. As I indicated, 21 States have enacted the compact and another 5 States are associate members; and that is in a very short time. This compact is very important and we ask for passage of congressional consent legislation. Now, the attorneys general of the States that have been asked have ruled that it is not the type of compact that does in fact need congressional consent. Yet we are running into a barrage of opposition from economic interests that suggest that this compact is unconstitutional. We have had a lawsuit filed against us in the State of New York by United States Steel, Procter & Gamble, Standard Brands, and General Mills; and others have asked to intervene—alleging that the compact is unconstitutional. We don't believe that that is so; but we believe that the work of this compact, the 21 States acting in unison during the past years, warrants your support by enactment of a congressional consent bill. We ask that you enact this bill.

As I have indicated, we met what we considered rather serious organized resistance in these efforts to improve ourselves. I frankly understand it quite well because the more effective the States become in enforcing their tax laws with respect to interstate businesses, the more interstate businesses are going to have to pay.

In North Dakota, as tax commissioner, I instituted an out-of-State audit program 4 years ago when I took over the job of State tax commissioner. In that short time with a very small income tax base, indeed, we have collected over $3 million in cash in back taxes from out-of-State audits. Ours is a very small State with a small base; and yet, we are collecting large amounts of money from those kinds of audits. So the money is there and I understand the opposition; but I might say that that opposition is not going to persuade us to disband our efforts. Our efforts are right and just; and they are efforts that must be made to protect every in-State seller in this country.

Finally, let me conclude by saying that I do not want the forcefulness of my testimony or the candor of it to paint with a black brush every corporation in America. It is true that we met some resistance and it is true that, just as there are some overzealous tax administrators, there are some corporations that don't want to pay their share. But there are other corporations that have cooperated and worked very hard with tax administrators.

To respond to one final point that was made by Senator Mathias, it seems to me that the growth pattern in the business community in the last 25 years in this country clearly tells us that State tax laws do not impede interstate commerce. It just can't be true, if you look at the growth of interstate sellers, the amount of activity that they carry on. State tax laws are not impeding this progress at all.

We ourselves are working at trying to do what we have to do to make it easier for the business community and to get full accountability. We are doing a good job and we want to continue to do a good job, but we do oppose Federal legislation, with the one exception that I mentioned.

With that I would ask for some comments from Mr. Corrigan, if the chairman wishes.

The CHAIRMAN. You are familiar with Mr. Traigle's suggestion?

Mr. DORGAN. Yes; I am.

The CHAIRMAN. That the State would set a flat rate and anyone who wanted to do business in that State could see what that flat rate is. How do you feel about that suggestion?

Mr. DORGAN. I think it is a good suggestion. I have read it and, as Mr. Back said, it may require a few minor drafting changes. I think the biggest merit in that suggestion is that it is going to give the States full accountability. It is going to allow to your Louisiana businessman, who operates in one State, the knowledge that he is not going to be competed against by someone outside of the State who is going to be able to sell tax-free; and yet at the same time, that person who wants to come into your market is not going to be faced with the barrage of 1,500 or 800 taxing jurisdictions that he cannot comply with.

The CHAIRMAN. Well, that seems to be an improvement over the present situation. If he is just looking for simplification, that seems like it would make it far simpler than it is now so he won't have to contend with a thousand different jurisdictional rates. Unless somebody can show me something better, I, frankly, think the businessman would be better off with that than the businessman would be with the impasse we have now. If they want to eliminate the confusion, I think they would be better off. If they just want to avoid paying taxes, that is something entirely different.

Mr. DORGAN. I think that is true, Senator, and I might note that that is the only proposal I have seen that guarantees full accountability. That is extremely important. Every other proposal would wash that out. I do think this proposal has merit, but it would be the only type of Federal intervention that we would support at all.

STATEMENT OF EUGENE F. CORRIGAN, EXECUTIVE SECRETARY, MULTISTATE TAX COMMISSION

Mr. CORRIGAN. Mr. Chairman, one of the best things about this bill is that it helps the small businessman. Now, you have heard testimony here this morning about the needs of the small businessman. One of the problems with S. 1245 is that it, in response to the needs of the small businessman, gives, as Mr. Dorgan has indicated, the cake to many large businesses which are well able to cope with what few problems they have in the field.

I think that we should point out a couple of things here for the record. One is that we are talking about 21 States which have enacted the compact bill; but a 22d State, Alabama, has also passed that bill subject to approval of Congress. Additionally, California's Lower House recently approved the compact bill. So we are making substantial progress there.

I would like for the subcommittee to know, too, that the Advisory Commission on Intergovernmental Relations has supported the com-

pact bill. Also, the Council of State Governments, the National Governors' Conference—Governor Rampton of Utah is expected to submit a statement to that effect—the National Association of Attorneys General, and the American Bar Association.

There are a couple of other things that we might emphasize. Senator Mathias mentioned that the State level of tax administration has grown up in the last 20 years, and he indicated that that has created problems for businesses. I think that we need to emphasize that big business has really developed in complicated conglomerate form during just the last 20 years, requiring commensurate sophistication on the part of the States.

I believe that Senator Long also asked awhile ago whether solicitation by mail was enough under S. 1245 to submit a taxpayer to the jurisdiction of the State. The answer was no, but the answer to that question is no, today, also. If you solicit only by mail today for sales tax purposes, you are not subject to the jurisdiction of the State. This is one of the things that Mr. Traigle's suggestion would cure because full accountability would come in there. Therefore, it has merit.

One of you also asked whether a traveling salesman alone in a State was enough to subject the taxpayer to the jurisdiction of the State under S. 1245. The answer was no. But the answer is no today without S. 1245. That is for both income tax purposes and sales and use tax purposes.

Most States have central administration of local taxes. For example, when we talk about there being some 3,300 local jurisdictions that have taxes today, the net effect on the out-of-State taxpayers is not really that great. As 1,400 of them alone are Illinois, that cuts substantially into your 3,300. California also has central administration. So it is easy to throw around a figure of, say 80,000 local jurisdictions which could tax, but the fact of the matter is that no more than about 3,400 impose taxes today and that a vast majority of them are administered at the State level. But this is not to take anything away from Mr. Traigle's proposal. It is not drafted in final form yet so that I can't speak authoritatively on it. But from what he has explained to me about his proposal, it would respond very well in the sales and use tax field to the problems of small business. This, I think, makes it extremely attractive because it also responds to the problems of the States in getting full accountability on sales made into the State by out-of-State sellers.

We would urge, then, that you give your support to, and that the Congress enact, the multistate tax compact consent bill.

Mr. Chairman, I have appended to my testimony here a resolution, which was recently approved by the executive committee of the Multistate Tax Commission, asking for approval of the consent bill. I also have attached a copy of a critique of S. 1245, which goes into the details of that bill and why they are objectionable to the States.[1]

The CHAIRMAN. Senator Hansen?

Senator HANSEN. Thank you, Mr. Chairman. I would like to ask one question of Mr. Dorgan. I appreciate your testimony. Would it be your opinion that one of the results of the legislation which has been introduced and the concern that is being focused on through the

[1] See p. 123.

various bills dealing with interstate taxation from the Federal level, has been to increase interest at the State level in entering into a compact such as you have alluded to, and taking all such steps as may result in a more equitable treatment of businesses doing business between States?

Mr. DORGAN. There is no question about it, Senator. The compact, I think, was basically an outgrowth of the threat of Federal legislation back in the mid-1960's. As I have said, 21 State legislatures have enacted it generally in response to that threat. Other States are considering it. The California House of Representatives just passed it. It will go to the senate. The more States we get involved, the more resistance we are getting. In California, we had substantial resistance from some of the Nation's business community. Others of the business community testified in favor of it. But the more active we are becoming in cooperatively enforcing our laws, the more resistance we are facing.

I do think the compact approach will succeed. It is not the answer for every State, but as I mentioned before, there is greater uniformity in this area than there has ever been in the history of this country: For someone to represent that there is tremendous nonuniformity and double taxation is to represent a myth. I think that we have to deal with the rule and not the exception. There may be some exceptions that you can treat with remedial action, but the rule is that we are doing a good job, and I think the Congress should allow the States to continue to do that job.

Senator HANSEN. Isn't it true that if Federal legislation were to be enacted, it wouldn't necessarily be the epitome of equity and fairness either, as applied to some 50 States that have dissimilar situations?

Mr. DORGAN. That is right. The result would be quite to the contrary, with the exception of the proposal by Mr. Traigle, which is the only proposal that guarantees full accountability. Every other proposal that I have seen would assure that there would never be full accountability. The ability to attribute sales to a State and at the same time prevent that State from having jurisdiction to tax guarantees undertaxation. There is no question about that. And, rather that moving toward equity, that practices gets us farther and farther away from it.

The CHAIRMAN. It is my understanding—and this is a question Senator Nelson wanted me to ask—it is my understanding that most State income tax laws will require allocation of corporate dividends to the State of commercial domicile. Why do you now advocate changing the established pattern? The State administrators have decided almost universally to separately allocate this income rather than to apportion it among the States.

Mr. DORGAN. Because the States have become more sophisticated. The fact that we have not audited for 20 years should not mean that we should never audit out-of-State. We didn't even have an out-of-State audit program in North Dakota and we now have got one. Someone might say, well, why did you decide to do this after 20 years of not doing any audits? Well, the members of the compact decided that dividends are part of the apportionment base under the Uniform Division of Income for Tax Purposes Act. I feel, as one Tax Com-

missioner, that where a dividend is received by a corporation commercially domiciled in Michigan, Michigan has no greater claim to that dividend or to part of that dividend than North Dakota in the sense that part of their business is done in North Dakota. That dividend represents apportionable business income in our opinion.

Mr. CORRIGAN. It is interesting to note, Mr. Chairman, that the very same corporations which will claim that, say, North Dakota should not apportion dividends in North Dakota will, if the corporation's commercial domicile is in Michigan, for example, tell Michigan "you should apportion; you should not attribute all of the dividends to Michigan and tax them." They will want you to apportion them, so it depends on which State you are in as to what position the corporation will take.

The position which the Multistate Tax Commission members by and large are trying to take on the apportionment of dividends would assure that the position of a taxpayer toward the States would not vary from State to State, and would result in full accountability.

The CHAIRMAN. Thank you very much.

[The statements of Mr. Dorgan and Mr. Corrigan, with attachments, follow:]

STATEMENT BY BYRON L. DORGAN, NORTH DAKOTA TAX COMMISSIONER AND CHAIRMAN OF THE MULTISTATE TAX COMMISSION

Mr. Chairman and members of the Committee. My brief presentation will discuss state taxation of interstate businesses from my perspective as an elected state official in North Dakota as well as the Chairman of the Multistate Tax Commission. Having worked for both a large corporation and for state government, I am familiar with the frustrations and concerns of both interests in the important area of interstate taxation. I am sure it will become obvious as this roundtable discussion progresses, that the state governments do not speak with one voice on this issue. There are differences of opinion among state officials on how to deal with the complex consideration of interstate taxation. Likewise, those persons representing the business community are representing broad, varied interests that are not monolithic in their approach to solving these problems.

The word "business" is often bantered about very loosely. I think it would be well to note that different types of businesses encounter different problems in the area of tax compliance. For example, intrastate businesses face different tax problems than do interstate businesses. There are both large businesses and small businesses facing different problems. Most of the representatives from the business community who participate in these discussions represent the large corporate interests in America. Their job is to comply with tax laws in the taxing jurisdiction where they conduct business and at the same time they have an obligation to their management and stockholders to minimize to every extent possible their total legal tax obligation.

There is nothing wrong with this practice and certainly there is nothing wrong with bigness in the business community. The economics of scale dictates that large corporate interests will be with us forever and that workers, and taxpayers alike will benefit from their existence.

However, I should note that as an elected official in my state, part of my constituency is the tens of thousands of small businessmen as well. These businesses are largely intrastate in nature. They conduct business only in one state and they pay income taxes to the state in which they reside. In many cases these intrastate taxpayers compete directly in the same market place with the interstate taxpayers. These intrastate taxpayers have every right to expect and demand that an interstate taxpayer is bearing the same burden of financing government as those businesses conducting businesses in only one state. That is, a taxpayer conducting business in several states should not be granted special privileges and exemption provisions which allow that taxpayer to pay less tax than the tax paid by the small businessman in many states. Every small businessman in America should expect and demand that the large interstate taxpayers be subject to the same tax treatment as the small businessman has had to face year after year. If we do not assure the

intrastate businessman of this, most surely he will find himself competing in a market against a large corporate taxpayer who is making more money and paying less taxes and selling at a lower price as a result of it.

If we cannot provide this guarantee, we will no longer have to make the distinction between "big business and small business" since an unfair tax advantage to interstate taxpayers will guarantee that this country will end up only with big business competing in the market place. The point I am making here is that we must delineate the needs of big business vs. small business and not continue to generalize about "business needs". This generalization is a waste of time and is turning the cheek to the economic facts of life.

In my role as Chairman of the Multistate Tax-Commission I would like to familiarize you with the activities of the Commission since its inception in 1967. The Multistate Tax Compact has been enacted by 21 state legislatures. Additionally, 15 other states are associate members. This brings to a total of 36 the number of states that are either regular or associate members participating in the Multistate Tax Commission's efforts to promote uniformity in the tax laws and rules and regulations that the interstate business must deal with, as well as providing the states with increased capability to enforce the tax laws through joint auditing.

The Multistate Tax Commission is the only tax organization that has had an ongoing effort during the past five years to study and analyze the needs of taxpayers and tax administrators in the field of interstate taxation. The Commission has worked closely with the National Association of Tax Administrators in this regard. During the past two years I have been aware of persons who state that there is a rift or chasm between the NATA and the MTC. Some say that the MTC is impossible to work with but the NATA is a very understanding organization. I would like to note that the 36 regular and associate members of the Multistate Tax Commission represent 70% of the membership of the National Association of Tax Administrators. The Past President of NATA was a Past Chairman of the MTC. I am Chairman of the MTC and I am also on the Executive Committee of the NATA. *The fact is that the organizations have common memberships, similar interests and cooperate very closely.* The distinction is that the MTC is an organization created by state law in its various member states and the MTC provides focus on uniformity in the interstate tax field and joint enforcement efforts in this same area.

Through the combined efforts of state legislatures, the NATA, the MTC, and others, there is more uniformity of law in the field of state taxation of interstate businesses than ever before. The Executive Director of the MTC, Eugene Corrigan, is going to briefly discuss the subject of uniformity.

I would like to discuss the Multistate Tax Commission's Joint Audit Program. In just 18 months we have implemented a joint audit program for the member states. Today, with a limited staff, and with audit offices in Chicago and New York, we are conducting joint income and sales tax audits on the books and records of interstate taxpayers with as many as 14 states participating in the same audit.

Joint auditing makes good sense for the taxpayers and the tax administrator. It relieves the taxpayer of the burden of entertaining individual auditors from every state, week after week after week. It provides the taxpayer with uniformity in audit procedures and techniques. It provides the tax administrator with expanded capability of enforcing their tax laws with respect to taxpayers who are headquartered hundreds or thousands of miles away.

As the Joint Audit Program has increased in effectiveness, the Commission has experienced increased resistance from many of the large taxpayers. Not only have some of the large interstate taxpayers developed an organized effort to refuse to comply with the various state laws which provide for joint auditing, but the Commission has been named a defendant in a lawsuit filed in New York by several corporations which seeks to disband the Commission. To be sure, any taxpayer has every legal right to file such a lawsuit, but I am inclined to believe that the suit was not filed so much to satisfy a curiosity about a constitutional question, as it was to try and bankrupt the state's efforts to cooperatively and jointly enforce their tax laws.

Joint auditing is an idea whose time has come. I am convinced that the states will prevail in this lawsuit. This lawsuit has important significance not only to the states involved in the MTC, but also to every other state government in which an interstate taxpayer conducts business.

I believe the role of the Multistate Tax Commission is a permanent one. I believe that the states have the authority to enter into interstate compacts of this nature and I believe that the rapidly changing nature of this nation's business community will persuade more and more states to join an interstate tax compact.

The Attorneys General of several states have ruled that the Multistate Tax Commission does not need Congressional consent. However, due to the aggressive attack by some of the business community on the constitutionality of the Compact, I believe the first recommendation of the Subcommittee on Interstate Taxation should be to give Congressional consent to the Compact. This is an effort by states to help themselves and there is no reason it should not receive Congressional blessing. I believe that any substantive federal legislation that might be passed in this area should provide for the administration of the Act by the MTC.

Consistency and uniformity in the interpretation of any federal legislation which may be enacted will require that it be centrally administered. I believe that it would be in the best interests of both the state and federal governments to utilize existing machinery for this purpose, namely, the Multistate Tax Commission.

In concluding my presentation, I would like to comment on S. 1245, which is a major piece of legislation to be considered by your Committee. In my judgment, S. 1245 represents a giant tax give-away program for the large corporations of America, which will eventually be paid for by the wage earner, farmer and small businessman. Not unlike some other tax legislation in recent years, this bill would give big business the cake, small business the crumbs, and give the State tax officials an empty pan to lick. Some will argue that S. 1245 makes some major concessions to the states. If that is true, it is similar to the episode in which the salesman sold a milking machine to a farmer, then took his only cow as a down payment. This is admittedly a nonprofessional analysis of S. 1245, but I did want to voice very decisively my opposition to this type of legislation.

The Multistate Tax Commission is under attack by those who would like to see it disbanded, but I can tell you today that the MTC is alive and well and will play a dominant role in the field of state taxation of interstate businesses in the years to come.

Statement of Eugene F. Corrigan, Executive Director, Multistate Tax Commission

Summary

I. Congress should not enact S. 1245. A. It would create impossible and unnecessary problems for the states. B. It would create tremendous advantages for large multistate businesses.

II. Congress should enact the Multistate Tax Compact Consent Bill. This would encourage the current effort of its member states to resolve interstate tax problems.

Statement

My name is Eugene F. Corrigan. I am the Executive Director of the Multistate Tax Commission. I am an attorney who has been involved in state taxation matters for more than 17 years, three with a large corporation, nearly ten with the Illinois Department of Revenue and nearly five in my present position.

For many years Congress has been importuned by many large businesses to "do something to straighten out the interstate taxation mess." Their pleas would have one believe that state and local taxation of multistate business was bringing interstate commerce to a halt.

This does not square with the fact that interstate commerce thrives now more than ever before and that multistate, multinational and multicorporate business organizations dominate the American scene today.

It is true that there are some interstate taxation problems. But they are mainly problems which are the result of the increasingly complicated manner in which multistate and multinational business is being carried on. Name almost any prominent corporate business today and you are referring to a multicorporate business. Dozens of corporations are not unusual under one organizational umbrella. The number runs into the hundreds in some cases.

Yes, there are some problems. But the states have not made them. They are doing their best to cope with taxation problems of the 70's; but corporate proponents of S. 1245 would have you restrict the states to tax administration techniques of the 40's. The states simply cannot accept that.

The states have been making steady progress in recent years toward reduction and resolution of interstate taxation problems. The better they have done, the more effective and efficient they have become, the more have they discovered that non-uniformity has worked to the detriment of the states and to the advantage of some multistate businesses; and the more have such large businesses urged Congress to intervene.

S. 1245 would have the effect of exempting practically all corporate dividends. Why should Congress exempt any type of corporate income from taxation at the state and local level? Why should Congress prohibit the states from using combination or consolidation, techniques which are absolutely necessary in trying to make any tax administration sense out of multicorporate interrelationships and dealings? Yet that is what S. 1245 would do. Why should Congress, in the name of uniformity, interfere with the improving capabilities of the states to cope with tax administration problems raised by multistate businesses which are usually of great size? S. 1245 would do that.

We cannot deny that there are problems; but they are not susceptible to cure by federal legislation alone. Indeed, the wrong kind of federal legislation will compound the problems. Such problems demand the application of reason and experience by knowledgeable people over a period of time sufficient to ensure that the problems will be resolved. To accomplish this will require the services of an agency, the task of which will be the delineation of the problems and the proposing of approaches to them.

Such an agency should be state-operated, state-controlled and state-oriented. It should work closely with state tax administration personnel and it should establish liaison with business representatives. It should be authorized to make recommendations for state action; and its activities should be subject to periodic review by Congress. It should have rule-making authority but those rules should be recommendatory only in nature. It should be the eye of the storm to which both problems and proposed resolutions are attracted. It should conduct research and it should be authorized to render services to states as needed.

The states have already established such an agency. Many of them have been participating in its activities for several years. It has made tremendous progress despite impediments thrown in its way in recent years. Its efforts should be encouraged and enhanced.

The agency is the Multistate Tax Commission. It represents a cooperative effort by its 21 member states and 15 associate member states to apply reason and knowledge on a day-to-day basis to the problems at hand. On September 6, the lower house of the California legislature approved the Compact by a vote of 63–9. That bill has the support of several huge multinational corporations which are clearly committed to a policy of uniformity and equity and which strongly support the Multistate Tax Commission. Enactment of the Multistate Tax Compact in California would clearly encourage additional states to join in this cooperative state effort.

Included in the results of that effort to date have been:

1. Codification of the sales and use tax jurisdictional standard.
2. Development of uniform corporate income tax allocation and apportionment regulations which are receiving increasing support from among the states, despite strong attacks from special interests.
3. Development of the concept of full apportionment of all corporate business income, including dividends, which is moving all of the states toward more uniformity.
4. Development and propagation of tax administration techniques of the 70's to cope with corporate business developments of the 70's. These include combined reports and consolidated returns, which are absolutely necessary to sophisticated state tax administration with respect to interstate commerce.
5. Preparation and dissemination to the states of a corporate income tax audit manual.
6. Presentation of training seminars for auditors in both the corporate income tax field and the sales and use tax field.
7. Participation in cooperative tax administration activities with and on behalf of member states.
8. Development of a uniform sales and use tax exemption certificate which 26 states to date have agreed to accept.

Increased state tax administration efficiency demands the benefits of a cooperative effort such as that which the Multistate Tax Commission represents. The Multistate Tax Commission's past successes have already established its value. Its future successes may well depend upon the encouragement of this

Congress through Congressional consent to its activities. We solicit that consent from Congress.

In granting that consent, Congress will be furthering the efforts of the Multistate Tax Commission to improve the tax administration capabilities of the states through cooperation.

We believe that Congress' role at this time should be to provide an overview function to evaluate the progress of the states. Congress should use the Multistate Tax Commission as a sounding board for future consideration of proposals for the resolution of problems.

Tax problems are not static. They change as business practices change. The Multistate Tax Commission can provide the flexibility to be responsive to change. Further legislation beyond approving the Compact and providing an overview function for Congress should not be considered at this time.

If, despite this opposition, Congress insists upon enactment of technical and substantive guidelines, then the need for an agency such as the Multistate Tax Commission will be even more necessary. Federal substantive legislation will not eliminate the problems which will continue to arise concerning jurisdiction; attribution of income; proper attribution of property, payroll and sales for formulatory purposes; choice of formula for certain types of corporations; etc. That is why the Multistate Tax Commission's uniform regulations are so important. That is why the day-to-day activities of the Multistate Tax Commission need Congressional support.

Precipitate federal enactment of state tax standards will create or accentuate more problems than it solves. At best, it will only shift the areas of uncertainty. Either way, it will require an agency to interpret its provisions and to work constantly toward proper implementation.

Thus, consent for the Multistate Tax Compact and the Multistate Tax Commission should be included in any federal legislation which may be enacted in this field.

We know that it is tempting to try to solve interstate taxation problems by Congressional action. But these problems cannot be solved that easily. They must be approached deliberately and reasonably against a background of experience and knowledge. This should be accomplished through the agency which we have suggested; namely, the Multistate Tax Commission. Congressional support for that Commission will greatly enhance the Commission's already demonstrated capabilities to work constructively through and on behalf of the states toward pragmatic and equitable solutions to interstate taxation problems. Congress' willingness to ensure that the cooperative state effort which it represents will mature into the type of helpful, constructive tax administration vehicle which is required for on-going solutions to day-to-day interstate taxation problems.

In short, Congressional consent for the Multistate Tax Compact will further the cause of good government.

MULTISTATE TAX COMMISSION.

To: Members of the Senate Subcommittee on State Taxation of Interstate Commerce.

From: Eugene F. Corrigan, executive director.

The attached Resolution was unanimously adopted by the Executive Committee of the Multistate Tax Commission on September 13, 1973.

RESOLUTION

Resolved that the Multistate Tax Commission.

(1) vigorously opposes any federal legislation which establishes limitations upon the ability of the states to tax multistate businesses, or which represents a massive tax give-away program primarily benefiting the giant corporations of this country, such as does S.1245;

(2) further asserts that there is no necessity for further federal intervention of any sort in the area of substantive standards regulating state taxation of interstate businesses;

(3) reasserts its position that effective state tax administration with respect to multistate business requires the services of a state-operated, state-controlled, and state-oriented agency to make available to states the benefits of a joint and cooperative effort to promote uniformity in tax administration practices, to share information among the states and to participate in a multiple audit program;

(4) reasserts its position that the only organization which qualifies as such an agency is the Multistate Tax Commission:

(5) reasserts its position that Congress should enact a bill consenting to the Multistate Tax Compact; and

(6) reasserts its position that in the event of federal intervention in the area of substantive standards regulating state taxation of interstate businesses, such legislation should also contain provisions establishing the Multistate Tax Commission as the administrative agency in the area of rule-making with respect to any such federal substantive provisions.

Critique of S. 1245 (1973 Mathias Bill)

(By Eugene F. Corrigan, Executive Director, Multistate Tax Commission)

1. Section 101, (1) and (2) applies the "business location" test to net income taxes, capital stock taxes, and gross receipts taxes, thereby substantially restricting the jurisdictional reach of the states. On the basis of estimates which various states have made in the past, the resultant tax losses would amount to hundreds of millions of dollars.

But the definition of "business location" has been so arranged that having an employee living within the state and installing and repairing property sold from outside the state would not subject the seller to the tax jurisdiction of the state. That installation could be a huge plant, a ski lift, a huge generator, or what have you. And remember that this restriction would apply to sales and use taxes, gross receipts taxes, and capital stock taxes as well as to corporate income taxes. The effect would be to increase greatly the losses which had been estimated under this bill's predecessors.

This effect is achieved by including, in Section 513 as a business location, the having of "one or more employees located in the State"; while at the same time providing in Section 515(c) (3) that an employee shall not be considered to be located in a State if his only business activities within such State on behalf of his employer are any of the following:

> (3) The installing or repairing of tangible personal property which is the subject of interstate sale by the employer, if such installing or repairing is incidental to the sale.

We doubt very much that the states should accept this extreme limitation on their jurisdictional reach. Incidentally, this is just one example of how complicated and far-reaching this bill is.

2. Section 101, (4) relieves the out-of-state seller of any obligation to collect use tax from a buyer from whom he "has obtained in writing the buyer's registration number . . .". The National Association of Tax Administrators has expressed concern that this section, when read in conjunction with Sections 304 and 503 might well relieve solicitation-only out-of-state sellers (i.e. those who have no activity in the state other than soliciting orders for sales of tangible personal property by means of salesmen, solicitors or representatives) "from being required to collect sales or use taxes on interstate sales to individual (non-business) buyers", as well as to business buyers. This could substantially destroy the effectiveness of the entire state use tax system in this country. The resultant tax losses could be horrendous.

3. Section 202(b)(1) adopts the "original cost" basis for valuing property for purposes of the property factor of the apportionment formula. Serious question exists as to whether original cost is the proper bases for all corporations. This is an especially troublesome concept when applied to natural resources corporations. Yet "original cost" may be the best approach.

4. Section 203 would subject the payroll factor to the limitations of the definition of "wages" in Section 3306(b) of the Internal Revenue Code of 1954 for purposes of the Federal Unemployment Tax Act. This means that no more than $4,200 of each employee's payroll earnings could be included in either the numerator or denominator of the payroll factor. The result could be substantial distortion in the payroll factor.

5. Section 204 adopts the straight destination concept for the sales factor. Although this seems fair at first glance, it must be viewed in connection with the jurisdictional restriction contained in Section 101.(1). The tandem result is that a large portion of a taxpayer's income can become "nowhere income" which would not be subject to tax in any state even though all sales were domestic in nature, i.e. have destinations in states in this country.

This can happen if a taxpayer in State A derives extensive business from State B by means of salesmen (who may, under Section 101.(1) accept orders

within State B without subjecting the taxpayer to State B's jurisdiction) and by means of all sorts of advertising but does not maintain a business location there. In many cases, such sales will produce for the seller tens of millions of dollars of revenue and millions of dollars of net income up to one third of which could be exempt "nowhere income" under the limitations of Section 101.(1) and 204 of S. 1245.

Of perhaps even more importance, the straight destination concept would eliminate the possibility of the states ever being able to achieve, through cooperation and information sharing, their potential total tax enforcement effectiveness with respect to individual corporate businesses. The need for improved tax administration among the states requires that the opportunity to utilize statistical analysis in this area continue to remain available to the states. Effective statistical analysis will require that the states be able to compel each seller to account for all of its sales for statistical purposes even though a state may elect not to include those sales in the numerator of its sales factor for tax purposes. It would be regrettable for this opportunity to be eliminated just as the capability of the states to use it is nearing fruition.

6. Section 205's zero denominator concept leaves the way open for taxpayer manipulation of income attribution in the case of specialized corporations. The "negligible denominator" concept of the "Revised Plan" is clearly preferable. Under Section 301 of the Revised Plan, a factor would be excluded from the apportionment formula applied to a particular corporate business if it has a "negligible denominator". A negligible denominator is then defined as "one which is less than 10% of one-third of the corporation's net income". Massachusetts has this concept in its statutes now and has found it a good one.

7. Section 207(a)(1) prohibits world-wide apportionment. This constitutes an attempt to exclude foreign income from state taxation of any type. Nearly all state tax administrators would agree that foreign income should not be subject to taxation by states. But the problem is: How do you determine which and how much income qualifies as foreign income? Great care must be taken to ensure that the states retain the right and power to see to it that expenses are properly allocated to any foreign income. Despite the provision in this section which purports to attribute deductions properly, this exemption of foreign income may open the door to the applying of full U.S. expenses to U.S. income for state tax purposes even though those same expenses may produce large foreign income later, perhaps after the years are closed for the states.

An example in the movie industry would be the production of a movie that costs, say, $10,000,000 with distribution in this country recouping the $10,000,000. It would appear that no money was made anywhere in the states, then. But the company then distributes the movie overseas, and receives another $8,000,000 which it terms "foreign income". This is the sort of thing that the states must be careful to protect themselves against. Some of that $8,000,000 certainly would be attributable to the states if the $10,000,000 worth of expenses were distributed properly among the entire $18,000,000 in revenue. The company has a net profit of $8,000,000. Some of that should go into the tax base of the various states on a formula basis.

8. Section 207(a)(1) would exclude from apportionable income all income from offshore mining, from offshore oil and natural gas wells and from exploitation of natural deposits in general in continental shelf areas.

Section 1333 of Title 43 of the U.S. Code already excludes from allocable income subject to state taxation income from these offshore sources; but there remains some question as to whether it also excludes such income from apportionment. Section 207(a)(1) seeks to make sure that such income is exempt from all state taxation.

This result is accomplished by defining, in Section 522, "Income From Sources Without the United States," as that term is used in Section 207(a)(1) of this bill. Section 522 defines the term "as defined by the Internal Revenue Code of 1954, as amended, *except that section 638 of such Code shall not apply.*" (underlining added) Section 638 of the Internal Revenue Code is the section which includes offshore income in the taxable base for federal income tax purposes.

A question arises as to whether or not there really is any "income" from such operations until the oil and gas is brought ashore. It would seem unlikely. But, even if no such "mythical income" exists, an irony is still to be found in the restrictions regarding offshore income in that the denominator of the factors of the apportionment formula would include property, payroll and sales attributable to those areas even though none of those amounts would appear in the numerators

of the factors of any states; and even though the resultant reduced percentage would then be applied against an income figure which did not include offshore income.

For example: Taxpayer has 40% of its payroll in State A, 40% in State B and 20% offshore; it has 40% of its property in State A, 40% of its property in State B and 20% offshore; it has 50% of its sales in State A and 50% in State B; its income from all operations is $10,000,000.

If the formula excludes all offshore figures, the result will be:

	Payroll (percent)	Property (percent)	Sales (percent)	Total
State A	50	50	50	50 percent times 10,000,000 equals $5,000,000.
State B	50	50	50	50 percent times 10,000,000 equals $5,000,000.
But if the offshore figures are included for denominator purposes:				
State A	40	40	50	43⅓ percent times 10,000,000 equals $4,333,333.
State B	40	40	50	43⅓ percent times 10,000,000 equals $4,333,333.

The difference between the $8,666,666 attributable to the two states and the $10,000,000 thus becomes so-called "nowhere income". This means that 13.33% of the $10,000,000, or $1,333,333 would, by virtue of such mathematical legerdemain, become exempt from all state corporate income taxation. This is a possible result against which the states need specific protection.

9. Section 207(a)(2) prohibits apportionment of dividends. This provision in conjunction with the first sentence in Section 208, constitutes an attempt to use Congress to impose upon the states the rule that non-affiliate dividends shall be allocable to the state of commercial domicile and that all other dividends shall be exempt from state taxation. Many states are no longer willing to accept, without questioning, the idea that dividends should be treated differently than other corporate income. They had long been led to accept the representation that this was the law. Proponents of Sections 207 and 208 obviously are concerned that the courts will rule that, in effect, the states have been misled over all of those years.

Many federal tax experts are of the opinion that dividends should not be subject to taxation at all for federal income purposes. They generally maintain that the taxation of dividends constitutes double taxation of the same income. They say that, since the income out of which the dividends were produced has already been subjected to federal income tax imposed upon the corporation issuing the dividends, the dividends should not be considered to be taxable income, for federal tax purposes, to the corporation receiving them. There may be substantial validity in this contention in view of the facts that (1) the same tax is applied in both instances and (2) the federal corporate income tax rate is very high compared to state corporate income tax rates.

The federal Internal Revenue Code imposes corporate income tax at a rate of 48% on all except the first $25,000 (which is subject to a rate of 22%) of taxable income of a corporation. Dividends which are paid by an affiliate to a parent in a multicorporate business or in a conglomerate situation are nearly always paid out of income which has already been subjected to tax at the 48% rate. To subject those dividends to another 48% tax in the hands of the receiving parent or affiliate would result in total tax of roughly 72% of the original income amount. Although many experts do not agree that the same income is being taxed, the 72% figure offends the sense of fair play in many others. The latter experts believe that this type of "duplicative" tax results justifies the 85% deduction which the federal Internal Revenue Code allows with respect to interaffiliate dividends; and many of them would have that deduction raised to 100%. Note, though, that under this interpretation they are talking about the applicability of the same federal tax to both the original income and the derivative dividends.

The situation is much different at the state level. Instead of one national tax, some 46 state-level taxes are involved. Therefore, in the vast majority of cases, the dividends which a corporation in one state receives will have been derived from income which has never been taxed by that same state. Indeed, that income may never have been taxed by any state or, if taxed, it may have been taxed at rates substantially lower than the rate in the state in which the receiving corporation is located.

Furthermore, even if that income has been taxed, it will have been taxed at a rate no higher than 12%, only two states exceeding even an 8% rate and the mean rate being roughly 6%. Since these state taxes are deductible for federal tax purposes, their effective rate after taking into account the 48% federal tax is only about half of their stated rate. Thus the effective rate of the median state tax rate level of 6% is only about 3%.

The rationale, then, which supports the substantial exemption of dividends for federal income tax purposes does not suffice as support for a similar exemption at the state level.

Furthermore, when combination is applied to a multicorporate business, the interaffiliate dividends are excluded. It is through combination that dividends should find their relief from taxation, not through an exemption federally imposed upon the states. (For the purposes of this discussion, "combination" involves the combining of the income of only those affiliated corporations which are involved in a unitary business.)

It should be noted that the dispute about dividends pertains mainly to 15% of the dividends since most states would apply their tax to only that portion of the federal dividend base, after the 85% deduction, attributable to their respective taxable bases. Nevertheless, the heat of the dispute indicates that a great deal of tax money is involved.

10. Section 207(a) also prohibits a State from making an offsetting adjustment of an otherwise allowable deduction where excluded income is concerned. This is a highly objectionable feature. Although few states have yet achieved the sophistication required to administer the offsetting adjustment concept, they can be expected to become increasingly aware of its importance. It should be obvious that a taxpayer should not be allowed to deduct expenses which are incurred for the purpose of producing exempt income. Yet this section would allow taxpayers to do that.

11. Section 207(a)(2) and the last sentence of Section 208 have the combined effect of exempting all interaffiliate dividends. As stated in 9 above, such an exemption should not be imposed upon the states; combination is the proper means of achieving equity.

12. Section 208 allocates so-called portfolio or non-interaffiliate dividends to the State of commercial domicile. While purporting to codify the current law on this subject, this section actually tries to force upon the states a concept which most of them have rejected. Nearly every member of the Multistate Tax Commission having a corporate income tax now apportions or intends to apportion all dividends, including portfolio dividends. So do several other states, including, as I understand it, Vermont, Massachusetts, and New Jersey. As a practical matter, so does New York. Other states are moving toward apportionment, and away from allocation, of portfolio dividends. Thus Section 208 is clearly trying to counter a state-inspired trend toward the uniform apportionment of portfolio dividends. Yet proponents of this bill claim to be promoting uniformity.

13. Senator Mathias has said that S. 1245 "involves a major simplification of the provision relating to consolidated returns and combined reporting." Actually, S. 1245 simply prohibits consolidation and combination for all practical purposes.

Although Section 209 is unclear on this point, it would apparently be as effective in precluding combination, in conjunction with Section 207, as it would be in prohibiting consolidation unless (1) the state can prove material distortion of income attribution or (2) the taxpayer chooses otherwise under an option permitted by the state.

At the very least, the states need the preservation of the option on their part to determine the apportionable income of a taxpayer by reference to the total income and apportionment factors of the taxpayer and all affiliates which are engaged in a unitary business with the taxpayer. This is the thrust of the regulations which have been adopted by the Multistate Tax Commission this year. The exemption of interaffiliate dividends from taxable income provided in Sections 207 and 208, and the raising of jurisdictional barriers in Section 101(1) make it more important than ever that combination be specifically preserved as an enforcement tool for the states. Whether or not the states want to use it at this time, their right to do so should be preserved.

One of the alleged business objections to combination is that it is not uniformly applied among the various states. Section 301(d) of the Ad Hoc Bill specifically dealt with this problem by giving both the taxpayer and the state the option to apportion income "by reference to the combined income and apportionment factors of all corporations of the affiliated group of which the corporation is a member." This provision would make true uniformity available. It would do so by consolidating all affiliated corporations meeting an 80% common ownership test.

This test, not the unitary business test, would be determinative then. The common ownership test has the advantage of mathematical determinability, whereas the unitary business test involves multiple judgments. Yet serious problems can arise in consolidating corporations which are not engaged in a unitary business, such as a bank, a manufacturer, an airline and an oil company.

Section 209(a) would accomplish the prohibition of consolidation by imposing upon the states the concept which is found in Section 482 of the Internal Revenue Code. High IRS officials will admit in private that the IRS has seldom been successful in carrying the burden imposed by that section; and this despite the fact that that section has been implemented by extensive and highly complicated regulations.

The reason is that the effect of the provisions is to impose upon the tax administrator the burden of establishing wrong-doing on the part of members of a multicorporate business or upon the members of a conglomerate. Interaffiliated corporations should be able to operate free from fear of such a taint. Rather, the only question should be: What is the nature and extent of the business entity being taxed?

Regardless of whether or not any particular state chooses to use combination as an auditing approach, the right of the states to use that approach should not be jeopardized by Congress.

Corporate conglomerate businesses have become common in America only during the past two decades. Their development and proliferation have presented the states with new, highly-complicated problems in determining that corporate income of a multicorporate business, or of a conglomerate, which should be available for tax purposes in each of the states from which income is derived. The combination technique has been developed as the most effective available response to those problems. To prohibit its use by the states would be equivalent to restricting them to the use of obsolete World War II methods in seeking to cope with space-age auditing problems.

Modern corporate organization techniques impose upon the states the need to utilize all available modern tax administration techniques. Congress should not deprive the states of the right to use such techniques.

14. Section 209(b) would appear to be superfluous in view of the limitations imposed by Section 209(a), which appears to prohibit combination. Assuming, however, that this bill still permits combination, one may well question the justification for:

(1) excluding from combination and consolidation, solely on the basis that it is incorporated outside the United States, an affiliate of the taxpayer. This constitutes nothing more nor less, it would appear, than an attempt to strip the states of any and all protection against foreign tax havens. This prohibition is especially objectionable when the affiliate is engaged in the same unitary business as the taxpayer.

(2) excluding from combination or consolidation an affiliate more than 50% of whose income is derived from sources without the United States. This entire exclusion appears to be especially objectionable where a unitary business is involved. This is a highly controversial area and deserves careful examination.

(3) excluding from combination or consolidation any and all affiliates which are "excluded corporations" as defined in Section 506. An especially significant type of corporation excluded from combination and consolidation by Section 506 is the so-called "captive financial" type of corporation. Such a corporation is apparently nothing more nor less than a part of the financial and credit structure of the parent corporation. The exclusion of this type of corporation from combination and consolidation would, in the opinion of many experts, permit serious maldistribution of a taxpayer's income for state tax purposes. Again, much controversy swirls around this subject.

15. *General comment on the interrelationship between jurisdiction, combination and dividends:* In sum, the higher jurisdictional barrier which would be created by this bill would not be nearly so objectionable absent the additional restrictions which would create even more nowhere income than exists today. Those objectionable restrictions include (1) the attribution of sales to destination only, regardless of jurisdiction; (2) the exemption of interaffiliate dividends even where combination is not applicable; (3) the virtual prohibition of all combination and consolidation; and (4) the exemption of foreign income. On the other hand, the attribution of sales to destination-only would be completely acceptable if jurisdiction were to follow sales; but exemption of interaffiliate dividends and foreign income should be accomplished only through combination or consolidation unless the states, not Congress, decide otherwise.

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16. The Willis bill allowed sales and use tax collection agreements among all states. Section 301(a)(2) of S. 1245 restricts those agreements to *reciprocal* agreements with "a *contiguous* State or political subdivision of a *contiguous* State" (italic added). One wonders why these limitations should be inserted. If the word "reciprocal" has any meaning at all, it can only impede the efficient execution and implementation of such agreements.

The word "contiguous" in this provision can truly provide weird results. Which, if any, west coast states are contiguous with Hawaii and Alaska? Are Alaska and Hawaii contiguous with each other? The eastern part of Kentucky is hundreds of miles from Chicago and Kansas City; yet merchants in these cities could be required to collect use tax from buyers in eastern Kentucky. The same situation could exist between sellers in San Francisco, California and buyers in Tucson, Arizona; between sellers in San Antonio, Texas and buyers in Santa Fe, New Mexico; between sellers in Norfolk, Virginia and buyers in Memphis, Tennessee; etc. In contrast, New Jersey is only a few miles from Connecticut; but no such agreement could be effected between those states. Nor could one between New York and Rhode Island, Delaware and Virginia, Pennsylvania and Virginia, South Carolina and Tennessee, Louisiana and Alabama, Ohio and New York, etc.

The Willis Committee recommendation was clearly the correct one. The words "reciprocal" and "contiguous" should be deleted from this bill.

17. Section 301(b) may be too limited. It does not protect the taxpayer who buys a vehicle in one state and pays the sales tax there; and then, upon registering it in another state, is required by the latter to pay a "registration fee" measured by the purchase price or by the "value" of the vehicle. Proper protection of such an unfortunate taxpayer, and he is usually an individual who cannot foresee such a situation, demands refining of this Section.

18. Section 303 encourages non-uniformity rather than uniformity. Currently, all states but one exempt from sales and use tax freight charges for transporting goods directly from the seller to the buyer, if those charges are separately stated in writing. Thus, if a Chicago buyer purchases an item from a seller in Pittsburgh, where the article was manufactured, for $100 plus $40 in shipping charges, the taxable amount is $100. But if the buyer purchases the same item from a Chicago seller for $140, the entire purchases price of $140 is taxable. Clearly, uniformity would require that the same $140 be taxable in both cases. That is the way that Michigan handles the situation, I am told, applying the tax to the buyer's cost, including all transportation. This ensures the same tax treatment regardless of how transportation is involved in the purchase. Too few of us have paid sufficient attention to this area. I submit that we should all take another look at it if uniformity is really our goal. This provision actually promotes non-uniformity.

19. Section 304 may open the door to relieving solicitation-only out-of-state sellers from collecting use tax from in-state non-retail business buyers. See Comment No. 2 above.

20. More ominous, Sections 304 and 305 relieve the seller from the requirement that his acceptance of an exemption certificate or registration number be "in good faith". The good faith requirement has long been a major means of protecting the states against a seller's accepting a resale certificate with respect to an item which he knows that the purchaser does not resell. Thus a jewelry firm cannot claim to have acted in good faith in accepting a resale certificate from a grocer; nor can a tire firm from a ready-to-wear store. Nor can a manufacturer of a huge printing press to a newspaper in a state where the retail sale or purchase of such a press is subject to the sales or use tax.

Many tax administrators have discounted the importance of the good faith requirement. But those of their auditors who have had experience with non-good faith situations would, if asked, advise them that the good faith requirement is often vitally important to effective enforcement of sales and use taxes.

21. Section 401 would grant to the U.S. Court of Claims "jurisdiction to review de novo any issues relating to a dispute arising under this Act or under Public Law 86–272, as amended." It would appear to be preferable for a specialized tax court to have such jurisdiction if, indeed, any court is to have it.

Proponents of Section 401 maintain that the judges of the Court of Claims would develop the requisite expertise. There are so many judges on the Court of Claims bench, however, that some might question whether their very numbers might not militate against the acquisition of expertise by all of them and might not ensure diversity rather than uniformity in decisions. The paucity of litigation in this field, both past and prospective, might well militate against the acquisition of expertise through consideration of litigated issues on the part of more than a very limited number of judges.

Perhaps the purpose of this section could be properly accomplished if the jurisdiction were granted to the Court of Claims under certain definitive requirements. Thus, perhaps a tax division of that court should be created. Perhaps it should consist of a limited number of judges, say 3 or 5. Perhaps they should hear all cases en banc. The work load could then determine whether expansion of the taxation division would be advisable.

At any rate the idea of one national court to resolve disputes in the field of State taxation of multistate business can achieve its purposes only if the participating judges are highly sophisticated in that field.

On the other hand, one may well question whether the "de novo" approach is the proper approach at all. One State's legal expert has suggested that it would have the effect of displacing State courts with respect to two-thirds of his State's corporate revenue. He notes that each State would be involved in much more litigation because it would be bound by any Court of Claims decision in a dispute between a taxpayer and any other State if his State were given notice of the proceedings.

CONCLUSION

This is a highly complicated bill containing many references over to the Internal Revenue Code as well as many internal references from one section to another. All of those references have significant effect on the impact of this bill upon State taxation. I have tried to highlight some of the problem areas. There may be others. *The bill merits, therefore, in-depth study by every State tax administrator.*

Developing Concepts in Attribution of Multistate Corporate Income

(Presented by Eugene F. Corrigan, Executive Director, Multistate Tax Commission, NTA-TIA Meeting, Toronto, Canada, September 12, 1973)

Any nation, state or province seeking to tax the net income of a corporate business is faced with the fact that many corporate businesses derive their net income from more than one political jurisdiction. Multistate or multiprovince corporations will be earning income in two or more states or two or more provinces; and a multinational corporation will be earning its income in two or more nations as well as in political instrumentalities in each of those nations. With each political entity seeking to tax net income of the corporate business, there naturally arises the problem of arriving at a fair means of determining how much of the total income should be available for taxation by each political entity.

It is not my intention to discuss here the ramifications of that problem among nations. At the international level the problem is complicated by matters of foreign policy, relative values of currency, and national policy with respect to the social and economic needs of the nation. It *is* my intention to discuss here the ramifications of this problem within the 51 state-level taxing jurisdictions in the United States. I hope that these comments will be germane to problems which may be experienced in Canada as well.

Historically the Eastern seaboard, particularly New York City, has been the situs of the corporate movement in America. Always a leader in the commercial activity of the United States from the early settlement days forward, New York naturally led from the start in the development of all matters pertaining to economic and financial activities and, accordingly, in the development of corporations. That development required the concomitant devising of a tax system appropriate for corporations. While that system had to produce revenue for the taxing body, it also had to take into account the value of the corporate taxpayers to the locale. Therefore, it was important that the tax system not drive away corporate businesses to other parts of the nation, thereby depriving the taxing jurisdiction of the economic benefits as well as the tax benefits which could be derived from the corporations.

Corporate net income taxes are a relatively recent development in America. Indeed, they are in only about their sixth decade now; and many of our states have less than 30 years of experience with them. It should not be surprising, therefore, that many states are now looking closely at the system of corporate net income taxation to determine whether improvement can be made in it.

A review of that system reveals that nearly every state uses a formula in determining what income of a corporate business is to be attributable to that state for tax purposes. That formula is based upon various types of corporate activity. With respect especially to manufacturing and mercantile corporations, approxi-

mately 60% of the 46 state-level taxing jurisdictions having a corporate net income tax utilize a three-factor formula consisting of a sales factor, a payroll factor and a property factor, with each factor being weighed equally. In the remaining 40%, variations of this formula are used. Thus one state will use only a property and payroll factor; another state will use only a sales factor; some states will weigh the three-factor formula somewhat differently; and some states are substituting a different factor, such as cost of goods sold factor for sales. Nevertheless, it is clear that a basic philosophy of corporate net income taxation has arisen in the United States which relies heavily upon a formula for the purpose of attributing income to each state. The reason for the use of the formula is, of course, that no one has ever been able to say with certainty that any particular aspect of corporate activity is solely responsible for the production of income or is more important than any other aspect. The absence of any single aspect, whether it be sales, property or payroll might well preclude the production of any income whatsoever for a business. The absence of other considerations might well have the same effect.

On the face of it, then, the application of the formula to all of a corporate business's income should result in a fairly uncomplicated determination of the amount of income which should be available for taxation in each of the states in which that business is operated. This is a position which increasing numbers of states in the United States are taking. There is stiff opposition to this position, however, from a large portion of the business community. The reason is that this position necessarily incorporates within it two concepts which offend the opposition: (1) full apportionment, and (2) combination or consolidation.

Full apportionment involves applying the formula to all income regardless of source or nature. Opponents maintain that some income should be treated differently. They refer specifically to dividend income. They would have that income be exempt, if at all possible; alternatively, they would have it attributed to the commercial domicile of the receiving corporation. The latter provision effectively exempts dividends in all states except the state of commercial domicile from which the corporate business is operated. New York, Pennsylvania, Illinois, Massachusetts and California are the corporate domiciles of a preponderance of U.S. corporations. In all but one of those states, the corporations have successfully maintained either that the dividends should be exempted entirely by the commercial domicile state, as is the case in Pennsylvania and Massachusetts, or that only a portion of the dividends should be taxed by the commercial domicile state and that that portion should be determined on a formulary basis, as is the case in New York and Illinois. The result is that only a portion, if any, of the dividends are subjected to tax anywhere. The prime exception to this position among commercial domicile states is California: but combination results in exempting most of the dividends in California since interaffiliate transactions and dividends are eliminated in the combination process.

While the attribution of so-called intangible income, including not only dividends but royalty and interest income as well, to the state of commercial domicile was originally insisted upon by the commercial domicile states for the purpose of increasing their corporate income tax revenue base, the corporations were soon able to obtain the special treatment accorded to corporate dividends on the basis that to do otherwise would encourage the corporations to move their domiciles to other states more friendly to the idea of exempting or taxing only a portion of the dividends. In these states, then, dividends are often treated differently than other intangible income. It is difficult to find a logical reason, other than a pragmatic or political one, for treating dividends differently from royalty and interest income. Yet today many leaders of the c rporate tax community will readily agree that states more friendly to the idea of exempting or taxing only a portion of the royalty and interest income should be included in the income base subject to formulary apportionment, while at the same time maintaining that dividends should be treated differently. Their position may be based upon the fact that dividend income generally far exceeds other intangible income in amount.

Corporation representatives maintain that dividends should really be exempt anyway on the basis that the income from which they are paid is taxed. This makes some sense at the federal level in the United States, since the federal tax at a rate of 48% often has applied to the income from which the dividends are paid; and it does somehow offend one's sensibilities to see that same tax applied to virtually that same income when received as dividends by a parent or affiliated corporation. The situation is much different at the state level, however. Instead of one national tax, some forty-six state-level taxes are involved. Therefore, in the

vast majority of cases the dividends which a corporation in one state receives will have been derived from income which has never been taxed by that same state or which, if taxed, may have been taxed at rates substantially lower than the rate in the state in which the receiving corporation is located. There would appear to be nothing naturally offensive, then, about allowing the various states to tax a portion of a corporation's dividend income, along with all of its other income, on the basis of a formulary determination.

Combination or consolidation is the other philosophy which is incorporated into the idea of full apportionment of all of the income of a corporate business or of a multi-corporate operation.

The key words in the field of combination are "corporate business." What makes up a corporate business where that business is being done by several affiliated corporations? The concept of combination is based upon the assumption that the business should be treated the same for tax purposes whether it is being conducted by one corporation, possibly through several divisions of that corporation, or through many corporations. This unitary business concept also envisages the possibility that a single corporation may be engaged in two or more businesses or that only portions of several corporations are engaged in the same unitary business. The concept of combination is complicated further by the jurisdictional consideration that a state should apply its tax to only those corporations which are actually doing business within the state, even though the determination of the amount of income to be taxed is made by applying the formula to the total income of the multicorporate business. Obviously this unitary business and combination approach involves the exercise of judgment on the part of the taxing authorities of each state taking that approach. Unfortunately, there is no guarantee that each state will exercise that judgment in the same way. The potential or variety in the results is obvious. Thus, if every state were to pursue this approach independently, then more than 100% of the income of one corporate business might be subject to taxation among the various states while substantially less than 100% of another corporate business'i ncome might be made available for taxation among those same states. Certainly some more definitive and widely used guidelines are desirable.

Equally as clear, however, is the fact that those guidelines are not to be found in prohibition of combination. Rather those guidelines are to be found in the development of a uniform approach to the application of the concept.

One such approach to bringing combination nearer to an objective standard is to be found in the concept of consolidation. As defined for the purposes of this presentation, consolidation contemplates combining the reports not only of all corporations which are engaged in the same business but of all corporations which are "affiliated." Two corporations are affiliated if more than 80% of the stock of one is owned by the other or if more than 80% of the stock of both is owned by the same third entity. This concept has the advantage of mathematical determinability. It has the defect, however, that, while the three-factor formula to which I have referred above may be proper for the mercantile and manufacturing corporations to which it is generally applied, it may not be proper, and I believe that it is not proper, for application to all other corporations of whatever types. Thus that same formula may not be proper for application to financial organizations, to construction contractors, to service corporations in general, to transportation corporations and public utilities in general, or to communications corporations. Since consolidation may often involve affiliated corporations from several of these types of businesses, it runs into the questionability of seeking to apply one formula to an entire group of affiliated corporations which may be involved in many different businesses.

The unitary business concept, then, appears to be the preferable concept if it can be subjected to objective standards and if those standards can be applied uniformly across the country in order to ensure fairness to both state government and corporate taxpayers alike.

I submit that the only manner in which this can be accomplished is through the auspices of an agency which would be involved in the making of such determinations and in the exercising of the necessary judgments on the part of the various states with respect to the same corporate businesses. On occasion, these judgments may even involve varying slightly from the standard formula because of special circumstances pertaining to a particular corporate business. Regardless of that consideration, however, the result would be that a taxpayer could know that that income which was attributed to one state as a result of the determination would not also be attributed to some other state and therefore be the subject of

potential duplicative taxation. By the same token, each state would have the comforting knowledge not only that it was treating the corporate business fairly but that the state also was being treated fairly by the corporate business for tax purposes and that the state had available to it for taxation purposes its proper share of that corporate business' income.

While this idea is receiving increased support across the country from among corporate and state tax administrators alike, there remain some philosophical and technical objections to its implementation. I have already referred to objections to the inclusion of dividends in any tax base and more specifically to their inclusion in any apportionable tax base of any but the state of commercial domicile of the receiving corporation. Many state tax administrators object to the idea of any centralized determination by anyone since it smacks of a federal take-over, something of which all of the states have seen too much during the last twenty-five years in the United States.

If we can accept the idea that the goal of uniformity and fairness has merit, then we should be able to move forward together toward that goal somehow. I think that there is evidence of substantial progress along that line. The course toward that goal might be acceptable to many people were it one which:

1. Would impose no limitations upon the states insofar as apportionable tax base is concerned, but would guarantee that no state would have available to it for taxation any of the same income that was available to another state for taxation; recognizing, however, that any state could exempt any portion of that income which it had available to it for taxation;
2. Would treat a business in the same way for tax purposes regardless of whether that business was conducted through one corporation or through many corporations, i.e., would apply the unitary business and combination concept;
3. Would provide guidelines on the basis of which to apply the combination concept; and
4. Would provide for the application of the combination concept on a uniform basis among all of the states.

If this approach can be accepted, then the only remaining question would appear to be How? By allowing each state to make its own determinations? By setting up a federal agency to make the determinations for the states? Or by providing for participation in the determination procedure by an organization of state tax administrators working within guidelines and objective standards to be established by them to meet the four purposes set forth above?

While there may be other alternatives, these appear to be the three prime possibilities. Of the three, I believe that only the third one contains the seeds of accommodation to the needs and desires of both the states and the corporate business community.

Only one organization in America currently exists which contains the potential to serve in this suggested capacity. That is the Multistate Tax Commission. It is the only entity which exists as a result of legislative fiat from among many states, the number of which is currently twenty-one, through its charter which is known as the Multistate Tax Compact. Through the provisions of that Compact, which is uniform legislation enacted by those member states, it is the only organization for which active participation in tax administration matters is a possibility. As a matter of practice, it already participates in some of the tax administration activities of some of its member states. Included among its activities is a pilot joint audit program under which an audit of a corporate business is performed on behalf of several participating states at the same time. While this has drawn the fire of a large segment of the multicorporate business community, that opposition has mostly been generated by disputes concerning matters to which I have already referred; namely, combination, allocation and apportionment, and exemption of dividends. It does not detract from the immense potential of the organization to accomplish the purposes set forth above. Operated by the tax administrators of its member states, it provides the best potential for a balancing of the interests of all of the states within the suggested guidelines with the interests of the business community.

Making sense out of corporate income attribution problems is a challenge to every government seeking to tax the net income of a multinational or multistate corporation. I think that that challenge can be met in America only if it is sought through the effective use of the Multistate Tax Commission, or of an organization substantially like it. Even federally enacted guidelines or restrictions cannot solve the problems. They can only move the areas in which the problems are to be confronted; or they can change the nature of the problems slightly. The need for the problem-solving and uniformity-encouraging organization will remain.

It is my contention that the Multistate Tax Commission can respond to that need successfully. Neither it nor the charter upon which it is based are perfect, any more than is any human being or any organization of human beings. Nevertheless, it has the potential to serve *most* of the indicated needs. Perhaps more important, it has the flexibility and the potential to change to meet the rest of those needs and to meet changing needs. I believe that any nation which has a federal form of government will need such an organization if it is ever to cope successfully with the problems of attributing among its federated states for net income tax purposes the income of multinational and multistate corporate businesses.

The CHAIRMAN. Next we will call the Honorable Mario A. Procaccino, commissioner of taxation and finance of the New York State Department of Taxation and Finance.

STATEMENT OF HON. MARIO A. PROCACCINO, COMMISSIONER OF TAXATION AND FINANCE OF THE NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE

Mr. PROCACCINO. We appreciate the opportunity to be here.

For the record, I am Mario A. Procaccino, commissioner of taxation and finance for New York State.

I wish, first, to commend the Subcommittee on State Taxation of Interstate Commerce for its initiative in this very important matter and I hope and pray that the momentum gained by the subcommittee will not be lost. There are presently, at least, four important bills before the 93d Congress on the subject of taxation of interstate business by the States.

Studies of previous legislation on this subject by Governor Rockefeller's staff and by principal business groups in New York, dating back to 1966, concluded that interstate business should have protection from unreasonable State and local tax requirements but that changes should not impair the capacity of States to design their own State structures or administration.

New York believes that one of the current bills, with some changes, provides such a balanced solution. We suggest the bill sponsored by Representative Rodino, H.R. 977, as the starting point for consideration because this bill deals with problems which are potentially solvable in a noncontroversial manner. The bill deals with those problems which were extant in the late 1960's and avoids the pitfalls of more recent suggested changes in State tax laws involving combination or consolidation of corporate returns and State taxation of foreign source income.

While a number of significant changes are necessary in the Rodino bill, we believe they are changes which are generally acceptable and would have broad support. They are, at least, the minimal changes New York would need to support the bill.

With the suggested New York amendments, the bill would still represent limited legislation, both in terms of the scope of issues covered and the extent of changes required in State and business practices. However, it would do four things: One, it would provide the most extensive Federal law ever passed by Congress in the area of State taxation of interstate business; two, set ceilings for corporation taxing jurisdiction and apportionment; three, provide a similar ceiling for purposes of State sales and use tax jurisdiction; and, four, provide for continuing congressional evaluation of State progress in resolving problems arising from State taxation of interstate commerce.

Passage of such a bill would, in our opinion, be a most significant achievement.

Mr. Chairman, I will now discuss in general terms the changes that we believe should be made in the Rodino bill. The recommended changes, of course, the committee knows by this time are set out in detail in our written testimony which has been submitted. I shall try to be as brief as possible so that we can move along and the changes are set forth in detail in the statement. I am sure the staff and yourself, when you look at it will get the full impact of what we are saying.

In the area of corporate net income and capital stock taxes, any formula for apportionment of income should include a receipts factor and that factor should be based on the destination of the goods. A receipts factor in an apportionment formula eases the burden of taxation which may be imposed by the State where the manufacturing takes place.

The apportionment formula should also be modified to insure that worldwide receipts, property and payroll, are reflected in the formula.

The bill should be applicable to all corporations rather than just to those below $1 million of average annual income. The double standard which the Rodino bill provides is impractical and probably will lead toward litigation.

Language should also be added to the jurisdiction provisions to cover certain situations such as providing for an employee location in connection with sporting, athletic, or entertainment events.

Now, in the area of sales and use taxation, I again wish to respectfully refer the committee to our detailed written statement, which has been submitted, and more particularly to pages 6 through 9. In this connection, you will note that we recommend that the sales and the use tax provisions of Senate bill 282, sponsored by Senators Cranston and Tunney, should be substituted in the Rodino bill. The provisions of Senate bill 282 are acceptable because the jurisdictional standards of the bill are generally appropriate and the provisions restricting the powers of the States to require collection of sales and use taxes are not unduly restrictive. And we do not object to inclusion of a provision restricting classification of interstate sales by geographical areas of the States since S. 282 delays the effective date of the provision for 5 years and a period of 5 years is needed to permit States to adjust their local revenue systems.

With respect to personal income tax problems, we believe such issues are not relevant to business tax legislation. If Congress finds it necessary to mandate changes in that area, the States should be given an ample separate opportunity to inform Congress of its far-reaching effects.

Some other areas of corporate taxation, with which neither H.R. 977 nor New York's suggested revisions deal, are also matters before the Congress. H.R. 977 has no specific provisions restricting or expanding the use of combined or consolidated returns. We submit that Congress should take no action in this area, at this time, for the reasons again set forth in our written testimony.

Now H.R. 977 has no provision for an interstate tax compact, but Senate bill 2092 gives congressional consent to a State compact and grants rulemaking powers to a multistate compact commission. New York has endorsed the compact idea as long as it is completely voluntary. The provisions of S. 2092 are not completely voluntary and

apply to every State regardless of membership. Under the proposal, a multistate tax commission would become an administrative agency to implement the compact. New York is opposed to any administrative setup under which a compact commission or any other agency would be given such power.

For the sake of brevity, Mr. Chairman, I again refer to our written testimony which sets forth our views on the subject of dividends.

By way of conclusion, Mr. Chairman, may we stress the following as guiding principles for Federal legislation in the area of State taxation of interstate business: Federal jurisdictional and apportionment limitations which generally codify existing court decisions and set up reasonable rules to serve as a ceiling will effectively insure a satisfactory level of uniformity of State and local law and practice. Such legislation will not impair the ability of any state to design or administer its own tax system. Before H.R. 977 could be considered as acceptable to New York, we believe the changes mentioned would have to be made. We also recommend that no Federal action be taken at this time regarding combined or consolidated returns that consent legislation, if any, be on a strictly voluntary basis, and that Federal apportionment limitations may not limit States to taxation of dividends at a firm's place of commercial domicile.

Now, I want to thank the chairman and the committee, of course, for the opportunity to be here and I also wish to point out that we are at your disposal and the entire staff of my department will be at your disposal for anything at all you need or any assistance we may give you in trying to reach a conclusion, and an answer to something that has really been perplexing to all of us today.

I thank you very much.

The CHAIRMAN. What do you think of Mr. Traigle's suggestion—I think he called it the Louisiana tax plan; he is the tax collector for Louisiana—have you had a chance to review his proposal?

Mr. PROCACCINO. Generally, we would be in favor. We would like a little more time to really study and look into it.

The CHAIRMAN. He will testify as the next witness so, after he has testified, you might let us know what you think about it.

I wish we had more members present but, unfortunately, we have a major bill, the pension reform bill, which is on the floor being debated right now that explains why Senator Nelson, who is the chairman of that subcommittee is not here and also why Mr. Bentsen is not here.

Mr. PROCACCINO. I am sure they will look at the written testimony there.

The CHAIRMAN. They will certainly study it and we appreciate your testimony.

[The statement of Mr. Procaccino follows:]

SUMMARY

1. New York State agreed with its principal industry groups in 1966 that some Federal legislation, limited to a "ceiling" for jurisdiction and apportionment, was necessary.
2. New York State supports the Rodino bill (H.R. 977) if certain changes are made, including:

CORPORATE NET INCOME AND CAPITAL STOCK TAXES

(a) Addition of a destination based receipts factor to the apportionment formula modeled after the receipts factor provision of S. 2092, Section 304.

(b) Elimination of the $1 million standard in determining included or excluded corporations (Section 606(a)(3) and (c) of H.R. 977).

(c) Adding language to the jurisdiction provisions to cover certain special situations.

SALES AND USE TAXES

(a) Substitution of the sales and use tax provisions in S. 282 (Cranston-Tunney) for those in the Rodino bill. The sales and use tax provisions of S. 282 are acceptable because the jurisdictional standards of the bill are generally appropriate and the provisions restricting the powers of the states to require collection of sales and use taxes are not unduly restrictive. We do not oppose the provision in S. 282 restricting classification of interstate sales by geographical areas of the state since the effective date of the provision is delayed for five years. A delay of five years is needed to permit states to adjust their local revenue systems.

(b) Where states change their laws so that classification of interstate sales by geographical areas is no longer required, Congress should provide for expansion of such states jurisdiction over firms selling by mail order.

(c) As an alternative, delete the sales and use tax provisions from H.R. 977 and deal with sales and use tax problems in a separate bill.

PERSONAL INCOME TAXES

Elimination of the personal income tax provisions (Title V of H.R. 977).

STATEMENT

Mr. Chairman and Members of the Subcommittee on State Taxation of Interstate Commerce:

I am Mario A. Procaccino, Commissioner of Taxation and Finance for New York State.

I wish first to commend the Subcommittee on State Taxation of Interstate Commerce for their initiative in this important matter.

I am sure the factual and analytical material developed here will be most valuable as we continue our efforts to solve the perplexing problems surrounding the taxation of multi-state businesses. I hope that the momentum gained by the Subcommittee will not be lost.

All of us are deeply concerned with the business climate of this Nation and of each of its states, and we should be constantly alert to assure that our tax systems benefit this climate.

But we must also be deeply concerned with preserving the highest degree of State and local autonomy consistent with the general welfare. Alert as we may be to conditions that affect our economic well-being, we should be as alert to proposals which threaten the principles of Federalism upon which our structure of government is based.

There are presently at least four important bills before the 93rd Congress on the subject of taxation of interstate business by the states, including H.R. 977 (Rodino), S. 282 (Cranston-Tunney), S. 1245 (Mathias-Ribicoff), and S. 2092 (Magnuson). Among the subjects covered are: taxation of corporate income, capital stock, sales and use, gross receipts and personal income, corporate income apportionment and consolidation or combination, jurisdiction to tax and creation of a new state Compact.

Studies of previous legislation on these subjects by Governor Rockefeller's staff and by principal business groups in New York, dating back to 1966, concluded that interstate business should have protection from unreasonable state and local tax requirements but that changes should not impair the capacity of states to design their own tax structures or their administration. New York believes that one of the current bills, with some changes, provides such a balanced solution. We suggest the bill sponsored by Representative Rodino, H.R. 977, as the starting point for consideration because only a bill with provisions identical to this bill has passed either House of Congress and this bill deals with those problems which are potentially soluble in a noncontroversial manner. The bill deals with those problems which were extant in the late 1960's and avoids the pitfalls of more recent suggested changes in state tax laws involving combination or consolidation of corporation returns and state taxation of foreign source income.

While a number of significant changes are necessary in the Rodino bill, we believe they are changes which are generally acceptable and would have broad support. They are, at least, the minimal changes New York would need to support the bill.

With the suggested New York amendments, the bill would still represent limited Federal legislation both in terms of the scope of issues covered, and the extent of change required in state and business practices. However, it would:

1. Provide the most extensive Federal law ever passed by Congress in the area of state taxation of interstate business;
2. Set ceilings for corporation taxing jurisdiction and apportionment, sufficient to generate greater uniformity in state laws and provide limits on state taxing powers;
3. Provide a similar "ceiling" for purposes of state sales and use tax jurisdiction; and
4. Provide for continuing Congressional evaluation of state progress in resolving problems arising from state taxation of interstate commerce.

Passage of such a bill would be a most significant achievement.

The Rodino bill would be acceptable to New York with the following changes:

CORPORATE NET INCOME AND CAPITAL STOCK TAXES

1. A receipts factor based on destination is necessary in Title II of the bill. The addition of this factor is recommended because it minimizes the discouraging effect of state taxes on the location or expansion of business within a state. Under a formula with a receipts factor, the interstate sales activity of a business eases the burden of taxation upon its income in the state where manufacturing takes place. With only one or two exceptions, all of the states imposing taxes based on net income now use a sales or receipts factor in their division of income formulas. Use of a destination based receipts factor would avoid complete disruption of practices which practically all states have developed over a long period of time.

New York would be happy to work with Congress in drafting an appropriate sales factor definition. One acceptable sales factor provision would be a modification of Section 304 of S. 2092. That provision calls for a sales factor based generally on sales destination, allows attribution to the origin state of sales into states where no jurisdiction to tax exists as well as sales to the United States Government which have a foreign destination, assumes inclusion of worldwide receipts, and otherwise provides a weighting for the types of income being apportioned. A proper modification to the suggested sales factor provision is to provide a weight reflective of income from rental of real property. New York has for years included rental income in the sales factor (whether from rental of real or personal property). The suggested amendment would be as follows:

> *§ 304(c) (3)*
>
> "Sales which consist of receipts from the rental of *real or* tangible personal property. . . ."

A second modification of the S. 2092 sales factor, to insure that worldwide receipts are reflected in the sales factor as well as the property and payroll factors, is to redefine "state" for purposes of Title II to include foreign countries. The suggested amendment would be as follows:

> *§ 615*
>
> "The term 'State' means the several states of the United States and the District of Columbia, *provided, however, that the term shall also mean for purposes of Title II, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.*"

Alternatively, the sales factor provision of the recently developed NATA Plan, not yet formally introduced, would be acceptable to New York. While that provision does not provide an attribution of sales back to the origin state when destined in states where not taxable, it does provide for elimination from the sales factor denominator of such sales which provides a similar result, that is, such sales become a part of the apportionment weighting to all states where taxable rather than just to the origin state. Also, the NATA Plan provides the proper provision for weighting real property rentals although the definitional amendment of "state" in Section 615 of H.R. 977 would still be needed.

2. Another necessary change in H.R. 977 is the elimination of the double standard for firms above and below one million dollars of average annual income. Although this distinction probably would not be utilized in New York even if permitted by Federal legislation, it would create confusion and inequities for New York firms in other states. A corporation might fall in one class in one year and in the other class the next year. With most state constitutions requiring uniformity of treatment, this arbitrary distinction also represents an undesirable innovation which would probably result in much litigation.

3. Several amendments should be made to the corporate jurisdictional and apportionment rules of the Rodino bill in order that state taxing jurisdiction not be unduly limited and that the apportionment factors reflect income which is in the taxable base. Specific amendments on these points are appended to this statement as Appendix A which in brief deal with:

A. Providing for a business location in case of tangible personal property regularly leased to others for use in a state;

B. Providing for an employee location in connection with sporting, athletic, or entertainment events;

C. Redefinition of employee location in connection with services performed in installing or repairing property incidental to an interstate sale.

SALES AND USE TAXES

1. The sales and use tax provisions of S. 282 should be used in lieu of the H.R. 977 provisions. The sales and use tax provisions of S. 282 are more acceptable than those of H.R. 977 for a number of reasons, including generally more appropriate jurisdictional rules and deletion of certain proposed unreasonable restrictions on the states' power to require collection of sales and use taxes.

The jurisdictional limits in H.R. 977 are more restrictive than the current common law as expressed in *Scripto v. Carson*, 362 U.S. 207. New York supports codification of the *Scripto* case as set forth in S. 282. Also, S. 282 does not restrict the jurisdictional rule with respect to regular delivery of goods to household delivery, but is properly more broadly phrased and the definition of business location in S. 282 includes vendors regularly leasing out tangible personal property.

In addition, by adopting the sales and use tax provisions of S. 282, Section 304(1) of H.R. 977 would be eliminated. That provision would excuse sellers from collecting or paying a sales or use tax on interstate sales as long as the purchaser supplies the seller with a registration number. Passage of such a provision would seriously weaken the states' ability to enforce their compensating use taxes. Current collections would be diminished since collection from many buyers would have to await audit. It would also impose an unreasonable audit burden on the states requiring them to audit all business buyers who purchase items which are sent across state lines as opposed to the audit of a much smaller group of sellers.

S. 282 in its Section 205 and H.R. 977 in its Section 305 contain provisions which restrict the classification of interstate sales according to geographical areas of the state. Enactment of such a restriction would immediately preclude the continuance of local sales and use taxes now imposed in New York State. This would be true because local businesses could not tolerate a 3% disadvantage in competing with out-of-state firms. New York currently allows local sales and use taxes at a maximum 3% rate, which produce over one billion dollars annually for local governments in New York.

While business in general would undoubtedly be glad to avoid the necessity of collecting and segregating local sales taxes, the importance of local nonproperty taxes in diminishing taxes on property must also be recognized.

In view of this, the states must be given time to adjust their local tax systems. While all bills currently before Congress contain provisions similar to Section 305 to Section 305 of H.R. 977, both S. 282 and S. 1245 realistically postpone the effective date for five years. S. 2092 postpones this provision for three years. Lack of a delayed effective date, preferably for five years, would create a chaotic situation.

The other sales and use tax provisions of S. 282 are nearly unanimously acceptable to the states and deal with the same problems as does the Rodino bill, except, for providing, in addition, for contiguous state sales and use tax collection agreements.

2. An additional use tax jurisdictional area requires comment. If the restrictions in Section 205 of S. 282 on classifications of interstate sales according to geographical areas of the State were passed, such a provision, in practical effect, would bring about uniformity as between the rate and base of a local sales and use tax and the state rate and base. Therefore, the burdens on interstate commerce which the United States Supreme Court pointed to in *National Bellas Hess v. Department of Revenue*, 386 U.S. 753, as a basis for its decision, would be removed by virtue of this legislation. In view of the uniformity in rate and base, Congress should provide for an expansion of the jurisdiction of states to require mail order firms to collect compensating use taxes on mail order sales. The burden on interstate commerce stemming from lack of State and local uniformity within

a State would have been removed. The effective date for the expansion in jurisdiction should be tied to removal by the state of those burdens on interstate commerce.

PERSONAL INCOME TAXES

Title V of H.R. 977 should be removed. This Title was added by a floor amendment when the bill passed the House in 1968 and imposes restrictions on the states regarding personal income taxation. This issue is not relevant to business tax legislation and no hearings have ever been held on the personal income tax proposals in either house.

If Congress finds it necessary to mandate some change in present state income tax requirements affecting persons who necessarily live away from their home state, it is felt that the states should be given an opportunity to inform Congress of its far-reaching effects.

The domicile test which the House amendment would establish as the sole criterion of taxation of income earned in another state would conflict with the present New York rules under which nondomiciliaries, who maintain homes in New York and who spend more than 183 days here, are taxed as New York residents. This might be interpreted as preventing our taxing the New York rental income and/or various types of New York business income received by nondomiciliaries.

Superimposing a special set of domicile rules on our existing statutory resident and nonresident definitions and procedures could also require drastic changes in New York statute which could have significant revenue effects. For example, it is probable that the proposed legislation would not permit us to tax income from intangibles owned by nondomiciliaries who are presently taxable as New York residents under the permanent-place-of-abode/183-day test of our statute.

The most basic problem with the provision may be the complete upheaval of fifty years of administrative experience in this complex area. We believe it is worth noting that the uniform definition of "residence" recommended by the Advisory Commission On Intergovernmental Relations is, with only one minor difference, derived verbatim from our statutory provision. (See Commission Report A-27 [dated October, 1965] entitled "Federal-State Coordination of Personal Income Taxes"—page 30).

Should Title V of H.R. 977 be adopted an extended period of litigation and uncertainty would inevitably occur. Hopefully, the objectives of Congress could be achieved without sacrificing the existing precedents and stability which the states and courts have gradually developed over a fifty-year period.

If the various changes in H.R. 977 described above are made, New York believes that most small and large interstate businesses will have gained significant protection from any state tax compliance overburdens. With the recommended revisions H.R. 977 would not result in burdensome or costly effects on the New York tax system.

An alternative acceptable approach to handling sales and use tax problems would be to consider two bills, one dealing only with corporate tax problems, the other only with sales and use tax problems.

Some other areas of corporate taxation with which neither H.R. 977 nor New York's suggested revisions deal are also matters before the Congress. We will comment on these matters with a view to indicating that Congressional action is not appropriate at this time.

COMBINATION OR CONSOLIDATION

H.R. 977 has no specific provision restricting or expanding the use of combined or consolidated returns. This is completely satisfactory to New York. We submit that Congress should take no action in this area at this time.

The problem of combined or consolidated returns, while the subject of some study by the original Willis Subcommittee on State Taxation of Interstate Business remains an area of great controversy.

In addition, it involves some of New York's largest taxpayers and any provisions so far suggested to Congress would appear to result in severe shifting of tax payments, perhaps from one state to another. It is not certain the extent to which any state would lose or gain significant revenues from any Federal requirement in this area, but there appears to be no way to anticipate the effects of any change except through more intensive Federal study. Only Congress has the resources to conduct a proper study, which would seem particularly apropos if the proposal under

consideration were the same as the Federal rules regarding consolidation. An explanation of New York's law in practice regarding combined or consolidated returns provides an example of potential impact of any change in this area.

New York State receives some 1000 combined returns each year. These returns represent 15 to 20% of the revenues received from the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law, the franchise tax applicable largely to general business corporations. In the fiscal year ending March, 1974, New York expects to receive some three-quarters of a billion dollars in revenue from its general franchise tax. Therefore, the area of consolidation and combination is of vital concern to New York because it involves some 150 million dollars in revenue.

New York does not provide for a consolidated return, but rather for a combined return. The practical distinction, for New York purposes, is that intercorporate profits are not eliminated from the combined return resulting only in a more current receipt of tax revenues by the state.

In the discretion of the Tax Commission, where a taxpayer owns or controls either directly or indirectly substantially all the capital stock of one or more corporations, or a taxpayer's stock is controlled directly or indirectly by another corporation, a combined report may be required or permitted by the Tax Commission. New York, by regulation, defines "substantially all" to mean ordinarily "the beneficial ownership or control of 95% or more of the issued and outstanding capital stock entitling the owners to vote for the election of directors or trustees".

Aside from the criterion of stock ownership or control, New York follows certain other standards set forth in the governing statute and regulations. New York's statute provides that no combined report covering any corporation not a taxpayer shall be required unless the Tax Commission deems such a report necessary because of intercompany transactions or non-arm's length agreements or transactions in order to properly reflect tax liability. Therefore, pursuant to that provision, New York can require a combined return without a showing of non-arm's length transactions. There must be either intercompany transactions or non-arm's length agreements or transactions. The touchstone is that a combined report can be required in order to properly reflect or reasonably attribute the portion of entire net income which is subject to tax by New York. The State Tax Commission, of course, takes cognizance of the restriction in its statute concerning requiring a combined report covering a corporation not a taxpayer. However, it should be noted that such a restriction does not prevent combining a corporation which has intercompany transactions but has no corporate autonomy, that is, a corporation which, in truth, is merely a division of another member of the combined group.

By regulation, New York provides that in deciding whether to require or permit a combined return the Commission consider whether the corporations are engaged in the same or related lines of business, whether the corporation is merely a department of a unitary business and whether there are substantial intercompany transactions.

In summary, the area of consolidation and combination returns is of great significance to New York because of the potential revenue implications and the potential shifting of tax burden in comparison with the existing system which we believe is reasonable. New York has administered its combined reporting provisions with fairness. It has not sought to require combined returns in any broad-scale manner. Less than 3% of the combined reports filed in New York have been required by the State Tax Commission. The balance have been granted at the request of taxpayers. It is with this background in mind that New York expresses great concern over Federal intervention in this area.

If action is unavoidable, it should not take the form outlined in S. 1245 (Messrs. Mathias and Ribicoff). This bill: (1) permits the taxpayer to determine income on a consolidated basis where there are non-arm's length transactions with affiliated corporations (2) defines affiliation where there is a common owner, corporate or non-corporate, and 50% or more of the voting stock of each member is owned by one or more of the members and the common owner owns at least 50% or more of the voting stock of at least one of the members and (3) is unclear as to whether it prevents the consolidation of bank holding companies with banks. It appears to prohibit them since banks are excluded corporations. New York now permits consolidated returns by such taxpayers.

These provisions are not acceptable to New York for several reasons. S. 1245 permits a taxpayer to choose to file on a consolidated basis through price manipulation. If consolidation is to be required or allowed in such a situation, clearly the State should have the right to decide, not the taxpayer who creates and engages in the non-arm's length transactions.

Secondly, the provisions would improperly restrict the State because it would not permit the consolidation of a corporation with no corporate autonomy. Thus, it would permit businesses to protect income from taxation through the use of corporate shells and the states could do nothing about it. In other words, there could be complete unitary connection and yet the State could not reach this income without proving non-arm's length transactions even though the controlled corporation was in reality only a division of the controlling corporation.

A third defect in S. 1245 is the low standard for affiliation. While New York probably would see fit to adopt an 80% rule, New York does not favor a rule of 50% or more. It should be noted, with a 50% or more rule, the same subsidiary could be in two separate combined or consolidated reports.

New York also expresses concern over the application of Federal rules covering elimination of profits attributable to transactions between members of the affiliated group. New York does not eliminate profit attributable to transactions between members of the affiliated group. This does not mean New York taxes the profit twice, but only that it taxes the profit currently. When the ultimate profit is earned through a transaction with persons outside the group, the profit is diminished by the amount already subject to tax.

INTERSTATE COMPACT

H.R. 977 has no provision for an interstate tax compact. S. 2092 gives Congressional consent to a state tax compact and grants rule making powers to the Multistate Compact Commission which have the full force and effect of Federal law and which apply to all states regardless of Compact membership. Rules are effective 180 days after adoption, except in states which by regulation, in accordance with their own laws, reject the rule. To be adopted, a rule must be approved by both a majority of members as well as those members representing a majority of the total population of the member states.

New York has, in the past, endorsed the Compact idea, as long as it was completely voluntary. The provisions of S. 2092 are not completely voluntary. In addition, they apply to every state regardless of compact membership and, in effect, require every state to take negative regulatory action if they disagree with compact rulings. The objective of this proposal is presumably to make a Federal interstate taxation act unnecessary by forcing uniform state administrative action through an interstate compact consented to by Congress. Under the proposal, the Multistate Tax Compact and its Commission would become an administrative agency to implement the Federal legislation.

New York is opposed to any administrative set-up under which the Compact Commission or any other agency would be given such power. New York withdrew its associate membership from the Multistate Tax Compact Commission in 1971 because it felt the compact proposals for solution to interstate taxation problems has more deleterious consequences than did proposed Federal legislation. The proposed administrative set-up under S. 2092 does not diminish the position.

TREATMENT OF DIVIDENDS

H.R. 977, by not providing any special treatment for dividends, sets a ceiling for state taxation based on the business apportionment percentage. S. 1245, on the other hand, specifically allows exemption from taxation for dividends of 50% or more owned affiliates and foreign source dividends, while allowing remaining dividends to be taxed only by the state of commercial domicile.

S. 2092's treatment of dividends provides yet another variation. Under S. 2092 dividends from affiliates, 80% or more owned are exempt with remaining dividends taxable and assigned to the state of commercial domicile.

New York's present practice more closely resembles H.R. 977 in that dividends other than from subsidiaries are apportioned among the states by formula, although New York uses a special investment income apportionment formula for this purpose.

Assignment of nonsubsidiary dividend income 100% to a corporation's state of commercial domicile would weaken our current incentive for the establishment of corporate headquarters in this state, by means of the favorable investment income apportionment formula now in use. We believe this type incentive should be continued to insure the maintenance of a business tax climate competitive with that of other states.

Conclusion

The current issues of State taxation of interstate business have been before us for some time. It would be beneficial for business and for the states if Congress completed its deliberations on the issues as soon as possible, whether its conclusions result in action, or inaction. Federal jurisdictional and apportionment limitations, which codify existing court decisions and set up reasonable rules to serve as a "ceiling", will effectively insure a satisfactory level of uniformity of state and local law and practice without impairing the ability of any state to design and administer its own tax system in the best interest of its citizens.

Before H.R. 977 could be considered as acceptable to New York, we believe the changes already discussed would have to be made. We also recommend that no Federal action be taken at this time regarding combined or consolidated returns; that compact consent legislation, if any, be on a strictly voluntary basis; and that Federal apportionment limitations not limit states to taxation of dividends at a firm's place of commercial domicile.

Thank you.

APPENDIX A

(*Rodino Bill* (*HR 977*))

AMENDMENTS

1. Lease of Tangible Personal Property—Business Location (Sec. 611) Amend Sec. 611(a) (Business Location—p. 21, line 10) by adding a new paragraph (4) to read as follows:

> "(4) Regularly leases to others tangible personal property for use in the State."

Amend Sec. 611(c) (Business Location in Special Cases—p. 22, line 8) to read as follows:

> "(c) Business Location in Special Cases—If a person does not own or lease property within any State or have an employee located in any State or regularly maintain a stock of tangible personal property in any State for sale in the ordinary course of business or *regularly lease to others tangible personal property for use in any State* (or in a case described in the last sentence of Sec. 204), that person shall be considered to have a business location only—(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."

Since leasing of property to others will create nexus, property so leased should be included in the property factor. Therefore, Sec. 202(b)(2), (p. 5, line 6), which excludes from the property factor tangible personal property rented out to others for a term of one year or more, should be deleted.

2. Sporting & Entertainment Events—Location of Employee (Sec. 613(b).) Amend Sec. 613(b) (Localization of Employee's Service) p. 25, line 9 by adding a new sentence at the end thereof, to read as follows:

> "Notwithstanding paragraphs (1) or (2) an employee whose service is in connection with the production, conduct or promotion of, or performance in single event activities, such as, a sporting, athletic or entertainment event, shall be deemed localized in the State where each such event takes place."

3. Installation & Repair—Location of Employee (Sec. 613(e)). Amend last sentence of Sec. 613(e) (Employees of Contractors and Extractors—p. 26, line 18) to read as follows:

> "This subsection shall not apply with respect to services performed in installing or repairing tangible property which is the subject of interstate sale by the employer if the cost of installing or repairing is a negligible part of the price of the property being installed or repaired."

The CHAIRMAN. Next we will call Mr. Traigle, Hon. Joseph M. Traigle, collector of revenue, State of Louisiana.

STATEMENT OF HON. JOSEPH N. TRAIGLE, COLLECTOR OF REVENUE, STATE OF LOUISIANA

Mr. TRAIGLE. Thank you, Mr. Chairman.

I am Joseph Traigle, commissioner of revenue for the State of Louisiana.

As we all know, this question of State taxation of interstate commerce has been pending for many years and it breaks down into two major questions: that of income tax and sales tax. Almost all of the proposals that have been introduced and those that are pending now, in my opinion as a State administrator, do not do a lot for State governments.

With that thought in mind, myself and my staff, in Louisiana, have attempted to develop a plan in the area of sales and use tax, which would not only solve the problem now facing business entities, and that being the multiple jurisdictional problem, but would really do something significant for State governments.

I, as a State administrator, and I think many others, if they would be honest with you, could not say that we are collecting all that we should in the area of sales and use tax on interstate sales, and so this is one of the key ingredients that we have tried to incorporate into the plan; that is, closing this gap and thereby increasing revenues for State governments.

Some of the major points of the Louisiana plan are:

It is easily administered on the part of the States.

The mechanics of the plan are relatively simple. The premise is that all transactions basically shall be brought in as taxable with certain exceptions, which are listed in the document and, also, certain State exemptions which can be furnished to the vendor. So this goes far beyond anything else and just says that, as a general concept, all transactions will be taxable. This, of course, leads to the increased revenue for the States and for local governments. The plan establishes, also, a maximum of 50 jurisdictions for any business entity, therefore solving the problem of multiple accounting jurisdictions within a State which we fully recognize as a serious problem for businesses.

By implementing the Louisiana plan we will also solve an internal problem in my State and many other States, that is, the penalizing of the in-State businessman, who is competing with the interstate businessman. For example, in Louisiana, this can lead to an automatic 6-percent advantage if the Louisiana businessman has to collect and remit the sales tax and the interstate businessman does not.

The plan, basically, involves the States setting a flat rate which would include both State and the local sales tax. The State would register with the Secretary of Commerce, mainly, as a clearinghouse so that businesses could determine what rates were applicable to what States. As I said before, the geography for business entities throughout the country, as far as accounting is concerned, would be limited to the 50 States.

After the roundtable discussion we had several weeks ago, we sent out copies of a draft of the proposal for the first time, drafted August 21. So far, nationwide as far as State tax administrators only, I have received 17 favorable or commitment responses as far as support for the proposition and only 1 indication of absolute opposition to it. And I believe that through some correspondence, we are going to change the one expression of opposition to a position of support.

Senator, the Louisiana plan is by no means a perfect solution to a very complex problem but I do believe it is an improvement over what we have now and a step in the right direction and we would ask everyone to give it consideration and, hopefully, support it.

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The CHAIRMAN. Well, now let me see if I understand your proposal, Mr. Traigle. You suggest that each State should file with the Secretary of Commerce one flat rate applicable within that State. Let's apply that to Louisiana. You have 156 different rates?

Mr. TRAIGLE. Yes, sir.

The CHAIRMAN. You have State sales tax and you have county taxes and you have city taxes.

Mr. TRAIGLE. Yes.

The CHAIRMAN. Now, how would you go about arriving at a flat rate for Louisiana?

Mr. TRAIGLE. We would more than likely, Senator, set up a formula and, by the various taxing jurisdictions all over the States with the volumes that are sold, we would most probably come out with what we would consider an average rate to be applied, perhaps 5 percent across the board.

The CHAIRMAN. Show me how you would go about recommending a 5-percent rate for Louisiana. I assume this would be cleared with the Governor and State legislature?

Mr. TRAIGLE. We would have to present it to the legislature, yes.

The CHAIRMAN. Show me in Louisiana how you would go about recommending, if you think 5 percent would be correct, that a 5-percent rate should be proposed. What is the State sales tax now?

Mr. TRAIGLE. Three.

The CHAIRMAN. All right, you have a 3-percent State tax. Now can you tell me how many parishes have parish sales tax?

Mr. TRAIGLE. I can't tell you that but the total of the parishes and the local government is 156.

The CHAIRMAN. So that in some areas you have both a parish sales tax and a city sales tax?

Mr. TRAIGLE. That is right.

The CHAIRMAN. How much would that be in some places?

Mr. TRAIGLE. It is a maximum of three in New Orleans, East Baton Rouge and so forth.

The CHAIRMAN. So in some of the cities in Louisiana, the total tax could be as high as 6 percent?

Mr. TRAIGLE. That is right.

The CHAIRMAN. Now, I take it that you would adopt the flat rate because in some places it wouldn't be any more than 3 percent no matter where they were sending the product in the State, that the 5-percent rate ought to be fair? In some cases, they would be shipping goods to New Orleans for instance, or Baton Rouge, and they would be getting a break?

Mr. TRAIGLE. That is right but not the kind of break they are getting now.

The CHAIRMAN. Not the kind of break they are getting now?

Mr. TRAIGLE. That is right. Now, they are getting by without paying any tax.

The CHAIRMAN. So that 5 percent would seem fair and, that being the case, in some instances they would pay a little bit more and in others they would pay less.

Mr. TRAIGLE. That is right.

The CHAIRMAN. But, in any event, Louisiana would set this flat rate on interstate transactions?

Mr. TRAIGLE. That is right.

The CHAIRMAN. Now how would you then divide the money when you got the money at the State level?

Mr. TRAIGLE. Well, Senator, I view that as a State problem and we would have to handle that in the legislature. My thought is that we would put this extra money, this new money into our State revenue-sharing formula, which is distributed, basically, by population which I think is a fair way to do it.

The CHAIRMAN. Not the Federal revenue-sharing but the State revenue-sharing program?

Mr. TRAIGLE. We have a State revenue-sharing formula, Senator, internally in the State. Perhaps we would add this to the pot.

The CHAIRMAN. But each State would decide for themselves how to distribute the money?

Mr. TRAIGLE. Yes, that is strictly a State matter and we are making no suggestions in the proposal at all.

The CHAIRMAN. Now, what would prevent a State from setting a 6-percent rate if there is only one county in the State where the rate went as high as 6 percent? In other words, suppose this proposal applied to Louisiana and only in one small parish did the rate go to, for instance, 7 percent flat rate although only in one small county with one small city, the rate would be as high as 7 percent?

Mr. TRAIGLE. I would say really nothing. We planned in drafting the bill itself, to put a maximum ceiling as the total of the State plus the highest local—now, it is conceivable that could happen but I would think that the legislature would not be inclined to do that, if that was the only county in the State with that rate.

The CHAIRMAN. It would seem to me in the spirit of compromise, the Federal Government would cooperate with the State on this and that the State ought to accept some limitation that would not permit the flat rate to be set at the highest rate charged in one isolated jurisdiction. There ought to be some limitation. Maybe it should be a minimum; maybe it shouldn't be more than the average rate of tax imposed in the State; or it shouldn't be more than the average between what would be the lowest and the highest rate of tax imposed.

Mr. TRAIGLE. That is a thought. We would be glad to give it consideration.

The CHAIRMAN. I think that in fairness, a business shouldn't be blackjacked by such a proposal.

Mr. TRAIGLE. Right.

The CHAIRMAN. Ordinarily, if you had one county and one city within that county where the rate was twice as high as the State, and that was not at all typical of the State, somebody doing business in interstate commerce would just move into the county next door, or just outside the city limits and avoid paying local taxes in any event.

Mr. TRAIGLE. That is true.

The CHAIRMAN. It is also true, isn't it, in many cases these sales taxes are not being paid because of the difficulty the States have in assessing such taxes and collecting them?

Mr. TRAIGLE. That is absolutely right. It is a question of cost benefit. If we had 200 men we could put on the project to go out and pinpoint who is making these sales, then yes we could collect it, but in terms of utilization of personnel, it is just not practical. That is one of

the big things we took into consideration when we developed the "Louisiana Plan." We want to make it as simple administrativewise as we can. We do not want the State or the businessman to have to spend a great deal of time in complying because we are still only talking about a relatively small piece of the pie in terms of a State's total sales tax activities.

The CHAIRMAN. What kind of help would you hope to get from the Federal Government in collecting these taxes if you used this system you are talking about?

Mr. TRAIGLE. Mainly to serve as a clearinghouse, Senator. We would like the Commerce Department to be the point through which each State would certify their flat rate. We would like it to be the place which all business entities could go and obtain a list of flat rates to handle distribution of the forms, copies of this act, et cetera. We do not see them being involved in a regulatory manner. I do not see our proposal needing a great deal of regulation. If the noncompliance with the proposal is a violation of Federal law, I feel like that is basically significant enough to generate compliance on the part of 80 to 90 percent of the business entities.

The overwhelming majority of them want and do the right thing. Of course, you will never get everybody and no matter how sophisticated a proposal you develop, still there will be people who will willingly violate the law, so it boils down to a question of how much time should we spend on this matter. I don't think we should spend a great deal of time. If it is a violation of a Federal law, I think that is significant enough to generate reasonable compliance.

The CHAIRMAN. You don't think the Federal Government would need a whole group of people going around inspecting peoples' books in order to enforce these proposed tax provisions?

Mr. TRAIGLE. I do not.

The CHAIRMAN. It is your thought most businesses would comply if they knew there was a Federal law requiring compliance?

Mr. TRAIGLE. I do.

The CHAIRMAN. Senator Mondale?

Senator MONDALE. Let me see if I can understand your proposal. Each State under your plan would file a document with the Department of Commerce which would give a simple combined rate?

Mr. TRAIGLE. That is correct.

Senator MONDALE. And I gather this would be for sales and use taxes only?

Mr. TRAIGLE. Yes.

Senator MONDALE. This does not deal with income tax?

Mr. TRAIGLE. No. Sales tax only.

Senator MONDALE. Then any company generating business in Louisiana would be required to send, in this case 5 percent I gather, of his gross sales to the State of Louisiana from sales derived in the State of Louisiana?

Mr. TRAIGLE. They would be required to collect and to remit to the State; yes.

Senator MONDALE. And that would be sales and use taxes?

Mr. TRAIGLE. Yes.

Senator MONDALE. That would be true whether they had an office or salesman? You would get away completely from those sets of standards?

Mr. TRAIGLE. No, Senator. We would work backward. If you maintained a business location in the State, then the normal set of State and local regulations would still apply to you. In other words, this proposal is covering everything that is left after you apply the strict test—well, for example, this proposal covers the mail order situation totally which we're speaking about. It says, all right, if you sell by mail order in the State of Louisiana, then you come under this proposal.

Senator MONDALE. Well, that is basically what it covers?

Mr. TRAIGLE. Everything that is left, this covers; yes.

Senator MONDALE. In other words, in the areas where the law is clear now, you are not talking about any jurisdictional modifications?

Mr. TRAIGLE. Right.

Senator MONDALE. You are talking about this grey area, which is in dispute?

Mr. TRAIGLE. Right.

Senator MONDALE. And you would deal with that through this uniform rate?

Mr. TRAIGLE. We would.

Senator MONDALE. No further questions.

The CHAIRMAN. Well thank you very much. I think you have made a very constructive suggestion.

[The statement of Mr. Traigle follows:]

STATEMENT BY JOSEPH N. TRAIGLE, COLLECTOR OF REVENUE, STATE OF LOUISIANA

Topic.—State Taxation of Interstate Commerce

"The Louisiana Plan" is offered as an alternative solution to one of the major issues being discussed here today, that being Federal Legislation in the area of sales and use tax laws.

The major point to be observed about "The Louisiana Plan" is that it is the first alternative that has been presented that significantly does something *to help state tax administrators and at the same time accommodates the business community in its effort for improvements in this area.*

The following is a list of the major points contained in "The Louisiana Plan":

POINT NO. 1

This proposal would establish the concept that every sale of tangible personal property which has a destination in any state would give that state the right to require the vendor to collect and remit sales and use taxes on such sales.

POINT NO. 2

Each state would set a flat rate which would apply to this class of sales and would include both state and local sales taxes.

POINT NO. 3

The United States Department of Commerce would act as the clearing house and information center. A state would be required to certify its flat rate to the Department of Commerce, and all business entities would go to the Department of Commerce for the listing of states that have certified combined rates.

POINT NO. 4

The Louisiana Plan would mean that a business would have to maintain its sales records by state geography only.

POINT NO. 5

The Louisiana Plan would significantly increase revenue for many states which have state and local sales tax laws on the books.

The Louisiana Plan is by no means a perfect solution to this very complex problem, but we feel that it is something that both the states and the business community can live with and will find mutually beneficial.

THE LOUISIANA PLAN—FEDERAL LEGISLATION—VENDOR COLLECTION OF SALES AND USE TAXES ON INTERSTATE SALES

INTRODUCTION

This proposal would establish the concept that every sale of tangible personal property which has a destination in any state would give that state the right to to require the vendor to collect and remit sales and use taxes on such sales either (a) in the conventional manner as is now required, or (b) in the uniform manner as is discussed hereinafter.

Whichever of these methods may be required would be dependent upon the nature of the activities of the vendor in the state. If a vendor (a) has a place of business in the state, or (b) regularly makes deliveries into the state other than by common carrier or U.S. Postal Service, such state would be permitted to require the vendor to collect its sales and use taxes in the conventional manner. On the other hand if the vendor neither has a place of business in nor regularly makes deliveries into the state (other than by common carrier or U.S. Postal Service) such state would be permitted to require the vendor to collect combined uniform state and local sales and use taxes but would be prohibited from requiring the collection of conventional sales and use taxes.

Under this proposal a political subdivision of a state would be authorized to to require vendors to collect conventional sales and use taxes on interstate sales delivered into such subdivisions only when such vendors (a) have a place of business in such subdivision or (b) regularly make deliveries into such subdivision (other than by common carrier or U.S. Postal Service).

When a state has certified a uniform flat rate to the Secretary of Commerce, this proposed Federal legislation would declare all sales made by a vendor who did not maintain a place of business within the state or who did not regularly make deliveries in the state other than by common carrier or U.S. Postal Service subject to the uniform rate. The point of or method of solicitation, acceptance of the order, place from which shipped and the method of shipment are immaterial; the governing factor in these sales would be final destination. The state of final destination, and that state along, would have the right to require collection and remittance of sales taxes by the vendor on such sales.

GENERAL PROVISIONS

So-called gross receipts taxes which in reality are income taxes will be distinguished from sales or transaction taxes, and sales taxes will be distinguished from use taxes. Note that under this concept, wherein all sales are subject to tax, use taxes will be effectively minimized to only those importations from abroad whose vendors would not be within reach of this act, and to the slight differences in rates between states. Under the final destination concept sales made to processors for fabrication into other articles of tangible personal property would not be taxable since final destination is not known at the time of the transaction.

TAX BASE

The tax base will be defined to include all elements of transportation, packaging, shipping, delivery preparation and all other such items unless those items are separately stated in writing.

EXEMPTIONS

Specific exemptions would be provided for the following:

(1) Sales for resale

(2) Sales to U.S. Government

(3) Sales for transhipment to another taxing jurisdiction or to another country

(4) Any other exemption provided by a state law, allowable only upon receipt by the vendor of a valid exemption certificate, in uniform format from the purchaser, such certificate to cite the legal basis for the exemption.

CREDITS

Any state availing itself of the benefits of this proposal will be required to allow credit for any sales or use taxes previously paid with respect to any particular property not to exceed the tax levied by that state.

RATE CERTIFICATION AND LIMITATION

All states must certify annually to the Department of Commerce what their flat rate will be in regards to this class of sales.

No vendor will be held liable for collecting taxes on behalf of any state or local government unless that state shall have certified a single combined state and local tax rate to the Secretary of Commerce, and only that certified rate may be imposed on behalf of any state. No local government below the state level may require the collection of tax on sales covered by this proposal.

The combined state-local rate may not exceed the highest rate required to be collected by a vendor having a business location within that state.

A vendor may collect and remit the State tax and the tax imposed by any political subdivision within that State in the same manner as a vendor having a business location therein only by agreeing to become subject to the jurisdiction of the State and local governments for sales and use tax purposes in the same manner and to the same extent as the vendor who has a business location therein.

REPORTING REQUIREMENTS

It is proposed that State filing requirements will be on a calendar year basis as follows:

Sales:	*Report period*
$0 to $1,000	No return required.
$1,000 to $20,000	Annually.
$20,000 to $60,000	Semiannually.
$60,000 to $100,000	Quarterly.
Over $100,000	Monthly.

All returns will be due on the last day of the month following the close of the tax period.

REPORT FORMS

Maximum information which may be required to be furnished by a vendor is limited to the following:

(1) Name and address of the vendor;
(2) Federal employer identification number;
(3) Type of report (total company, division, et cetera);
(4) Period covered by the report;
(5) Gross sales within the State;
(6) Exempt sales within the State;
(7) Net taxable sales; and
(8) Tax liability.

AUDIT AUTHORITY

A State will have the authority to audit the records of a vendor subject to this proposal, and the audit may be made independently or in combination with any other State or group of States, provided each of such States serves legal notice upon the vendor and guarantees confidentiality of records. A group of States may designate an auditor from any one or more States to conduct the audit, but each State must signify this election to the vendor in writing.

PRESCRIPTIVE PERIODS; EFFECTIVE DATE

No local government may assess a tax against any vendor covered by this proposal for any period commencing after the effective date of the act or January 1, 1976, whichever is later. Local governments may pursue collection of taxes assessed within the above period.

This act shall be effective with respect to all sales made on or after January 1, 1976.

There shall be no prescription in the case of a vendor who fails to comply with the filing requirements provided in the act or in the case of a fraudulent return.

Gross negligence will be prima facie upon the omission of 25 percent or more of taxable sales from the net taxable amount reported. Prescription in the case of gross negligence shall be 5 years from the due date of the return in which the negligence occurred.

PENALTIES AND OTHER CHARGES

Civil penalties will be provided for:

(1) Failure of a vendor to comply;
(2) Fraud;
(3) Negligence; and
(4) Delinquency.

No additions other than interest may be made to the tax due except the penalties covered by (1) through (4).

JUDICIAL REMEDY

Recourse from administrative findings by any State shall be directly to the U.S. district court for the district in which the administrator is domiciled.

EXCLUSIONS

No State which fails to certify a tax rate to the Secretary of Commerce or which fails to adopt the uniform reporting forms and filing requirements described in the proposal may require a vendor who would otherwise be subject to these provisions to collect or remit a sales tax.

ELECTIONS

A vendor shall have the right at any time to agree to comply with the sales tax provisions of any State or political subdivision as opposed to compliance with this proposal.

The CHAIRMAN. Our next witness is Mr. Jerome R. Hellerstein, adjunct professor of law, New York University School of Law and partner, Hellerstein, Rosier & Rembar, New York, N.Y.

STATEMENT OF JEROME R. HELLERSTEIN, ADJUNCT PROFESSOR OF LAW, NEW YORK UNIVERSITY SCHOOL OF LAW, AND PARTNER, HELLERSTEIN, ROSIER, & REMBAR, NEW YORK, N.Y.

Mr. HELLERSTEIN. Thank you, Mr. Chairman. Over the years, I have been a consultant to a number of State and local governments and the Federal Government in the area of State and local taxation of interstate business and at the same time I have counseled a good many corporations in this same field. And for more than 25 years I have given a course at New York University Law School in State taxation and have written extensively in this field.

Today, however, I appear for no organization, no client, public or private and simply am here to set forth before this committee what at least in my view is the public interest in this area. Of course I have filed a longer written statement which I request be included in the record.

I would like to begin with what seems to me to be the fiscal policy that ought to govern the power of the States to tax interstate commerce. I suggest that out-of-State businesses which carry on activities, on a more or less regular basis, exploit the market in a State, or otherwise use its resources, ought to be subject to the power of the State to impose a net income tax or a capital stock tax, unless there are overriding compliance or administration considerations which dictate a contrary result.

In line with that principle, if you an out-of-State manufacturer or a vendor has not become a local merchant, by setting up an office or other place of business in the State, and maintains no stock of goods there, and the cost of collecting the tax and complying with the tax law would amount to a large part of the income or capital stock tax to be collected, then it seems to me it makes good fiscal sense not to impose the tax at all.

Consequently, to deal with such cases, I would recommend that Congress adopt a minimum quantitative jurisdictional standard so that, for example, if $100,000 or less of sales receipts are derived by an interstate merchant or manufacturer from sales of goods destined for a State, which was the general quantitative standard that had been considered by the Willis committee, no income or capital stock tax could be imposed by that State. Perhaps now, in view of inflation, the quantitative minimum might be increased to the $300,000 figure which I understand has been considered as a minimum jurisdictional standard by the National Association of Tax Administrators. If we had such a minimum quantitative jurisdictional standard, which would exempt from taxation such businesses without locations or property in the State, then it would be appropriate for Congress to authorize the States to tax the income or capital stock of any out-of-State corporation whose sales receipts from within the State exceed the minimum, regardless of whether the business makes its sales by radio, television, mail order, or otherwise.

This type of approach would solve many of the compliance difficulties and hardships the committee has heard about and will continue to hear about; it will largely exempt the comparatively small out-of-stater, which does have real problems in compliance. But it will not exempt the larger businesses which are readily able to comply. I have worked for a long time in this area, and I think I know something about the way large businesses operate. Of course, compliance with State tax laws is a nuisance. Of course it costs money, but so does compliance with other laws, such as blue sky laws, and State regulations of various other types. State taxes are one of the costs of expanding a business, and tax compliance is not a serious problem for the larger businesses, with their knowledgeable staffs, their computers, and the like. I think it is fair to say—as Mr. Dorgan has suggested—that when you get down to the essence of the controversies in this area, by and large what is really involved is how much tax businesses are to be called on to pay the States; the real conflict is not over compliance costs or administrative costs for the substantial businesses, but the amount of tax.

I want to turn now to apportionment and allocation. It is important to realize that apportionment by formula grew out of necessity; it grew out of the fact that no one has ever been able to develop any kind of satisfactory method of accounting for measuring the legitimate claims of the various States to tax the income which is reflected in a series of interdependent basic operating transactions of an enterprise, such as manufacturing, producing, mining, or timbering in one State and selling in another, or buying in one State and selling in another.

Over the years a rather general consensus has developed that the three factors, property, payroll, and receipts, afford a fairly equitable yardstick for measuring the claims of the States involved, for levying

income or capital stock taxes. And I know of no good reason why the rules of apportionment by formula should vary whether the enterprise is organized through branches or in an intercorporate structure.

In the light of the rationale back of apportionment and the scope of unitary apportionment as applied to affiliated groups, S. 1245, on this score ought to be rejected, and the reason is that it simply misconceives the whole point of unitary apportionment. Unitary apportionment does not grow out of the fact, as S. 1245 assumes, that there has been overreaching in pricing among controlled companies. Instead, unitary apportionment is proper because there is no other acceptable method for dividing among the States the income derived from basic interdependent operations taking place in more than one State.

S. 2092 adopts a different but equally unsatisfactory approach to the problem, in that it authorizes unitary apportionment of affiliates in all cases in which the corporations are interconnected by 80 percent of voting stock, and only in those cases. The effect of the S. 2092 proposal may be illustrated by a conglomerate which has an 80-percent owned subsidiary, and which processes cereals and sells them in the Midwest. It also has another 80-percent owned subsidiary which is engaged in an automobile leasing business in the Northeast. Under this proposal, these two businesses whose operations are not in any way interdependent on each other, would be subject to unitary apportionment; such a result makes no sense in terms of the reasons for formulary apportionment. By the same token, if a parent company manufactures products, all of which are marketed through a 75-percent owned subsidiary—and believe me, we lawyers can, with considerable ease, move from 80 percent to 75 percent of stock ownership—then there could not be a unitary apportionment in a situation where the unitary principle ought to apply.

Consequently, I would reject the provisions of both S. 1245 and S. 2092 with respect to unitary apportionment of multicorporate businesses. Instead, I would suggest that Congress adopt a provision to authorize unitary apportionment at the election of either the taxpayer or the State, with respect to branches or affiliated corporations which are engaged in basic operations which are interdependent.

If this general approach is adopted, I think it offers the proper solution to the dividend problem about which Senator Long raised a question about earlier, and the related problem which has been mentioned here, of how the uniform formula is to be treated in allocating or apportioning business and nonbusiness income. At the outset, it must be recognized that there are dividends and dividends. If we are dealing with a manufacturer which receives dividends from its sales subsidiary corporation operating in other States, the dividends represent earnings of unitary business, just as if they came from a branch; and they ought to be apportioned under the three-factor formula. Under UDITPA, that kind of dividend derived from a unitary subsidiary ought to be classified as business income.

But now take the case of the conglomerate I mentioned earlier. If the parent company receives dividends from the midwestern cereal company and from the northeastern automobile leasing company, the dividuends are not unitary business income, and there is no reason that I can see why the dividends from the two nonunitary operations

should be apportioned in accordance with whatever happens to be the apportionment formula of the parent company. The dividends ought to be treated as nonbusiness income in the same way as investment income, and they should be allocated to the State of the parent company's commercial domicile. It seems to me there is a lot of wisdom in the traditional rule in that nonbusiness income of this general character ought to be allocated to the State of the company's executive and financial headquarters.

Senator HANSEN. I have to leave at this point.

The CHAIRMAN. I have asked each witness to confine himself to 10 minutes. I hope you will summarize your statement.

Mr. HELLERSTEIN. Yes, I am just about finished. Let me make one more point, Senator. I simply wanted to make reference to one provision that so far nobody has said anything about, and I think it is extremely important. I want to register my strong opposition to the startling proposal made by S. 1245 for bypassing the State judicial system and for vesting in the Court of Claims jurisdiction over State tax assessments, whenever there is involved a question of Public Law 86–272, or any other legislation in this area that may be enacted. And my reasons very briefly are not only that the proposal is contrary to our whole system of federalism, but also that it would be costly, cumbersome, and virtually unmanageable. A large taxpayer could bring 10, 20, or even 50 States into a hearing in the Court of Claims in Juneau, Alaska, or Austin, Tex., or Montpelier, Vt., with a whole room full of lawyers and witnesses and tax auditors, all because an issue in the single State's case involves the Federal legislation. Such a procedure would be so costly and so burdensome to the States, and inevitably produce such long delays in disposing of tax claims against multistate businesses, that in my opinion the States would be forced to accept offers of settlements from taxpayers at figures that would be ordinarily unacceptable.

These judicial review provisions of S. 1245 ought to be given short shrift by the committee, particularly since there is no need for the cumbersome, disruptive structure proposed. There is a better way to handle judicial review of such issues, and it has been in practice in this country ever since the Constitution was adopted. And that is to follow normal procedures for contesting tax assessments in the State courts. If the highest court of the State construes its tax law and the limitations imposed by congressional legislation contrary to the taxpayer's view of the statute, the taxpayer would have opportunity for review of the decision by the Supreme Court of the United States under the Judicial Code. And if there should be conflicting decisions concerning any of these matters by the State courts, the Supreme Court would ordinarily in such a conflict case hear the appeal, and its decision will govern in all jurisdictions.

The CHAIRMAN. Thank you very much.

Mr. HELLERSTEIN. You are welcome.

The CHAIRMAN. You have made a very thoughtful statement, and you have explained it in much greater detail in the prepared statement. Now I would like to call——

Senator MONDALE. Might I ask just one question?

In other words, your recommendation on the sales tax issue is to establish an earnings threshhold within a State?

Mr. HELLERSTEIN. On sales and use tax?

Senator MONDALE. Yes.

Mr. HELLERSTEIN. No, Senator. I made no reference to sales and use taxes. However, if I may, I'd like to take 30 seconds to suggest that I think the principles back of Mr. Traigle's proposal are eminently sound and would eliminate multiple jurisdiction of the local governments in sales and use taxes, and we would have full accountability to the States. Whether Mr. Traigle's proposal is the best proposal to accomplish those results, I am not entirely clear. I am a little concerned about State constitutions and home-rule provisions, and perhaps there are better ways of achieving the desired objectives. The principles are sound, and if Mr. Traigle's specific proposal is not workable, some technique along those lines, perhaps by reverting the sales or use tax, if necessary, to the State of origin can be used.

Senator MONDALE. Well, would it be fair to say that your proposals are designed to substitute the present jungle of artificial rules for some kind of simple formula?

Mr. HELLERSTEIN. Let me put it this way. Legislation in the apportionment and allocation area could impose greater uniformity, than now exists, although I am not one of those who thinks that there is a great need for Congress to move into this field to achieve uniformity in apportionment and allocation. In the most important area, the income tax, about three-quarters of the States have already essentially uniform laws. The income tax base has never presented serious problems of diversity, because most States use the Federal base, with a few adjustments. In my opinion, our most important apportionment and allocation problem involves the need for more uniform and more effective administration by the States. In so stating, I want to call your attention to the fact that I am counsel to the Multistate Tax Commission in the United States Steel Corp. case. We need a central administrative agency formed by the States, whether the Multistate Tax Commission or some other State agency, but not the Internal Revenue Service which is overburdened and is Federal tax oriented. There ought to be a collaborative central agency of the States to do what the Multistate Tax Commission is doing, which is to take the audit of multistate businesses out of the horse-and-buggy stage and bring it into the electronic computer stage which big businesses already have, and to conduct multistate audits for groups of States, prescribe uniform forms, and issue advisory regulations for adoption by the States, if they so choose, and the like.

Senator MONDALE. Thank you very much.

The CHAIRMAN. Thank you.

[The statement of Mr. Hellerstein follows:]

TESTIMONY OF JEROME R. HELLERSTEIN, ADJUNCT PROFESSOR OF LAW, NEW YORK UNIVERSITY SCHOOL OF LAW

SUMMARY

1. *Jurisdiction to impose income or capital stock taxes.*—Congress ought not adopt any further restrictions on the power of the States to tax interstate businesses, except as dictated by compliance and administrative costs. To that end, a minimum quantitative jurisdictional standard of perhaps $100,000 to $300,000 of receipts from sales of goods in the State's market should be imposed, and P.L. 86-272 should be amended to permit income taxation of all out-of-State businesses exceeding the minimum, regardless of the maintenance in the State of employees, an office, or an inventory of goods.

2. *Apportionment and allocation.*—Apportionment of the income or capital stock of a taxpayer and its affiliates which are parts of a unitary business ought to be permitted, at the option of the taxpayer or the States; the unitary business should be defined neither by reference to the broad California judicial test of the three unities, the narrow Section 482 type of approach of S. 1245, nor the formalistic 80% stock ownership rule of S. 2092. Instead, the test of the unitary business should be whether the branches or affiliates are engaged in interdependent basic operations of the enterprise, such as buying and selling, manufacturing or producing and marketing, and the like.

Because there is no fiscal justification for a "no-man's land" of immunity of income or capital stock of the interstate seller, while its local competitor is taxed in full, either the throw-back rule of S. 2092, or the full accountability proposal of the NATA should be enacted.

3. *Taxation of dividends and the business non-business income controversy.*—There is no warrant for the immunity of dividends from State income taxation. The treatment of dividend income as apportionable or allocable ought to depend on whether they represent earnings of an integral part of a unitary enterprise. If so, they would be eliminated under a combined or consolidated apportionment, but if that is not elected or is unavailable under the law, the dividends, nevertheless, retain their character as business income, and should be apportioned. On the other hand, if the dividends are paid by a non-affiliate, or by an affiliate which is not part of the recipient taxpayer's unitary enterprise, the dividends should be treated as investment or non-business income, and be allocated to the State of commercial domicil.

4. *Judicial Review and Administration.*—The provisions of S. 1245 lodging in the Court of Claims jurisdiction to review the decisions of State tax administrators which involve the restrictions of P.L. 86–272 or any further Congressional legislation, would impose on the States burdensome costs and intolerable delays, result in virtually unmanageable multiparty litigation, and disrupt the traditional roles of the Federal and State courts under our Federal system. There is no need for any legislation relating to judicial review, since conflicting decisions of the highest State Courts construing Federal limitations on the State taxing powers are subject to review by the Supreme Court of the United States.

An administrative agency is required to implement Federal legislation and to conduct multistate audits at the request of the States. The overburdened Internal Revenue Service, with its national orientation, ought not be designated as the agency; what is required is a collaborative agency of the various States, modelled along the lines of the Multistate Tax Commission.

There is no need to make such an agency's regulations interpreting the legislation mandatory; advisory regulations will in practice accomplish a large measure of uniformity without encroaching on the proper functioning of State tax administrators.

STATEMENT

I am Jerome R. Hellerstein, Adjunct Professor of Law, New York University Law School, and a practicing lawyer in New York City. I have over the years been counsel or a consultant to a number of State and local governments and Federal agencies in matters affecting State taxation of interstate business, and have been counsel to corporations in connection with their problems in this area.

For more than 25 years I have taught a course in State and local taxation at New York University Law School and have written extensively in the field. I served as a member of the Advisory Committee of the Willis Subcommittee on State Taxation of Interstate Commerce. A curricular vitae is attached as Appendix A.

I appear here today on behalf of no client or organization, public or private, and am here only to present what in my view is the public interest. My testimony will deal principally with the net income and capital stock tax provisions of the measures pending before the Senate, and other proposals made to the Committees.

JURISDICTION TO TAX

The fiscal policy which in my view ought to govern the power of the States to tax interstate commerce is that multistate or out-of-state businesses which, on a more or less regular or continuous basis, conduct activities, exploit the market or otherwise employ the resources or facilities of a State, ought to be subject to the power of the State to levy a fairly apportioned tax on their net income or capital stock, unless there are overriding administrative or compliance problems which would dictate a contrary result. This principle is important not only to State

revenues but is also bottomed in the need to protect local merchants from being put at a competitive disadvantage with out-of-state businesses.

By this standard, P.L. 86–272 has already gone far enough in limiting the power of the States to levy income taxes, and, indeed, has gone too far in stripping them of the power to tax businesses which make substantial sales to customers in the State. I refer to the prohibition by P.L. 86–272 of State income taxes on business which exploit the State's market through large scale sales made by salesmen or agents, TV, radio, direct mail solicitation and the like, without maintaining offices offices or inventories of goods within the State.

Congress is now being asked by the proponents of S. 1245 to broaden the immunity of multistate business from income taxes by making the maintenance of a business location in the State a condition of taxation, and to impose the same limitation on the levy of capital stock and gross receipts taxes (§§ 101, 513–15). Moreover, S. 1245 would also expand the coverage of businesses embraced by the jurisdictional limitations beyond the mercantile, manufacturing and other businesses selling tangible personal property in a State, to which P.L. 86–272 is confined (§ 101). The bill covers all businesses other than "excluded corporations", a term which is defined as excluding banks, loan and finance companies, insurance, investment, transportation, electric power, gas and water companies (§§ 101, 506). As a result, all the service businesses, such as printing and other graphic arts, processing of fabrics and other products, television and radio broadcasting, advertising and stock brokerage, the licensing of franchised businesses, copyrights and patents, the exploitation of other intangibles, and a host of other businesses deriving income from sources within a State would be brought under the umbrella of the Congressional jursidictional limitations. No basis has been laid for the need for any restrictions on the taxation of such interstate business; for the focus of the Congressional hearings, which led to P.L. 86–272, the Willis Subcommittee Report and the debates since then, has been on the interstate seller of tangible personal property.

Moreover, the jurisdictional limitations and the apportionment and allocation requirements of S. 1245 are inappropriate to many of the businesses to which it would apply, such as stock brokers, radio and television stations, franchisers and other enterprises. To apply jurisdictional and apportionment and allocation provisions designed for the interstate merchant to all business would be to create a Procrustean bed which would produce arbitrary and capricious results. Accordingly, I would recommend that the Committee confine its proposed legislation, as does P.L. 86–272, to the interstate seller of tangible personal property.

The other aspect of the fiscal policy which I have suggested as a guiding principle, i.e., that taxation of businesses which exploit a State's market may be properly restricted where compliance and administrative problems so dictate, points to the adoption of a minimum quantitative limitation on State taxing powers. If the taxpayer has not become a "local merchant", through the maintenance of a sales office or other place of business or an inventory of goods within the State, and the costs of compliance and administration would amount to a large percentage of the income tax to be collected, it makes a good deal of fiscal sense not to impose the tax at all. The use of a minimum quantitative jurisdictional standard, by contrast to the vaguer and more uncertain qualitative standard of jurisdiction established by P.L. 86–272, is not a new idea. It was explored by the Willis Subcommittee, in which it was found that a wholesaler or retailer having $100,000 of receipts from sales made in a State, with the typical 2% profit on sales, would apportion to the State, under the three factor formula, $667 of taxable income and would be subject to a tax of $33 at the then typical 5% rate.[1] On the same assumptions, by applying the current typical corporate income tax rate of 7%, the tax would still amount to only $47. In the case of manufacturers, the Willis Report assumed the comparatively high rate of profit of 12% on sales; $100,000 of sales receipts from goods destined to a State, under the three factor formula and a 7% tax rate, would produce a tax of $350 (*Ibid.*).

The use of a minimum quantitative standard of gross sales in a State as a sine qua non for State income and capital stock tax jurisdiction, in the case of interstate vendors not maintaining a place of business or a stock of goods in the State, has a good deal to commend it, since it would eliminate from the tax rolls a considerable number of interstate sellers not integrated into the local market and would, in all probability, produce no significant loss of revenue. At the same time, it would accomplish the desirable objective of exempting a substantial segment of smaller out-of-state businesses from the costs and burdens of complying with

[1] "State Taxation of Interstate Commerce", Report of Special Subcommittee on State Taxation of Interstate Commerce, House Committee on the Judiciary, Vol. 1, pp. 508-509.

the tax laws of States in which they are not based. Whether the minimum should be $100,000 or $300,000 or some other figure needs to be examined more closely, in the light of the probable impact on businesses and on the revenues. Moreover, like most tax exemptions, safeguards would have to be adopted to prevent tax avoidance, such as a requirement that sales of both the taxpayer and its affiliates be taken into account in determining whether the statutory minimum has been exceeded.

If Congress were to adopt the type of minimum quantitative jurisdictional standard here suggested as a basis for State income and capital stock taxation, P.L. 86-272 could then properly be amended so as to carry out the proposal made earlier, viz., that interstate sellers which make sales of goods destined for a taxing State in excess of the minimum ought to be subject to taxation, even though their only nexus with the market State is the sale and delivery of goods into the State, whether the solicitation is done by local or traveling salesmen, by television or radio, by newspaper or periodicals or by direct mail.

The National Association of Tax Administrators (NATA) has also proposed a quantitative jurisdictional standard in its bill. Under that proposal, taxpayers whose gross receipts, and the gross receipts of their affiliates, from sales of goods with a destination in a State exceed $300,000 would not be protected by P.L. 86-272, if such total gross receipts from sales made to all destinations exceed $2,000,000. I have two reservations about this approach to a minimum quantitative standard. First, it is inadequate to protect the small interstate businesses from the ambiguities and uncertainties of P.L. 86-272 as to the effects on their taxability of activities ancillary to solicitation, as the litigation construing that statute is demonstrating.[1] For that reason, the more definite and specific minimum jurisdictional standards applicable to small businesses of the type recommended above, such as the maintenance of a place of business or an inventory of goods in the State, are very much to be preferred. Second, I have some difficulty in understanding why the overall size of the business outside the taxing State ought to be a factor in deciding whether enough business is done in the State by the taxpayer, which has no place of business or inventory in the State, to warrant the costs and burdens of tax filings and the policing of the returns by the States. Consequently, the type of minimum standard I have suggested appears to me to be better tailored to deal with this problem than the NATA proposal.

APPORTIONMENT AND ALLOCATION

A. Delineation of the Unitary Business and the Scope of Combination and Consolidation for Apportionment Purposes

Apportionment of the income or capital stock of corporations to a particular State, that is the attribution of a portion of the tax base by formula, as distinguished from allocation by source, commercial domicile or the like, developed out of necessity. No one has been able to devise a satisfactory separate accounting, or other non-formulary method for measuring the legitimate claims of the various States involved in taxing, for example, manufacturing, mining or mercantile businesses which produce or buy goods in one State and market them in other States. The reason for this inability to develop an acceptable mathematical, or cost or other accounting method of attributing the income, for example, of such businesses to the States involved is that the profit realized by such enterprises is the product of a series of interdependent operations, taking place in more than one State. As a consequence, during the past half century or more, the States have increasingly resorted to the use of apportionment by formula, employing as the factors the elements of the business they regard as fairly reflecting the claims of the various States to tax segments of the base. A fairly widespread consensus has gradually developed, both among State tax administrators and the spokesmen for business groups, that property, payroll and receipts are the most appropriate and workable apportionment factors.

To be sure, the definition of the factors, the circumstances in which resort to the relief provisions will be had on the ground that the formula does not work out fairly, the type of income, if any, to be allocated instead of apportioned, and other matters may need to be reviewed and from time to time adjusted to changing business conditions and practices, but overall formulary apportionment, albeit only a "practical approximation", is the most viable State tax tool we have been able to devise for the division of income among taxing jurisdictions.

[1] *Clairol, Inc.* v. *Kingsley*, 100 N.J. Super. 22, 262 A. 2d 213 (1970), aff'd per curiam 57 N.J. 199, 270 A. 2d 702 (1970); and the cases collected in Hellerstein, "State and Local Taxation: Cases and Materials", pp. 267 et seq. (3d ed. 1969).

One of the current controversial issues in the apportionment area is how to delineate the scope of the unitary business. For the justification for apportionment has traditionally been based on the interdependence and interrelation of the aspects of the business being conducted in the various States; and the judicial acceptance of the formulary method of dividing income among the States has been generally restricted to businesses which are unitary.

(*a*)

In reviewing the proposals currently being made for determining the scope of the unitary business, there is, at one extreme the position embodied in the Ribicoff-Mathias bill (S. 1245 [1973]), which concerns itself only with businesses organized in a multicorporate structure. This provision would prohibit the combination of the income, or the use of a consolidation method, to determine the income of any business, even though it is unitary, unless it can be demonstrated that the taxpayer, has engaged in non-arm's length dealings which produce a "material distortion" of the income apportioned to the State (§§ 209(a), 201). The bill misconceives the purpose of formulary apportionment and the reasons for its development, and in substance rejects the entire approach, except in circumstances to which a Section 482 (of the Internal Revenue Code) type of provision would apply. Formulary apportionment, as the Supreme Court of the United States long since recognized, does not "impeach the integrity of the taxpayer's accounting system." (See *Butler Bros.* v. *McColgan*, 315 U.S. 501, 62 S. Ct. 701 [1942]). Instead, it is based on the view that separate accounting is not an adequate technique for determining the segment of the profit (or capital stock) of a unitary multistate business which was earned, or had its source, within a particular State. In the language of the California Supreme Court, "where a business is unitary in character, so that its separate units could not be fairly considered by themselves and the whole business in the several states derived a value from the unity of use", apportionment, instead of, separate accounting, is appropriate, (*Edison California Stores* v. *McColgan*, 30 Cal. 2d 472, 183 P. 2d 16,20 [1947]). Consequently, I reject the Ribicoff-Mathias bill's approach to the unitary business and, in turn, its concept as to the proper scope of apportionment of the base of multistate businesses.

(*b*)

At the other extreme lies the position of the California courts, which have developed the three unities of ownership, use and operation as the yardsticks for measuring the scope of a unitary business.[1] Unity of ownership is, of course, readily supplied in the case of a multicorporate structure by the ownership of the capital stock of the subsidiaries. Unity of use looks essentially to the executive force and general system of the conduct of the enterprise. Unity of operation refers to the centralization of such functions as financing, accounting, research, legal, patent, engineering and other services, advertising, personnel and the like.

The California approach, which would sweep into the unitary principle virtually every manufacturing, mercantile, mining enterprise, or the like, conducted in more than one State, likewise, appears to me to ignore the circumstances which justify formulary apportionment. This is not to underestimate the importance to the profitability to many businesses of matters such as centralized control and management, top company financing, pooled research, patents and know-how, advertising, centralized technical services and the like. Indeed, I would suppose that a principal economic justification for the existence of large enterprises, and a considerable factor in their rapid growth and increasing domination of national and international markets, are the advantages of such centralization.

Nevertheless, the costs and effects of centralized control, management and services are readily susceptible of being spread and attributed to all aspects of the business, wherever carried on, by means of separate accounting. The costs of such activities, wherever incurred, can be spread among the components of the business by cost accounting methods, or percentages of volume, and other accounting procedures which are widely used in preparing financial statements and in rate fixing by regulatory agencies. To be sure, the States must be alert to the allocation of centralized or pooled costs and apply effectively their counterparts of Section 482 of the Internal Revenue Code, in order to prevent or curb manipulation and tax avoidance, the siphoning off of income from one affiliate to others, and artificial loading of costs. By fairly spreading the costs of top company financing, centralized management, pooled services and activities, each segment of the

[1] See *Superior Oil Co.* v. *Franchise Tax Board*, 34 Cal. Reptr. 545; 386 p. 2d 33 (1963), *Chase Brass & Copper Co.* v. *Franchise Tax Board*, 86 Cal. Reptr. 350, 95 Cal. Reptr. 805 (1970), appeal dismissed 400 U.S. 961 (1970).

business, wherever conducted will absorb its fair share of the operations it conducts. This is a very different matter from the largely unsuccessful attempts to use separate accounting to break down the income of a business as between interdependent basic operations, such as manufacturing in one State and selling in others, in determining the income taxable by the various States.

It is for these reasons that I do not regard the California Court's three unities approach as providing acceptable yardsticks for measuring the scope of the unitary business for apportionment purposes.

(*c*)

Instead of the Ribicoff-Mathias bill approach, or the California three unities, my prescription of the metes and bounds of the unitary business, whether operating through branches of a single corporation or in a multicorporate structure, is that the essential formulary apportionment test ought to be whether the basic operating functions of the branch or affiliate in question are interdependent upon basic operating functions of other branches or affiliates. This would embrace the manufacturing or buying goods in one State and selling them in another, interstate transportation and communication, mining or processing in one State and selling in others, and the like. Factors such as centralized management, financing, advertising, the use of patents, trade marks and know-how, personnel, or technical services, and other ancillary or supportive activities, important though they be to the profits of the entire enterprise would not under this approach lay the foundation for multistate unitary business apportionment by formula.

To concretize the way in which the basic operations interdependence test would work, let me refer briefly to two recent decisions, the *Superior Oil* case in California and the *Skelly Oil* case in Minnesota.[1] *Superior* produced and sold petroleum and petroleum products in eight States, including California and in foreign countries. It is not an integrated oil company, as that term is used in the petroleum industry, since, except to a minor extent, it did not engage in refining or processing of oil. Generally, the petroleum was sold at the well site to other companies; the California produced oil was sold within that State and none of Superior's out of state produced oil was sold in California.

The California Supreme Court held that the company's out of state Operations, including those in Arkansas and Louisiana in which large losses had been suffered, were part of the California unitary business. The Court relied on the centralized control and management of the business exercised in the Los Angeles executive offices, from which accounting, legal, tax and engineering and other services were rendered, the financing of the entire business was carried on, drilling equipment and other supplies were purchased, and the company's exploration activities, its well production and land acquisition were coordinated. Superior also conducted centralized research, training of personnel, handling of insurance and other matters.

Under the test of unitary business which I propose, the production and sale of oil by Superior in Arkansas, Louisiana and other States would not be deemed part of the California unitary business, because producing and selling petroleum were the basic operating functions of the business, and the production in each State was marketed within its own borders. The centralization of management and control in California and the common handling of nonoperating functions, such as financing, administration and technical services do not, in my view, warrant unitary treatment of the business.

When we turn to the Minnesota case, we find that Skelly Oil Company was in part intergrated, carrying on all the functions from producing crude oil, refining and manufacturing oil products, transporting and marketing the products. Skelly produced no oil in Minnesota; instead, in that State, it sold gasoline, lubricating oil and other oil products, which it had produced and manufactured from its own resources and with its own facilities outside the State. The Minnesota Court held that Skelly's Minnesota business was not unitary with its out of State business, treating the out of state production and manufacture of the oil as "separate and independent businesses" from the marketing operations in Minnesota.

Here too, I respectfully dissent, since Skelly was a classic example of interdependent basic operations, which in my view are the essence of a unitary business to which apportionment and the formulary approach should have been applied.[2]

[1] *Superior Oil Co.* v. *Franchise Tax Board*, supra; *Skelly Oil Co.* v. *Commissioner of Taxation*, 269 Minn. 351, 131, N.W. 2d 632 (1964).

[2] For a further statement of the approach here proposed and the basis for it, see Hellerstein, "Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business," 21 National Tax Journal 487 (Dec. 1968), a copy of which is attached to the master copy of this statement for the record of the hearings.

Let me fill in one or two major aspects of the unitary business concept I am proposing. Because we are concerned with economic and fiscal problems, I would reject all distinctions or limitations on the scope of the unitary business, and in turn of apportionment, by reason of the particular legal form under which the enterprise may be structured. Whether we are dealing with a single corporation operating through branches, or with a corporate structure operating through subsidiaries, joint ventures and the like, whether subsidiaries are incorporated in the taxing State, other States or in foreign countries, all appear to me to be irrelevant to out inquiry. So long as any legal entity making up a part of the unitary enterprise, or any branch of the taxpayer is subject to the jurisdiction of the State to tax, that State would ordinarily be justified in determining the liability of the taxpayer subject to its taxing jurisdiction, through an apportionment of the income or capital or a unitary business of which the taxpayer is a component.

If the basic operations interdependency principle of unitary business, should be adopted, there will, of course, inevitably be developed, as is true with most legal priniciples and yardsticks, qualifications and exceptions required by the varying patterns of business operations. Thus, I would suppose that there ought to be *substantial* interdependence of the basic operations between the segments of the business conducted in the taxing State and the rest of the enterprise, before the unitary principle would come into play. For example, if a corporation sells to affiliates only a small part of its output, and in turn purchases from them only a small part of the raw or the semi-processed materials it uses in its manufacturing operations, it ought not be includible in the unitary business. Some quantitative minimum measure of substantiality ought to be present before the business be deemed part of a unitary enterprise. Quantitative tests of this character are common in State and Federal tax legislation and would appear to me to be feasible and appropriate here.

(*d*)

There is also the controversial question as to whether the unitary business line ought to terminate at the boundaries of the United States. The problem grows out of the fact that formulary apportionment is based on the premise that a dollar of wages or property spent and a dollar of sales receipts realized in each of the taxing jurisdictions involved produces approximately the same amount of income. We know, of course, that there are variations in wage rates, property costs and sales prices among the States in this country, but we have usually dismissed the differences as insufficient to outweigh the efficacy of unitary apportionment, and have charged the differentials to the necessity of making an approximation of the source of income. The differentials, however, may result in significant distortions, if the scope of the unitary business, and hence apportionment, is extended world-wide.

It is my impression that wage rates in the United States are often three or four times as high as the wages paid for comparable work in manufacturing and other enterprises carried on in the Far East, Africa, and in some cases in Latin America; and that they also tend to be substantially higher in the United States than in many European countries. Prices of natural resource products, processed materials and manufactured goods appear to vary markedly between the United States and other countries; and it may be that the same is true of the third factor, the cost of property used in business. Of course, other facts need to be considered, such as the productivity of labor country-by-country, so as to translate the apportionment factors into comparative unit wage costs. These and other facts need to be taken into account in relating the three factors to the comparative profitability of operations in the United States and various foreign countries.

What I am suggesting is that the disparities in the factors employed in the typical formula, as between the United States and other countries, may be so great as to dictate the need for a cut-off of unitary apportionment at the borders of the United States. This subcommittee could, I believe, make a signal contribution to this controversy by making an investigation of the underlying facts relevant to world-wide apportionment, so as to advise Congress whether unitary apportionment, applied world-wide is an acceptable device for carving out the income of multinational enterprises properly attributable to the States within this country. Such factual data ought to be in the possession of Congress before it legislates on unitary apportionment.

If such a study should indicate that the standard three factor formula applied worldwide tends to produce such distortion in the apportionment of income to the United States and to foreign countries as to make it unacceptable in determining the income of multinational enterprises fairly attributable to foreign and domestic

sources, the Committee will be faced with the necessity of considering alternative approaches. As the Committee is aware, there are techniques employed by the Internal Revenue Service for separating the income of United States corporations from that of their foreign affiliates operating abroad, and the income of the United States corporations operating abroad from that of their foreign affiliates operating within the United States. In determining the income derived from the sources within and without the United States, as is required for these purposes under the Internal Revenue Code (I.R.C. §§ 861-863), separate accounting is used, with intercompany transactions subject to scrutiny under Section 482. But if the requisite data for separate accounting are not available, the Internal Revenue Service resorts to apportionment techniques (Fed. Income Tax Regs. § 1-863-3(b)(2)). The separate accounting and apportionment methods used by the Internal Revenue Service are crude and inadequate as compared with State division of income methods. Thus, under the Federal rules, typically receipts from sales are allocated or apportioned to the locus where title to goods passes (idem. §§ 1.861-7, 1-863-3), a standard which ignores economic factors, and readily lends itself to tax avoidance. It is understandable, therefore, that the States tend to reject the Federal rules in separating foreign from United States income.

It may, however, be possible to adjust the three factor apportionment formula for variations in wages, prices and property over the world, provided the requisite data can be obtained. If the Department of Commerce were to publish annual indices of comparative wage data in major industries, country by country, weighted for labor productivity, and indices of the comparative prices of products, the distortion due to variations in these factors would be largely eliminated. The property factor might similarly be handled by an index of comparative costs of buildings, plant, machinery and equipment used in business, based on reports of annual depreciation. It is my understanding such indices do not now exist, and that, although some of the necessary underlying data are available to construct them, additional fact gathering would be required. Conceivably, this may be too ambitious a project even for the Department of Commerce with its vast resources, and with possible collaboration by UNESCO, although I should add that information concerning comparative country-by-country unit labor costs, prices and the costs of property used in various businesses would serve other highly useful purposes in decision making with respect to United States policies affecting foreign trade, tariffs, the operations abroad of United States-based multinational corporations, and so on.

Doubtless, there are other ways of separating the United States and foreign income of unitary multinational enterprises. This area has been given comparatively little study or thought by students of the field, although it has become an increasingly pressing problem with the rapid expansion of American-based multinational enterprises. Perhaps, it would be useful for the Committee to invite representatives of business organizations, the States and students of public finance and world-wide trade to offer recommendations as to techniques for applying the apportionment principle to worldwide businesses.

(*e*)

There is another and very different approach to the unitary business, which needs to be considered, that the scope of the unitary business, where it is organized as are most large enterprises through subsidiaries rather than branches, ought to be simplified by adopting the Federal rule of consolidation by reference to 80 per cent of intercorporate stock ownership. (See Ad Hoc Committee Report, Magnuson bill, S. 2092 § 505 [1973]). The major argument offered in support of this approach is its simplicity, and that, as a result, it would relieve tax administrators and taxpayers of the burden of making judgments as to what constitutes a unitary enterprise. My view is that the stock ownership rule is too high a price to pay for whatever simplification and easing of tax administration and compliance it would entail.

At the outset, the argument is often made that because the Federal government uses the stock ownership rule with respect to consolidated income tax returns, it ought to be adopted by the States. I do not regard the Federal analogy as pertinent. Under the Federal income tax, whether consolidated or separate returns are filed, the tax rate and the measure of the tax (aside from certain intercompany eliminations) are the same, and the taxes paid go into the same Federal treasury. Obviously, none of this is true in State taxation, where rates and measures vary significantly State-by-State, and the revenues of some States will be increased, while those of others will be decreased, depending on the standards for determining combination or consolidation.

Simplification measures, as we have learned from experience with Federal and State tax legislation, seldom live up to the expectations of their proponents, and I suggest that this would be true with respect to the stock ownership rule for defining the scope of the multicorporate unitary business. The conglomerates are a case in point. If a single corporate umbrella, interconnected by the requisite 80 percent stock ownership, covered a group of subsidiaries, one of which manufactures and markets goods along the West coast, a second, operating in the Midwest, processes and sells food products, and a third conducts an automobile and truck leasing business in the Northeast, I know of no tax policy which would justify the combination or consolidation of the income and losses of these disparate businesses, simply because of the common stock ownership. And I suspect that many of the proponents of the 80 percent stock rule would be the first to contend that such an enterprise should not be subject to the unitary business apportionment principle. Consequently, qualification of the "simple" 80 percent rule would be necessary, perhaps by the adoption of a legal principle that only "a single business" is to be covered by the stock ownership rule (compare Multistate Tax Commission Regs. IV 1(b), relating to two or more businesses of a single taxpayer), or some other yardstick requiring the exercise of judgment. Moreover, I know of no greater justification for consolidating the income of 80 percent owned subsidiaries, all of which are engaged in the same type of business as the parent company but operate in different States, so long as their basic operating functions, such as buying, manufacturing, processing and marketing, are carried on entirely with non-affiliated interests. These are illustrations of the types of problems which are likely to require judgments and the application of flexible principles, which the stock ownership yardstick of unitary business seeks to avoid, but which in my view are unavoidable, if we are to adopt rational and equitable standards for defining the scope of unitary apportionment.

There is another weakness in the stock ownership rule of unitary business, namely, that it would open up comparatively easy avenues for manipulation and reduction of taxes by corporate lawyers and accountants. If we are concerned with the need to protect the fisc and the objective of keeping our tax laws equitable as between taxpayers, we ought, if possible, to devise tests which do not readily lend themselves to tax reduction by formal changes which have no real impact on the operation of the business. This is one of the strengths of the basic operations interdependence test, for it minimizes the possibilities of reducing tax by making formal or paper changes which do not alter the conduct of the business.

To put the matter otherwise, the stock ownership rule, by utilizing 80 per cent of stock ownership as the test of the unitary business, as distinguished from an economic test, would put in the hands of taxpayers, to a very considerable extent the power to elect unitary apportionment or, so avoid it for such units of the enterprise as they choose. I would opt instead for a yardstick of the unitary enterprise, which, while requiring judgments to be made and lines to be drawn by taxpayers, administrators and the courts, would tailor the concept to the justifiable role of apportionment, would achieve greater equity among taxpayers, and would reduce tax avoidance. It is my belief that it is possible to develop such statutory standards, which would at the same time considerably clarify existing law and be workable in administration and in compliance.

B. Throwback Provision or Exclusion of Nontaxable Income from Sales Factor

There is no justification for placing a portion of the income of the interstate businesses in "no man's land" in which no State has the power to tax the income, while their intrastate competitors are taxable on 100% of their income. The throwback provision of S. 2092 (§ 304) and the exclusion by the NATA bill, both from the numerator and denominator of the sales factor, of receipts from sales made with a destination in a State which lacks the power to tax by reason of the Federal Constitution or of Federal legislation (§ 205), are designed to accomplish this objective. Some such provision appears to me to be essential in any Federal legislation dealing with apportionment and allocation which Congress may enact.[1]

[1] For similar reasons, any legislation dealing with the duty of the interstate seller to collect sales taxes should likewise contain provisions for a throwback to the State of origin of the duty to collect and pay over sales taxes, where the State of destination is without power to impose the tax or the duty to collect. Moreover, if any reasonable and viable administrative procedures can be devised for assuring the collection of sales and use taxes on interstate sales made by nonresident salesmen or independent agents, television, radio, newspapers or periodicals, or by direct mail order solicitation, they ought to be adopted. I know of no justification, other than administrative difficulties, for freeing the customer from tax or for giving the out-of-state seller a trade advantage over local businesses, simply because interstate commerce is being carried on. The magnitude of this trade advantage is indicated by the fact that, in some markets in this country, sales and use taxes run as high as 7% of the price of the goods.

TAXATION OF DIVIDENDS AND THE BUSINESS–NON-BUSINESS INCOME CONTROVERSY

The controversy concerning the taxation of intercorporate dividends and the definition of business and non-business income, as those terms are used in UDITPA, needs to be approached by recognizing that there are dividends and dividends. Thus, if a manufacturing company receives dividends from its wholly-owned subsidiary which is engaged principally in selling the product of the parent company, the dividends constitute a part of the profits derived from the parent-subsidiary unitary business. Such profits constitute operating income, income of the business, just as they would if the enterprise were conducted through sales branches, instead of a subsidiary. Such dividends ought to be apportioned as part of the basic operating income of the enterprise and, therefore, should fall within the UDITPA classification as business income.

As I have already indicated, the realistic and fiscally sound tax treatment of such an enterprise is to combine or consolidate the income of the parent and selling subsidiary for purposes of unitary apportionment. The dividend issue would then disappear, since the dividends would be eliminated as an intercompany item. If, however, neither the State nor the taxpayer exercises the option granted by the type of statute which it is assumed would be in force to utilize the combined or consolidated approach, or, if for one reason or another, the taxpayer does not qualify under the statutory provision for combination, the character of the dividend income on a separate parent company basis, nevertheless, does not, in my thinking, change; it is still operating income which ought to be apportioned in taxing the recipient.

When we turn, however, to dividends paid by nonaffiliates, or by corporations which are not integral parts of the unitary enterprise, the situation will ordinarily be different. Apart from a corporation engaged in the securities business, dividends received from investments in nonaffiliated corporations, or from affiliates in a conglomerate which are not a part of the unitary enterprise, constitute investment income. Such income does not flow from the unitary basic operating activities, of which the taxpayer is a part. To apportion that type of dividend income by reference to factors such as the location of the taxpayer's plant and inventory of goods, the States in which its manufacturing employees and its salesmen operate, the location of its customers, would appear to me to be distorting, and simply would not reflect the activities of the taxpayer which produced the non-unitary dividends, or other factors relevant to the attribution of the dividends to particular States.

If this conclusion is accepted, the commercial domicile rule which has been traditionally applied to income from intangibles, reflects a good deal of wisdom. For that State has the dominant claim to tax such non-operating dividend income, since the activities relating to the investment, the control and management of the stocks which produced the dividend income typically take place at the executive offices, where the financial work is carried on. Consequently, in the language of UDITPA, such investment or non-operating dividend income ought to be treated as non-business income and be allocated to the commercial domicile.

Finally, I should like to comment on the provision of S. 1245 which would prohibit States from taxing dividends received from 50% or more owned subsidiaries, and would bar the taxation of dividends, whether paid by subsidiaries or otherwise, which are treated as foreign source income for Federal income tax purposes (§§ 208, 207). The major argument made by the proponents of this restruction on the State taxing powers is that this is in substance what the Federal government does, through the intercorporate dividend exclusion and the indirect foreign tax credit. (See, Cahoon and Brown, "The Interstate Tax Dilemma", 26 National Tax Journal 187, 184 [June 1973].) The Federal model appears to me to be irrelevant to State taxation. The justification given for this rule in the Internal Revenue Code is that, because the Treasury already taxes the earnings of the underlying corporation, there would be double taxation if the dividend were taxed to the corporate recipient. But that situation does not obtain in the States where the dividend paying corporation may not be doing business or may not be taxable in the State in which the recipient carries on its business. The State in which a corporation exercises its holding company functions has a legitimate claim to tax that company for the benefits and protections it receives, to help defray the costs of maintaining the governmental services from which the taxpayer and its employees benefit, and by which they are protected. Moreover, there is the overriding pragmatic consideration that State income tax rates amount to only a small fraction of the 48% Federal rate.

Likewise, the fact that a foreign tax credit is allowed to the dividend recipient under the Federal income tax for taxes paid to foreign countries by the dividend paying corporation has little bearing on State tax policy. Congress has never sought to impose on the States the income tax policies it has developed as incentives to foreign operations of American enterprises; and I suggest that it would be inappropriate for Congress to impose any such Federal tax policy on the States without a full examination of the operations of American multinational business abroad, and the impact of such policies on revenues, employment, and business investments at home and abroad.

JUDICIAL REVIEW AND ADMINISTRATION

A. Judicial Review

S. 1245 vests in the United States Court of Claims jurisdiction over controversies arising under the bill and P.L. 86-272. If enacted, this measure would mark a radical shift from State to Federal courts of the administration of major State tax controversies.[1]

The bill provides that any decision of a State, administrative body, appealable only to a court, and involving any dispute under its provisions or P.L. 86-272 may be reviewed de novo by the Court of Claims (§ 401). Either the taxpayer or the State would be able to by-pass the State courts and start afresh in the Court of Claims, where both the facts and the law would be tried, with respect to questions of jurisdiction to tax, apportionment or allocation, the duty to collect sales or use tax, and the like. The taxpayer could also require any States whose tax claims might be affected by the proceeding, by giving notice to such States to appear, or in any event be bound by the results of the proceeding (§ 402). Thus, if one State determines that a taxpayer is part of a unitary business carried on in a number of States and the taxpayer contends that it is not unitary, all the States in which the enterprise is conducted will be bound by the Court of Claims proceeding, if they are given notice; and they will be obliged to appear and participate in the proceeding in order to protect their interests.

This procedure would, in my opinion, impose intolerable burdens, excessive costs, and unwarranted delays in the sensitive and vital area of State taxation, in which prompt determinations of controversies are essential, and administrative costs ought to be kept at a minimum. Knowledgeable tax counsel would be likely to resort to the Court of Claims to force advantageous settlements from the States; they would tend to give notice to any State which, in the most remote contingency, might be affected by the proceeding. Apportionment or allocation cases affecting sizeable multistate businesses would frequently involve 10 or 15 States, and where the controversies involve the corporate giants, as indeed has been true in recent years in a good deal of State tax litigation, a single case could bring before the Court most of the 50 States in the country. Whether the trial of such a multi-party litigation were held in Washington, D.C., or at a session of the Court of Claims in Juneau, Alaska, or Montpelier, Vermont, depending on where the case initially arose, lawyers, tax administrators and witnesses from all parts of the country would have to appear, file answers, participate in the taking of interrogatories, conduct trials in what could become endless examination of witnesses by numerous counsel, file briefs, and participate in appeals. Such suits in practice would be virtually unmanageable and the costs to the States and the delays would become intolerable, and would undoubtedly force settlements favorable to large, interstate taxpayers, unjustifiable on the merits.

Moreover, serious disruption of State practice would result from the wrenching of State tax controversies out of their own locale, where lawyers and judges are used to their own local procedures and rules of evidence, and are familiar with the tax laws of their State, and entrusting the trials and decision to Hearing Commissioners or Judges brought in from Washington, who know little or nothing about local procedures or the State's laws.

The judicial review provisions of S. 1245 ought to be given short shrift by the Committee, particularly since there is no need for the cumbersome, disruptive

[1] There is also a question arising under the Eleventh Amendment to the Constitution as to whether Congress can require the States to submit themselves to the jurisdiction of a Federal court to dispose of controversies arising under State taxing statutes, as limited by Federal legislation. The proponents of S. 1245 rely on *Parden v. Terminal Railway of Alabama State Docks Department*, 377 U.S. 184 (1964), and *Employees of Department of Public Health and Welfare, State of Missouri*, —U.S.—, 93 S. Ct. 1614 (1973). Those cases involved suits against States in the Federal courts brought by (a) employees of a State-operated railroad to recover under the Federal Employers' Liability Act, and (b) employees of a State hospital and training school to recover overtime and minimum wages under the Federal Fair Labor Standards Act. They are by no means dispositive of the power of Congress to require the States to respond in the Federal courts with respect to controversies arising under their own tax laws on the ground that Federal restrictions on State taxation of interstate commerce are involved.

structure proposed. There is a better way to handle judicial review of such issues, and it has been in practice in this country ever since the Constitution was adopted. And that is to follow normal procedures for contesting tax assessments in the State courts. If the highest court of the State construes its tax law and the limitations imposed by Congressional legislation contrary to the taxpayer's view of the statute, the taxpayer would have opportunity for review of the decision by the Supreme Court of the United States under the Judicial Code (28 U.S.C. § 1258). In the event that Congress should, for example, enact a provision determining what constitutes a unitary business subject to apportionment on a combined or consolidated basis, a decision by the California Supreme Court going one way and the Utah Supreme Court going another, on essentially the same set of facts, as it has been argued occurred in *Chase Brass & Copper Co. v. Franchise Tax Board*, (86 Calif. Reptr. 350 [1970], appeal dismissed for want of jurisdiction, 400 U.S. 961 [1970]), and *Kennecott Copper Corporation v. State Tax Commission*, (27 Utah 2d 119, 493 P.2d 632 [1972], appeal dismissed for want of a substantial federal question, —U.S.—, 93 S. Ct. 323 [1972]), would produce the type of conflict which would doubtless lead to review of the issue by the Supreme Court. (Compare Rule 19, Revised Rules of the Supreme Court.) Because we would be dealing with a Federal statutory restriction on State taxation, the Supreme Court would have final jurisdiction to construe the Federal statute. In the *Chase Brass* and *Kennecott* cases, the only possible basis for Supreme Court review was the existence of substantial constitutional question; the Court evidently adhered to its traditional view that conflicting State tax apportionment methods do not present substantial questions under the Commerce or Due Process Clauses. The Court would have jurisdiction to review conflicting interpretations by the highest State courts of Federal legislative restrictions on the State taxing powers.

Accordingly, I would urge the Committee to reject proposals such as that embodied in S. 1245 for review by the Federal courts of interstate tax controversies, and suggest, instead, that Congressional legislation dealing with judicial review of controversies arising under P.L. 86-272, or any further legislation which Congress may enact, is neither necessary nor desirable.

B. Administrative Provisions

There is a related problem as to what, if any, provisions should be enacted relating to the administration of any Congressional legislation restricting State taxation of interstate business. Our experience with legislation dealing with complicated economic problems unmistakably teaches us that an administrative agency is a sine qua non to effective implementation of any Federal legislation setting up jurisdictional restrictions, uniform apportionment and allocation provisions, and the like. We need such an agency to issue regulations, to prescribe uniform forms; and it could be particularly important in conducting multistate audits, at the request of the States, of business carried on across State lines. It could also perform an invaluable watchdog function, making recommendations to Congress for improving legislation in the light of experience.

To lodge such State tax and administrative functions in the already overburdened Internal Revenue Service, with its national orientation, and its artificial and formalistic approach to determining the source of income, would clearly be the wrong choice. Because I am involved in the litigation pending in the Federal courts challenging the constitutionality of the Multistate Tax Compact and the multistate audits being conducted by the Multistate Tax Commission, I should prefer not to comment on the proposal made by S. 2092—that the Multistate Tax Commission should be designated to perform such administrative functions.[1] But it is appropriate for me to suggest that the basic model of the Compact as a collaborative agency of the States, acting to administer their own tax laws in light of Congressional legislation restricting their jurisdiction and prescribing methods of dividing the income of interstate businesses, and the like, has much to commend it. It is the least disruptive of existing State practices and procedures and it would reflect a sound accommodation of the proper roles of Federal and State governments under our Federal System.

Finally, I should like to comment on the provisions of S. 2092 which would make regulations issued by the administering agency (under S. 2092 that agency would be the Multi-state Tax Commission) mandatory as to States which do not formally reject them within six months. I see no need for Congress to adopt any measure which would exert pressure on the States, even indirect pressure, to

[1] I am counsel for the Multistate Tax Commission and the twenty-one State tax administrators who are members of the Commission in the case of *United States Steel Corporation, et al.* v. *Multistate Tax Commission, et al.*, a suit for declaratory judgment and injunction pending in the United States District Court for the Southern District of New York.

adopt the administrative agency's regulations. Regulations issued by such a central agency, whether advisory or mandatory, will in fact have a considerable influence on State tax administrators and the Courts; and they will gain their support over the country largely by their own merit. Consequently, in my view the agency's regulations ought to be advisory; the States, of course, would be free to adopt them if they commend themselves to the tax administrators. In practice, there will be no controversy as to many questions covered by the regulations, and they will have a unifying effect over the country. With respect to controversial issues, involving important matters and conflicting approaches, the courts must ultimately decide them in any event. The tendency will be for State courts to follow the views of the courts of other States which have passed on the same issue, so that a great deal of uniformity over the country is likely to develop in actual operation. When the State courts do disagree in their interpretation of the Federal restrictions on the State taxing power in matters of consequence, the Supreme Court will remain the final arbiter to lay down rules which will govern all the States.

APPENDIX A

CURRICULAR VITAE OF JEROME R. HELLERSTEIN

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Assistant Corporation Counsel, City of New York, Tax Division;

Member, Advisory Committee, Willis Subcommittee on State Taxation of Interstate Commerce, House Judiciary Committee;

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Selected writings:

"State and Local Taxation: Cases and Materials" (West, 3d Ed. 1969);

"State Taxation in a National Economy" (with E. B. Hennefeld), 54 Harvard Law Review 949 (1941);

"State Franchise Taxation of Interstate Business", 4 Tax Law Review 95 (1948);

"An Academician's View of State Taxation of Interstate Commerce", Procs. 53rd N.T.A. Annual Conf. 201 (1960);

"Allocation and Nexus in State Taxation of Interstate Business", Symposium on State and Local Taxes of Business, Tax Institute of America 67 (1964);

"Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business", 68 National Tax Journal 487 (1968).

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RECENT DEVELOPMENTS IN STATE TAX APPORTIONMENT AND THE CIRCUMSCRIPTION OF UNITARY BUSINESS

JEROME R. HELLERSTEIN *

TWO RECENT decisions of the Supreme Court of the United States suggest that a shift may be taking place in the Court's policy, of some four decades standing, of virtually abstaining from interfering in apportionment methods applied by the states in taxing businesses engaged in interstate commerce.[1]

Appeals to the Supreme Court from the decisions of the highest courts of the states for relief from allegedly improper or oppressive apportionment methods arise principally under the Due Process Clause of the 14th Amendment and the Commerce Clause.[2] The Due Process Clause has traditionally been held by the Court to forbid extraterritorial taxation, so that if an apportionment method results in the taxation of a larger portion of the income, capital stock, property or other tax base than is properly attributable to the state, under established legal doctrine the taxpayer's rights, protected by the Due Process Clause, have been infringed.[3]

The role of the Commerce Clause in apportionment matters is more elusive, since the issue as to the propriety of the measure of the tax, given a subject of tax that is not barred by the Commerce Clause, is whether an undue burden has been imposed on interstate commerce.[4] In giving content to the "undue burden" standard, as applied to tax measures, the tests developed by the Court appear to be essentially the same as those employed in deciding whether there has been extraterritorial taxation in violation of the Due Process Clause.[5] For, if a

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1 *General Motors Corporation v. District of Columbia*, 380 U.S. 553 (1965); *Norfolk & Western Railway Co. v. Missouri State Tax Comm.*, 390 U.S. 317, 88 S. Ct. 995 (1968).

2 There are other Federal constitutional issues that may affect apportionment that are outside the scope of this paper. For a consideration of the Equal Protection of the Laws Clause, see Hellerstein, *State and Local Taxation: Cases and Materials*, 45 et. seq. (2d ed. 1961). Because corporations are not "citizens," they are not protected by the Privileges and Immunities Clause of the 14th Amendment. See *Western Turf Ass'n. v. Greenberg*, 204 U.S. 359 (1907).

3 See the discussion, infra.

4 See Hartman, *State Taxation of Interstate Commerce*, ch. 2 (1953); Hellerstein, loc. cit., supra, 2, ch. 6; Note, "Developments–Federal Limitations on State Taxation of Interstate Business," 75 *Harv. L. Rev.* 953 (1962).

5 As stated by Mr. Justice Fortas in Norfolk & Western Railway Co. v. Missouri State Tax Commission, Note 1, supra:

> We have said: "The problem under the Commerce Clause is to determine 'what portion of an interstate organism may appropriately be attributed to each of the various states in which it functions.' *Nashville, Chattanooga & St. Louis R. Ro. v. Browning*, 310 U.S. 362, 365, 60 S. Ct. 968, 970, 84 L. Ed. 1254. So far as due process is concerned, the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State. See *State of Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444, 61 S. Ct. 246, 249, 85 L. Ed. 267, 130 A.L.R. 1229. Those requirements are satisfied if the tax is fairly apportioned to the commerce carried on within the State." *Ott v. Mississippi Barge Line*, 336 U.S. 169, 174, 69 S. Ct. 432, 434, 93 L. Ed. 585 (1949). Neither appellants nor appellee contend that these two analyses bear different implications insofar as our present case is concerned. (88 S. Ct. at 1001, Note 5)

For other discussion of the interrelation of the two clauses in state tax cases, see the dissenting opinion of Justices Brennan and Goldberg in *General Motors Corporation v. Washington*, 377 U.S. 436, 449, 451 (1964). See also, Rutledge,

state employs an apportionment method that may be fairly regarded as taxing only income, assets and the like, attributable to business activities, or property within the state, there is neither a Due Process nor a Commerce Clause barrier to the tax. While the courts have generally been particularly vigilant in seeking to protect interstate business from the risks of multiple taxation not borne by local commerce—by way of contrast, it is established that the Due Process Clause does not prohibit double taxation, so that the same income or intangible property may be taxed by more than one state having adequate nexus, so long as interstate commerce is not involved [6]—in the actual working out of the decided apportionment cases affecting multistate businesses, there appears to be little or no distinction between Due Process and Commerce Clause issues.

The Doctrinal Setting

At the turn of the century, the Supreme Court dealt with a series of apportionment cases arising under state property and capital stock taxes imposed on railroads, express companies, and other transportation businesses. In the 1890's, the Court upheld the use of a rail mileage formula to apportion a capital stock tax; [7] and in succeeding cases a similar method of apportioning capital stock taxes was sustained, where the apportionment included the going business value and other intangibles of the corporation.[8] The Court was, however, alert to strike down the levies where it found that apportionments were employed in a manner that taxed out-of-state values. Thus, where a track mileage apportionment method resulted in a ratio far in excess of the ratio of car mileage actually travelled by the rolling stock of a tank car line used in the state, the levy was held unconstitutional; [9] and a tax apportioned under a track mileage apportionment was likewise held to violate the Due Process and Commerce Clauses, where the Court concluded that its effect was to attribute to Indiana a part of the value of securities and other assets that it regarded as New York property.[10]

Beginning in 1920, however, as the Court was increasingly faced, not with taxes imposed on the instrumentalities of interstate commerce (which have always been the favorite child of the Court because of its understandable concern that the channels of commerce remain unobstructed by restrictive state action), but with taxes on manufacturing and mercantile businesses, a different judicial atmosphere set in. The theory remained unchanged, but in practical application

J., discussing the interrelations of the two clauses in the sales and use tax area in *McLeod v. Dilworth*, 322 U.S. 327, 340 (1941); and Professor Powell's comment in "The Current Current of the Commerce Clause and State Taxation," *1940 Nat. Tax Ass'n. Procs.* 274.

[6] *Curry v. McCanless*, 307 U.S. 357 (1939); *State Tax Comm. v. Aldrich*, 316 U.S. 174 (1942).

[7] *Pullman's Palace Car Company v. Pennsylvania*, 141 U.S. 18 (1891), three Justices dissenting.

[8] *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194 (1897); *Adams Express Co. v. Indiana*, 165 U.S. 255 (1897). These were both five to four decisions.

[9] *Union Tank Line Co. v. Wright*, 249 U.S. 275 (1919), three Justices dissented.

[10] *Fargo v. Hart*, 193 U.S. 490 (1904), three Justices dissented. A gross receipts tax, apportioned on a mileage basis, was invalidated in *Galveston, Harrisburg & San Antonio Ry. Co. v. Texas*, 210 U.S. 217 (1908), on the ground that it was a levy on receipts from interstate commerce prohibited by the Commerce Clause, but such an apportionment had been sustained in *Maine v. Grand Trunk Railway*, 142 U.S. 217 (1891), both holdings drawing the dissent of four Justices. Although the use taxes appeared to be essentially the same in character, in the *Galveston, Harrisburg* opinion, the Court distinguished the earlier case as involving the use of gross receipts to measure the value of property employed in the state, as in effect an "in lieu" tax.

for the next four decades, virtually no taxpayer succeeded in persuading the Supreme Court that a state tax apportionment was unconstitutional.

Implementation of the Doctrine

The reason for the virtual invulnerability of state apportionment methods was that the standards now imposed by the Court for establishing that a state was taxing property, income, values, or other tax measure not properly attributable to the state were such as to preclude, for all practical purposes, successful attack. The first major decision in this development was the 1920 case of *Underwood Typewriter Co.* v. *Chamberlain*,[11] in which a crude, single factor property formula apportioning the net income base of the Connecticut tax on corporations, was sustained against Due Process and Commerce Clause attack. Underwood conducted all its manufacturing operations in Connecticut, but had branch offices and inventories in other states, and sold its products over the country. Because 47 per cent of Underwood's real estate and tangible property was located in the state, Connecticut assessed its tax on some $630,000 of net income, based on a 47 per cent income apportionment. The company contended that it derived a profit of only $43,000 from its Connecticut operations, and that the tax as assessed violated the Due Process Clause, because it was "imposed on income arising from business conducted beyond the boundaries of the state." [12] The taxpayer's appeal was dismissed on the ground that it had failed to prove its case. The Supreme Court said:

> "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The Legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the state. 'The plaintiff's argument on this branch of the case,' as stated by the Supreme Court of Errors, 'carries the burden of showing that 47 per cent of its net income is not reasonably attributable, for purposes of taxation, to the manufacture of products from the sale of which 80 per cent of its gross earnings was derived after paying manufacturing costs.' The corporation has not even attempted to show this; and for aught that appears the percentage of net profits earned in Connecticut may have been much larger than 47 per cent. There is, consequently, nothing in this record to show that the method of apportionment adopted by the state was inherently arbitrary, or that its application to this corporation produced an unreasonable result." [13]

The reductio-ad-absurdum of this result, from the point of view of equitable division of a tax measure among the states, came in 1933, when a single factor property formula was applied by North Carolina to the net income measure of a corporation that did all its manufacturing and warehousing in the state. It had 99 per cent of its real estate and tangible property in North Carolina, but sold less than 1 per cent of its products in the state. Nevertheless, the state court sustained a 99 per cent apportionment of the net income to the state.[14] The highest court of the land apparently regarded the result as so obviously within the state's taxing powers that it affirmed, per curiam, without opinion.[15]

[11] 254 U.S. 113 (1920).
[12] 92 Conn. 199, 102 Atl. 600 (1917).

[13] 254 U.S., at pp. 120-121.
[14] *Maxwell v. Kent-Coffey Mfg. Co.*, 204 N. C. 365, 168 S. E. 397 (1933).
[15] 291 U.S. 642 (1933).

In the 40's and 50's, in two cases arising from California, extensive efforts were made to provide the proof that the Court had held in the *Underwood* and other cases was missing, in order to show that extraterritorial values were being taxed. In *Butler Bros.* v. *McColgan*,[16] an Illinois corporation engaged in the wholesale dry goods and general merchandising business was assessed some $4,000 in tax under the California apportionment formula; it contended it actually had an $82,000 loss from its California operations. Butler Bros. maintained a regional distribution office in San Francisco; each of its seven regional offices served its territory, with its own sales and other employees, and each office handled credit, collections and accounting. The corporation maintained a central buying division, through which goods were ordered. All goods were billed at cost to the regional offices and it was conceded that overhead, central advertising and similar expenses were billed at cost; no complaint was made by the state as to the fairness of these expense allocations. By utilizing these figures and separately accounting for the regional office, the taxpayer showed an $82,000 loss for its California operations. The Commissioner of Taxation employed the California Massachusetts type formula, using the ratios of in-state property, payroll and sales to totals of the entire business, and applied the 8 per cent resulting California average ratio to the taxpayer's net income of $1,149,677 from all sources, and thereby apportioned a profit of $93,500 to the state. The Supreme Court affirmed the holding of the California court that the tax did not violate the Due Process Clause, saying:

"One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extraterritorial values being taxed. See *Norfolk & Western Ry. Co. v. North Carolina*, 297 U.S. 682, 688, 56 S.Ct. 625.

"It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand.

"At least since *Adams Express Co. v. Ohio*, 165 U.S. 194, 17 S. Ct. 305, this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis. As stated in *Hans Rees' Sons, Inc. v. North Carolina*, supra, p. 133, '. . . the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits.' And see *Bass, Ratcliff & Gretton, Ltd. v. Tax Commission*, supra, p. 282. By the same token, California may properly treat appellant's business as a unitary one. Cf. *Great Atlantic & Pacific Tea Co. v. Grosjean*, 301 U.S. 412, 57 S.Ct. 772. There is unity of ownership and management. And the operation of the central buying division alone demonstrates that functionally the various branches are closely integrated. Admittedly, centralized purchasing results in more favorable prices being obtained than if the purchases were separately made for the account of any one branch. What the savings were and what portion is fairly attributable to the volume contributed by the San Francisco branch do not appear."

"The fact of the matter is that appellant has not shown the precise sources of its net income of $1,149,677. If factors which are responsible for that net income are present in other States but not present in California, they have not been revealed. At least in absence of that proof, California was justified in assuming that the San Francisco branch contributed its aliquot share to the advantages of cen-

[16] 315 U.S. 501 (1942).

tralized management of this unitary enterprise and to the net income earned.

"We cannot say that property, pay roll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors may properly be deemed to reflect 'the relative contribution of the activities in the various states to the production of the total unitary income,' so as to allocate to California its just proportion of the profits earned by appellant from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula." [17]

In the later case of *John Deere Plow Co. v. Franchise Tax Board*,[18] counsel, undaunted, once more attacked a California apportionment, this time for the far-flung business of an out-of-state manufacturer, seeking to show that operations in California were considerably more expensive and less profitable than in other states. In rejecting the appeal, the California Supreme Court stated that the formula:

> " 'is not framed on the assumption that there must be uniformity of operating revenues and expenses in the relative functions of the various units contributing to the earnings of an integrated, multistate business' and concluded that the attack on the formula by proof of the higher costs and the less profitable nature of the California business misconceives the whole purport of the unit rule of assessment, which rests on the principle that 'where a business is unitary in character, so that its separate parts cannot be fairly considered by themselves and the whole business in the several states derives a value from the unity of use, allocation of income upon a reasonable formula is properly sustained.' " [19]

The Supreme Court dismissed the appeal for want of a substantial Federal question.[20]

A corporation did succeed in attacking the constitutional validity of an apportionment formula in the celebrated *Hans Rees* case.[21] There, the trial court had refused to permit the taxpayer to offer evidence to show that extraterritorial income was being taxed, apparently on the ground that, in view of the *Underwood* case, a single factor property formula is, as a matter of law, an unassailable method of apportionment. Thereupon, counsel for the taxpayer read into the record what he hoped to prove. His proffer of evidence analyzed the business into "buying profit," "manufacturing profit" and "selling profit," with percentages he hoped to show for each; and since his proffer allocated only 17 per cent of manufacturing profit to North Carolina, the allocation to the state of 66 per cent to 85 per cent of the profit for the years in question was, he contended, violative of both the Due Process and the Commerce Clauses. On this state of the record, the Supreme Court was required to assume the correctness of

[17] 315 U.S., at pp. 507-508.

[18] 38 Cal. 2d 214, 238 P. 2d 569 (1951).

[19] 38 Cal. 2d, at p. 228, 238 P. 2d at p. 577.

[20] 343 U.S. 939 (1952). The holding had some support in *Nashville, Chattanooga & St. Louis Ry. v. Browning*, 310 U.S. 362 (1940), in which the Tennessee Tax Commission, in assessing an ad valorem tax on tangible and intangible property of an interstate railroad, applied a mileage formula to the total value of the property. The taxpayer presented evidence showing that the revenue producing capacity of its lines outside of Tennessee was greater than within the state. The Court sustained the state Supreme Court's view that "this evidence, however weighty, was insufficient to displace the relevance of the formula." See the trenchant dissection of the opinion and holding in Powell, "The Current Current of the Commerce Clause and State Taxation," *1940 Nat. Tax Ass'n. Procs.*, 274, 274-276, 287-298. Such decisions tended to support the view of the then Attorney General of the State of New York that "it would be a very exceptional case indeed that would prompt the courts to substitute a direct accounting method for any reasonable allocation formula which a state might adopt." Goldstein, "Allocation of Income for Purposes of Corporate Taxation," 1 *Tax L. Rev.* 149 (1946); Brookes, "Another View," 2 id. 72; Goldstein, "A Reply," 2 id. 80.

[21] *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123 (1931).

counsel's assertions, which had never been put to proof. Accordingly, consistently with its earlier pronouncements, the Supreme Court held that "upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by appellant in that State."[22] Thus, because of the procedural guise in which the case came to the Supreme Court, the taxpayer never had to prove its allegations as to the amount of income attributable to North Carolina, the very issue on which attacks on apportionment formulas had typically faltered. While the case does reestablish the theoretical point that particular apportionment formulas are not, per se, necessarily within a state's constitutional powers, it offers little comfort to taxpayers put to proof of an assertion that a state has in fact included in the apportioned measure of a tax more than is properly attributable to the state.[23]

Invalidation of the District of Columbia's Single Factor Sales Formula

It is in the light of this background that the two recent cases take on special significance. *General Motors* v. *District of Columbia*, the first case, was not decided on constitutional grounds—that is, if we are to take the Court's word for what it was deciding, which may not necessarily reflect the springs of the decision. The case involved the apportionment of a net income measure of the franchise tax of the District of Columbia.[24] The District Tax Commissioners had promulgated a single factor sales receipts formula, in apportioning net income. General Motors, which sold cars and parts in the District, chiefly to retailers, but did no manufacturing there, attacked the apportionment of its net income, on the grounds that the formula was not authorized by the statute, and that, if authorized, the levy violated the Due Process and Commerce Clauses. The Supreme Court held that the statutory authorization to the District Commissioners to prescribe regulations, including apportionment and allocation, so as to determine "the portion of the net income of the corporation . . . as is fairly attributable to any trade or business carried on within the District," was not met by the single factor sales receipts formula. In so holding, the Court declared:

> "The conclusion which we reach by analysis of the plain language of the statute also finds support in the consequences which a contrary view would have for the overall pattern of taxation of income derived from interstate commerce. The great majority of States imposing corporate income taxes apportion the total income of a corporation by application of a three-factor formula which gives equal weight to the geographical distribution of plant, payroll, and sales. The use of an apportionment formula based wholly on the sales factor, in the context of general use of the three-factor approach, will ordinarily result in multiple taxation of corporate net income; for the States in which the property and payroll of the corporation are located will allocate to themselves 67 per cent of the corporation's income, whereas the jurisdictions in which the sales are made will allocate 100 per cent of the income to themselves. Conversely, in some cases enterprises will have their payroll and plant located in the sales-factor jurisdictions and make their sales in the three-factor jurisdictions so that only 33 per cent of

[22] 283 U.S., at p. 135.

[23] For analyses and comments on the developments described, see Palestin, "Interstate Taxation: Non-Unitary Corporation—Should Statutory Apportionment Yield to Separate Accounting?" *1965 Procs. Nat. Tax Ass'n.* 531; Beaman, *Paying Taxes to Other States*, ch. 3 (1963); Cohen, "State Tax Allocations and Formulas Which Affect Management Operating Decisions," 1 *J. of Taxation* 2 (July 1954).

[24] Note 1, supra.

their incomes will be subject to state taxation. In any case, the sheer inconsistency of the District formula with that generally prevailing may tend to result in the unhealthy fragmentation of enterprise and an uneconomic pattern of plant location, and so presents an added reason why this Court must give proper meaning to the relevant provisions of the District Code.

"Moreover, the result reached in this case is consistent with the concern which the Court has shown that state taxes imposed on income from interstate commerce be fairly apportioned . . . While the Court has refrained from attempting to define any single approriate method of apportionment, it has sought to ensure that the methods used display a modicum of reasonable relation to corporate activities within the State. The Court has approved formulae based on the geographical distribution of corporate property and those based on the standard three-factor formula. See, e.g., *Underwood Typewriter Co. v. Chamberlain, supra; Butler Bros. v. McColgan*, 315 U. S. 501. The standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates. By contrast, the geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus of either factor. We of course do not mean to take any position on the constitutionality of a state income tax based on the sales factor alone. For the present purpose, it is sufficient to note that the factors alluded to by this Court in justifying apportionment measures constitutionally challenged in the past lend little support to the use of an exclusively sales-oriented approach. In construing the District Code to prohibit the use of a sales-factor formula, we sacrifice none of the values which our scrutiny of state apportionment measures has sought to protect." [25]

This language does not augur well for the constitutionality of a state's single factor sales receipts formula, at least as applied to a similar factual pattern. For if the "geographic distribution of a corporation's sales is, by itself, of dubious significance in indicating the locus" of "either a corporation's sources of income or the social costs which it generates," it's hard to see how the single factor gross receipts apportionment of capital stock upheld in *Ford Motor Co.* v. *Beauchamps* can survive against a Due Process and Commerce Clause attack.[26] Moreover, despite the Court's apparent approval of the *Underwood* case, the single factor property formula there upheld appears equally vulnerable, as applied to a case in which the lion's share of the income of nation-wide manufacturing enterprise is attributed to the state in which its manufacturing plants are located.

Indeed, both these formulas suffer from inherent weaknesses. The gross receipts factor was used in the *Ford Motor* case to apportion what was in essence a property measure; and the property factor was used in *Underwood* to apportion a net income measure. A switching of the two formulas would have made a bit more sense, for it would be the sheerest accident if receipts from sales in a state fairly reflected the property there located, or if the property located in a state fairly reflected the net income attributable to the state, given the tendency of large enterprises to locate factories and warehouses regionally, and to sell and deliver into adjoining states. Hence, the *General Motors* case may possibly foreshadow a new judicial departure in reviewing constitutional apportionment questions, despite the Court's disavowal that it decided the case on constitutional grounds.

Judicial Acceptance of a Taxpayer's Proof of Overreaching of Intrastate Assets by Apportionment

The other recent piece in the mosaic suggesting a fresh approach by the Court to apportionment cases, *Norfolk*

[25] 380 U.S., at pp. 559-560, 561.

[26] 308 U.S. 331 (1939).

& Western Railway Co. v. *Missouri State Tax Commission*,[27] decided in 1968, was explicitly rested on constitutional grounds. Like the taxes involved in the line of transportation cases of the 1890's, the case arose under a rail mileage method of apportioning a levy, here the state's ad valorem property tax. The Tax Commission determined the total value of all rolling stock owned or leased by the railroad on tax day; it used as the value of the property original cost, less accrued depreciation, and then applied an equalization factor of 47 per cent, the ratio at which property generally is assessed in the state. The Commission found that 8.2 per cent of the railroad's mileage (owned or leased) was located in Missouri and, in this manner, allocated approximately $20,000,000 of tangible property value to the state. Intangible values were not taxable under the statute.

The railroad offered an inventory of the actual rolling stock on hand in Missouri on tax day and, utilizing the Tax Commission's valuation and equalization figures, established that $7,600,000 in rolling stock was actually within the state on tax day. The taxpayer also established that the day-by-day inventory over the year varied little from the assets on hand on tax day.

In holding that the state had exceeded its taxing powers in making the assessment, Mr. Justice Fortas, writing for the majority (Mr. Justice Black dissented), did not impugn mileage formulas as such, and reiterated the rule that:

> "A railroad challenging the result reached by the application of such a formula has a heavy burden. . . . It is confronted by the vastness of the State's taxing power and the latitude that the exercise of that power must be given before it encounters constitutional restraints. Its task is to show that application of the mileage method in its case has resulted in such gross overreaching, beyond the values represented by the intrastate assets purported to be taxed, as to violate the Due Process and Commerce Clauses of the Constitution."[28]

But in language reminiscent of the opinions in the transportation cases of the earlier era, the Court invalidated the levy, because it found that "here the appellants have borne that burden, and the State has made no effort convincing to offset the convincing case they have made." The Court also stated:

> "Our decisions recognize the practical difficulties involved and do not require any close correspondence between the result of computations using the mileage formula and the value of property actually located in the State, but our cases certainly forbid an unexplained discrepancy as gross as that in this case. Such discrepancy certainly means that the impact of the state tax is not confined to intrastate property even within the broad tolerance permitted.
>
> ". . . when a taxpayer comes forward with strong evidence tending to prove that the mileage formula will yield a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits."[29]

Conceivably, this decision merely reflects the Court's sensitivity to the importance of keeping interstate transportation free of burdensome tax barriers, and it may have no impact beyond the instrumentalities of commerce. I suggest, however, that this is too narrow a reading of the signs, and that taken together the *General Motors* and *Norfolk & Western Railway* cases appear to have a broader import, reflecting the first stirrings of a revival of the Court's intervention in the area after decades of judicial hands-off state tax apportionment.

[27] Note 1, supra.

[28] 88 S. Ct., at p. 1001.

[29] 88 S. Ct., at pp. 1002, 1003.

The temper of the times is in keeping with such a new departure in Federal-State constitutionalism. The opinion in the *General Motors* case indicates that the Supreme Court is not insensitive to the widespread criticism of its recent decisions broadening the powers of the states in taxing interstate commerce, and the restive mood of Congress in responding to the outcries of businessmen by enacting P.L. 86-272 with unprecedented haste. The opinion in the case cites the *Willis Subcommittee Report,*[30] which sets out in impressive detail the crazy-quilt of diverse and inconsistent apportionment formulas used by the states, with their capricious concomitants of undertaxation, overtaxation, non-compliance and non-enforcement. It may be that the Court is indeed following "th' iliction returns"[31]; for that may help to explain its decision in the *National Bellas Hess Case,* denying to the states authority to require collection of use tax by mail order houses—in this writer's view, an unfortunate constitutional backlash in an area of fiscal importance both to the states and to locally based merchants, who are thus put at a serious disadvantage in relation to their out-of-state mail order competitors.

If the Supreme Court is entering an era in which it may play a larger role in state tax apportionment, its function will, nevertheless, be a limited one, acting as it must (in the absence of Congressional legislation dealing with apportionment) only to strike down apportioned taxes that violate constitutional proscriptions on the states. Fortunately, in the all-important area of achieving greater uniformity of apportionment methods—diversity is the great plague, since almost any apportionment method uniformly applied by all the states is likely to be less capricious than a variety of conflicting methods[33]—the states have made unprecedented progress since 1959 in this direction. Undoubtedly, they have been motivated largely by the threat of further Congressional legislation; yet, as of this writing, 19 states and the District of Columbia have enacted the Uniform Division of Income for Tax Purposes Act, and 14 states have adopted the Multistate Tax Compact.[34] This unprecedented State drive for uniformity in apportionment may perhaps be given further impetus by the intimation of the Supreme Court, in the District of Columbia case, that a single-factor formula does not fairly measure the income attributable to a state, and could cause states still utilizing crude, single-factor formulas to discard them for the more refined Uniform Act.[35]

[30] "State Taxation of Interstate Commerce," Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88th Cong., 2d Sess., H. R. No. 1480; see Vol. 1, ch. 7.

[31] Mr. Dooley told Mr. Hennessy that "no matter whether th' constitution follows th' flag or not, th' supreme court follows th' iliction returns." Bander, *Mr. Dooley on the Choice of Law,* 52 (1963).

[32] *National Bellas Hess, Inc. v. Department of Revenue of Illinois,* 386 U.S. 753 (1967).

[33] Over half a century ago, Professor T. S. Adams of Yale saw this crucial point, for he declared to the National Tax Association:

> "What is most needed is a uniform rule. Just what rule shall be selected is less important than the general adoption of the same rule by competing jurisdictions." *1917 Nat. Tax Assoc. Procs.,* 185, 194.

The history of the efforts to achieve uniform apportionment and allocation is traced in *Willis Subcommittee Report,* Vol. 1, p. 128, et seq.

[34] The Uniform Act is printed in the *Willis Subcommittee Report,* Note 30, supra, Vol. 2 p. 227, et seq. The Multistate Tax Compact may be found in *All States Unit, P-H State and Local Taxes,* Par. 6310, et seq.

[35] The three-factor Massachusetts type formula has been supported by Committees of the National Tax Association for many years. See "Report of the Committee of the N.T.A. on Allocation of Income," *1939 Nat. Tax Ass'n. Procs.* 190; "Final Report of the Committee on Tax Situs and Allocation," *1951 Nat. Tax Ass'n. Procs.,* 456; "Interim Report of Committee on Interstate Allocation of Business Taxes," *1965 Nat. Tax Ass'n. Procs.* 397.

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The Unitary Business Conception

There is another aspect of apportionment in which the Supreme Court might play a significant restraining role, acting under the Due Process and Commerce Clauses, and in which the state courts could play an even greater role in construing their statutory provisions authorizing formulary apportionment—the circumscription of the scope of "unitary business." The underlying justification for applying an apportionment formula to the over-all tax base of a multistate business is that there exists a unitary enterprise being carried on in more than one state. The formula is a device for attributing to the taxing state its share of the over-all tax measure that admittedly is attributable only in part to the state. This principle extends, at least in a good many states, both to the branches of a single corporation and to subsidiaries and affiliated corporations that are a part of the enterprise.[36] By applying the typical three factor formula, the property, receipts and payroll ratios of all branches, subsidiaries and affiliates are taken into account in determining apportionment ratios, which are then applied to the tax base of the entire business.

A taxpayer, claiming that an apportionment formula, as applied in its case, does not satisfy the statutory standard for determining the amount of income, capital stock, or other measure attributable to the state, or that it violates the Due Process and Commerce Clauses, has frequently sought to determine its tax liability by a separate accounting method, as is indicated in a number of cases discussed above.[37] Under this method, the activities of the enterprise carried on within the state are treated as a separate unit, and the income, capital employed and the like, derived from sources within the state or used in the state, are to be ascertained. While some state statutes specifically permit separate accounting for a unitary business,[38] and others by administrative action employ that method, in many states separate accounting is not permitted if the business is unitary. Hence, at the center of many of the cases, the crucial controversy has been the delineation of the contours of a unitary business. Accordingly, we turn to that question.

In defining "unitary business," a leading work in the field declares:

> "The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state."[39]

Manufacturing or purchasing goods in one state and selling in another, and transportation and communication between the states are typical of cases considered unitary. Altman and Keesling suggest that mining, banking, farming

[36] *California Edison Stores, Inc. v. McColgan*. 176 P. 2d 697 (1947), rehearing 30 Cal. 2d 472, 183 P. 2d 16 (1947); *Zale-Salem, Inc. v. State Tax Comm.*, 237 Ore. 261, 391 P. 2d 601 (1964); *Interstate Finance Co. v. Wisconsin Dept. of Revenue*, 28 Wis. 2d 262, 137 N. W. 2d 38 (1965); see *Gulf Oil Corp. v. Clayton*, 267 N. C. 15, 147 S.E. 2d 522. *Per contra: American Bakeries Co. v. Johnson*, 259 N. C. 419, 131 S. E. 2d 1 (1963). The apportionment provisions of many states permit or require the filing of combined or consolidated reports of income of a controlled group of corporations; other statutes use general language authorizing the application of the unitary business principle, so as to cut through the legal barrier of affiliated corporate entities.

[37] See *Willis Subcommittee Report*, Vol. 1, pp. 161, 167, Note 30, supra.

[38] See *McWilliams Dredging Co. v. McKeigney*, 227 Miss. 730, 86 So. 2d 672 (1956), appeal dismissed, 352 U.S. 807 (1956); *Parks* Co. v. Allphin, 295 S. W. 2d 562 (Ky. 1956); *Magnolia Petroleum Co. v. Oklahoma Tax Comm.*, 190 Okla. 172, 121 P. 2d 1008 (1941).

[39] Altman and Keesling, *Allocation of Income in State Taxation*, 101 (2d ed. 1950); see Goldstein and Brookes, loc. cit., Note 20, supra. The nature of a unitary business is briefly discussed in the *Willis Subcommittee Report*, Vol. 1, p. 167, Note 30, supra.

and hotel operations are typical of businesses that "may generally be considered separate even though similar activities are carried on in other states," but the authors are careful to add the qualification that such a business "may be conducted so as to make it unitary in character." [40]

The California Concept of Unitary Business

The California Supreme Court has in recent years developed the unitary business doctrine, acting on initiative of a vigorous and widely respected state tax administration. Perhaps the leading judicial statement of the nature of a unitary business is found in the California Supreme Court's opinion rejecting the claim for separate accounting in the *Butler Bros.* case.[41] As described in the later California Supreme Court opinion in *Superior Oil Company:*

> "Butler Brothers was a corporation engaged in a wholesale merchandising business with outlets in several states, including California. Each outlet operated independently, including the purchase and sale of goods, but each was subjected to central executive control from the corporation's principal office in Chicago. The outlets shared in corporate overhead, executive salaries, central advertising, and the expenses of maintaining a central buying division, although the cost of each purchase and the expense incurred therein were chargeable to the individual outlets concerned. During the year in question the California operations suffered a loss, whereas the overall operations realized a profit. The corporation's separate return of its California business included the apportioned share of the common administrative expenses.
>
> "In affirming the judgment, this court stated . . . 'It is only if its business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used. Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer. . . . If there is any evidence to sustain a finding that the operations of appellant in California during the year 1953 contributed to the net income derived from its entire operations in the United States, then the entire business of appellant is so clearly unitary as to require a fair system of apportionment by the formula method in order to prevent overtaxation to the corporation or undertaxation by the state.'
>
> "'In accordance with the foregoing analysis it is our opinion that the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation.'" [42]

These three "elements of a unitary business" have been repeated in other cases.[43]

The interrelation and interdependence of the various steps in the production of income, within and without the state, as the basis for unitary business treatment were emphasized in the *Superior Oil Co.* case, cited above, in which the *taxpayer* sought and obtained unitary business treatment over the California taxing authority's objection. Superior was engaged in producing and selling petroleum and

[40] Op. cit. Note 39, supra, at p. 102.

[41] *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 111 P. 2d 334 (1941).

[42] *Superior Oil Co. v. Franchise Tax Board*, 34 Cal. Repr. 545, 386 P. 2d 33 (1963).

[43] See *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16 (1947); *cf.* the language of the Supreme Court of the United States in *Butler Bros. v. McColgan*, Note 16, supra.

petroleum products in eight states, including California. It sought unitary treatment because, as reported, it sustained losses in Arkansas and Louisiana, and sought thereby to offset the income as reported from California by these losses. Superior was not an integrated oil company, since it did no refining and processing (except on a minor scale). It sold its crude petroleum typically at the well site to other oil companies, which refined and processed it for retail distribution and sale. All its California crude oil mined was sold within the state, and all crude oil mined outside the state was sold outside California. The executive offices of the Company were located in Los Angeles, which also handled accounting, purchasing of equipment and supplies and insurance matters for the entire enterprise.

The state sought to tax Superior on its separate net income, determined by reference to its operations, receipts and expenses in California alone. The Trial Court found that:

> "'California business operations contributed substantially to the out-of-state portion' of its business in areas relating to executive policy making, administrative control, coordination of exploration activities, well production and land acquisition, training of technical personnel, specific scientific and technical development and testing laboratories, drilling operations and drilling equipment, manufacturing and sales, accounting, tax returns, personnel, insurance and purchasing.
>
> "The court also found that 'Superior's California operations were substantially dependent upon the out-of-state operations' in areas relating to the borrowing of substantial funds on assets located outside of California in order to finance projects within California, the transfer of company funds from sources outside of California to finance projects within California, legal counseling provided by the chief counsel located in Texas and other attorneys in Washington, D. C., the supplying and control of tubular materials from Superior's Texas office and transfer of other materials to California from company sources outside of California, fiscal control from Superior's Texas office for half of the year in question, geophysical technical information and services supplied to California from the company's Texas laboratories, certain land-lease controls supplied by offices in Texas, the transfer of valuable drilling equipment from out-of-state for California operations, the transfer of skilled personnel from out-of-state for purposes of performing services in California, and the supply, on a daily basis, of technical and other information to the company's California offices in order that executive and policy decisions could be made and overall control exercised." [44]

The State argued, strangely for a taxing authority that has pressed the unitary business conception to the limit when the result was to produce larger taxes, that "the employment of an allocation formula is justified only when the various local operations are so essential to the overall operations that it is impossible to make separate accounting computations." The Court rejected this position and held that the business was unitary and that the taxpayer was entitled to formulary apportionment, declaring:

> "It is only through a multitude of individual operations which precede and make possible the outflow of petroleum at a producing well that Superior is able to obtain possession of a product which it can market. While the actual recovery and sale of the crude oil are, perhaps, local activities, nevertheless very extensive interstate transactions are theretofore involved in the other individual operations which make such production possible. The evidence here reveals that such essential factors as land acquisition, exploration, technology, testing, availability of equipment and personnel, financing and many others are definitely interstate in character. It must also be considered that each producing well in a particular

[44] 386 P. 2d, at p. 37.

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state is the end product of interstate activities which may involve many other unproductive wells in many other states. Superior's products are thus acquired for the local market only as the result of interstate transactions . . . ."[45]

A Restrictive View of Unitary Business

The Minnesota Supreme Court by way of contrast has recently gone to the other extreme in narrowing the scope of unitary business, likewise in an oil company case. In *Skelly Oil Co.* v. *Commissioner of Taxation* the company, unlike Superior Oil, carried on the functions of an integrated oil company, from production and manufacturing to the marketing of crude oil products and accessories; it also maintained its own pipelines.[46] All of Skelly's production facilities were located outside Minnesota. Although Skelly is an integrated oil company, it sells the bulk of the oil it produces to other oil companies; less than 10 per cent of the crude oil Skelly produces is manufactured by it into gasoline, lubricating oil and other products. It was these products, manufactured by Skelly from its crude oil resources outside the State, that were marketed in Minnesota.

In determining Skelly's net income tax, the Minnesota Commissioner of Taxation applied the state's three factor Massachusetts formula to the company's entire net income. In a lengthy opinion reviewing the unitary business decisions, the highest court of Minnesota sustained Skelly's contention that its production operations and its manufacturing on the one hand and marketing operations on the other, constituted "separate and independent businesses." Since no production or manufacturing operations were carried on within the state, the company was entitled to exclude from its apportionable base all income derived from the production and sale of crude oil outside the state. In reaching this conclusion, the Court approved the analysis of the State Board of Tax Appeals, as follows:

"Skelly's refining and marketing operations do not serve to increase the amount of the company's production income, which is fully earned at the point where the crude oil is available for sale, . . . it is there that production operations cease, and that the value of the crude oil produced is represented by the posted field price, a bona fide competitive price. . . . Under the circumstances the Board of Tax Appeals was clearly justified upon the record in finding that the taxpayer was engaged in two separate businesses; that the business of producing was in no way dependent upon the business of marketing; that each business could be operated entirely independent of each other; and that all producing income is fully earned at the well-head and is not increased or affected by Skelly's manufacturing and marketing activities.

"The business of producing was in no way dependent upon the business of marketing. Each business could be operated entirely independent of each other. Some companies are engaged only in the producing business and some only in the marketing and refining. All producing income is fully earned at the well-head and is not increased or affected by the manufacturing and marketing activities.

"Under our interpretation of the Minnesota law and the Minnesota cases interpreting that law as well as the United States Supreme Court decisions in allocation cases in general, unless there can be shown some connection or interdependence between the two businesses, in this case production and marketing, none of the income from production could be allocated to Minnesota for income tax purposes."[47]

The Operation of Separate Accounting

The *Skelly* and *Superior* cases reflect two extremes of defining the contours of a unitary business, both of which, I suggest, ought to be rejected. The *Skelly*

[45] 386 P. 2d, at p. 39.
[46] 269 Minn. 351, 131 N. W. 2d 632 (1964).
[47] 131 N. W. 2d, at pp. 642, 643.

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case disregards the underlying reasons for the development of formulary apportionment, namely, that there is no viable way of separately accounting for the profits of a business where interdependent operating functions that produce the profits of the enterprise are carried on in more than one state. Thus, to take a simple case, where goods are manufactured in State *A* and sold in State *B*, efforts to account separately for the profit from these interdependent operations have floundered on the inability to find acceptable methods of breaking up the profit realized into a "manufacturing" profit and a "selling" profit.[48] Two methods of making the segregation are commonly employed: (a) determining the price at which the goods should be deemed to be billed by the manufacturing affiliate or division, by using the prices at which similar goods are sold by other manufacturers to independent customers in the trade; and (b) determining manufacturing costs, and adding a judgment determined "reasonable profit." In both cases central administrative and general expenses are then allocated between manufacturing and selling; and other specific costs for each of the economic steps are likewise separately charged.

The latter step can be accomplished without too much difficulty or too great error, by using normal cost accounting techniques, but the segregation of the "manufacturing" and "sales" profit is a speculative and unreliable process. The major difficulty in resorting to the prices used by other manufacturers selling to independents is to find a sufficient number of comparable sales under comparable terms and conditions. At the outset, what is the trade to be used to make the comparison? In the motor industry, for example, the evidence must doubtless be broken down, so as to compare the profit on truck sales with other truck sales, not passenger cars; and, with respect to passenger cars, the profits on lower priced mass-produced cars, such as Falcons, must probably be compared with Corvairs, although Chevrolets might possibly be comparable, but probably not with Lincolns or Cadillacs. In some industries, the major manufacturers do not sell to wholesalers or jobbers, but deal directly with retailers, so that there are no sales of significance to wholesalers or jobbers on which to base the manufacturer's selling price to its sales division. Moreover, if we do find enough sales of comparable products at arm's length by other manufacturers, we must still account for profit variations, depending on volume of sales terms of payment, delivery dates, geographical variations, and so forth. All these variations make the search for comparable prices elusive and speculative.

If we turn to the other method of segregating "manufacturing" profit from "selling" profit, by determining the costs of manufacture, and then adding a "reasonable profit," we find ourselves in a similar morass of dissimilarities. Mark-ups vary sharply industry by industry, and are affected by such factors as the ownership of patents, trade secrets, the manipulation of prices where monopoly or oligopoly reigns, special problems involved in the introduction of new products, and the like. To seek to develop standards of normal mark-up over manufacturing costs is difficult enough in dealing, for example, with the women's clothing industry, but becomes hopeless in setting standards for the endless variety of products manufactured by a giant such as General Electric—where, for example, entirely different standards prevail for atomic power stations as compared with mass products such as TV sets and refrigerators. Bearing in mind that State Tax Commissioners must deal

[48] Professor Ford many years ago demonstrated the inherent weaknesses in such an effort. See, *The Allocation of Corporate Income for the Purposes of State Taxation*, N.Y. State Tax Comm. Sp. Rep. No. 6 (1933); see also, Palestin, loc. cit. Note 23, supra.

both with such conglomerates as General Motors, General Foods, RCA, I.T. & T., and the great oil and chemical companies with their endless variety of products, as well as with the thousands of smaller enterprises which do business across state lines, it becomes apparent that it is virtually impossible to administer a taxing statute that requires the establishment of imputed reasonable manufacturer's profits for American businesses over the country.

A Middle Ground: The Tie-In of Unitary Business with Interdependent Operating Functions

These are the considerations which underlie our conclusion that the Court in *Skelly* erred in holding that the business of producing and refining oil outside Minnesota and marketing it within the state was not a unitary business. *Skelly* was, in our view, a classic example of interdependent operations of a unitary business, where formulary apportionment is both appropriate, and, crude though it be, is our best available viable tool for determining a state's proper share of the income of the enterprise.[49]

Superior Oil, on the other hand, pushes the unitary business conception to an extreme that is not responsive to the reasons for formulary apportionment, and tends to produce misallocation, and hence tax inequities. Because the company's operating functions consisted of drilling for and producing oil and selling it at the well site to other companies, with each state's production being sold within the state, the crucial factor that underlies the rationale for reaching out to take into account activities in other states, the segregation of the profits from producing and from selling, was missing. The Court bottomed its conclusion that "Superior's operations were substantially dependent upon out-of-state operations," on (a) transfers of funds from out of state and borrowing on out-of-state assets to finance California operations, (b) legal counselling provided by company counsel outside the state, (c) the transfer of equipment and materials from out-of-state branches, (d) fiscal control, (e) technical and laboratory assistance and information, and (f) the transfer of employees from other branches.

Obviously, the non-operating functions relied on by the Court to conclude that Superior's in-and-out-of-state operations were a unitary business, subject to apportionment, are important, and may be crucial in contributing to the profits of the enterprise. Indeed, a major function of holding companies, and of a large aggregation of branches in a single-entity set-up is to provide capital which each individual company or branch could not command; and the same may be true of research laboratories, national advertising, specialized legal, accounting and engineering services, and so forth. And these centralized operations may be a factor in the greater profitability of some larger enterprises, as compared with smaller businesses. But that is not the linchpin of formulary apportionment. The costs of these centralized operations can be spread by cost accounting methods regularly used by accountants for internal accounting, *SEC* registration statements, reports to regulatory agencies for rate-making, and for other purposes. True, since controlled companies or branches of a corporation are involved, the charges for the centralized

[49] The Committees of the National Tax Association that have been the prime movers in developing formulary apportionment for unitary business have long recognized that:

"All methods of apportionment of trading profits are arbitrary. . . . [T]here is no one right rule of apportionment. . . . [T]he only right rule of procedure is a rule on which the several states can and will get together as a matter of comity." "Report of the Committee on the Apportionment Between States of Taxes on Mercantile and Manufacturing Business," *1922 N.T.A. Procs.* 198, 201.

services or joint operations, such as a research laboratory, ought to be closely scrutinized so as to avoid the risk that costs will be improperly loaded onto operations in high tax states in order to siphon off income to states with lower taxes. But the state statutes have provisions designed to prevent such improprieties in cost allocations. The underlying point is, however, that such matters require a spreading of costs; which can be acceptably accomplished by distributing charges on a time, or gross volume basis, or by other workable methods, and do not involve the elusive effort to segregate profits between interdependent steps in operations, such as producing in one state and selling in another.

Consequently, the non-operating functions of an enterprise, relied on in *Superior Oil,* although centralized, ought not lay the basis for holding the enterprise unitary. Not only is there no reason in the considerations which gave birth to formulary apportionment to push the technique to this point, but perhaps of greater moment is the fact that so broad a sweep of formulary apportionment tends to push distortion and misallocation to unacceptable levels. *Superior Oil* is a case in point. The company had earnings in California, on a separate accounting for the operations in that state, of $10.6 million, but because it had losses on a separate accounting basis in other states ($3.4 million in Louisiana), unitary apportionment enabled the taxpayer to reduce its California income by such out-of-state losses to $1.1 million, about 10 per cent of its California operating profits on a separate accounting basis. Businesses again and again do operate more profitably in one state than another; regional profits vary; when a new market is being exploited, profits are likely to be low, and when a new product has been developed ahead of competitors, profits for that division may be high, and so on.

Moreover, there is ample statutory warrant in the laws of most states, at least, for avoiding the type of distortion due to formulary apportionment—at times resulting in overtaxation and at other times in undertaxation—where the formulary apportionment is grounded on ancillary, non-operating functions. The California statute applied in *Superior Oil* is typical. The statute called for "an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property, or by reference to any of these or other factors or by such other method as is fairly calculated to determine the net income derived from or attributable to sources within this state. . . ." The Uniform Division of Income for Tax Purposes Act contains a similar provision.[50]

Such statutory provisions afford adequate legal authority for limiting formulary apportionment to interdependent operating functions.[51] It is to be observed that frequently this may mean treating an enterprise as unitary on a regional basis. For example, if a manufacturing business divides its operations on a regional basis, with its sources of raw materials, processing and marketing, in the Pacific Coast states interrelated, but with similar functions carried on along the East Coast by the Atlantic region, the Pacific and Atlantic regions

[50] The Uniform Act prescribes a three-factor Massachusetts formula for operating income, and then provides that if

> "the . . . allocation and apportionment provisions . . . do not fairly represent the extent of the taxpayer's business activity in this state, the tax authority may, or the taxpayer may petition for separate accounting, a variation of the formula 'which will fairly reflect the taxpayer's business activity in this state' or the 'employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.'" Sec. 17.

[51] It is to be observed that most state statutes measured by net income already require direct allocation of designated items of income, such as rents, royalties, dividends, interest, in addition to formulary apportionment of general business or operating income.

would each properly be classified as unitary businesses and be subject to apportionment by formula, but not the combined enterprise, despite centralized management, financing, advertising, research, and the like.

Formulary apportionment has long been, and remains, a highly useful invention but, like many new devices, it has been pushed beyond its effective scope to a point where its proper functions need to be carefully re-examined. In this re-look at the growth of formulary apportionment, I have suggested that the test of a unitary business be bottomed on the interdependence of the basic operating activities of the enterprise. This would embrace not only the typical buying or manufacturing of goods in one state and selling them in another, but also interstate transportation and communication, mining or processing in one state and selling in others, and the like. However, centralized management, financing, advertising, the use of patents, trade marks and know-how, the training or furnishing of personnel and of legal or technical services, and other ancillary or supportive activities, important though they be to the profits of the entire enterprise, ought not ordinarily, at least, lay the foundation for multistate unitary business apportionment by formula. Such an approach to the contours of the unitary conception is amply justified by the broad and flexible statutory provisions for the division of income, capital stock and other tax measures in most states. And given the recent Supreme Court decisions, which may perhaps reflect a new approach to state tax apportionment problems, such a circumscription of the unitary business may conceivably emerge as a requirement of the Due Process and the Commerce Clauses in preventing extraterritorial taxation and in proscribing undue burdens on interstate commerce.

The CHAIRMAN. I am going to call Mr. L. Ward Mendenhall next because I have to leave but before I do I want to hear this witness. I see Mr. Taylor is accompanying Mr. Mendenhall. I am indebted to your lawyer, Mr. Mendenhall, I studied his notes when I went to law school.

I am pleased to hear from you both.

STATEMENT OF L. WARD MENDENHALL, SECRETARY-TREASURER, NATIONWIDE ADVERTISING SPECIALTY CO. AND TEXAD SPECIALTY CO., BOTH OF ARLINGTON, TEX., ACCOMPANIED BY B. B. TAYLOR, ESQ., TAYLOR, PORTER, BROOKS & PHILLIPS

Mr. MENDENHALL. Thank you, sir. I would request that my entire written statement be made a part of the record at these hearings.

The CHAIRMAN. We will do that.

Mr. MENDENHALL. And I am talking solely about sales and use taxes. I am a certified public accountant in Texas and I am employed as secretary-treasurer of the Texad Specialty Co. and Nationwide Advertising Specialty Co.

These two corporations are wholly owned by the widow and children of the late John W. Newbern, who founded the business in 1947. We have 98 employees and last year had a net income after taxes of $44,000.

Our only offices are in Arlington, Tex., and we do nothing anywhere else except through the U.S. mails.

These companies are jobbers in the advertising specialty industry. Dealers mail us their customers' orders for prints, calendars, and so forth. After acceptance we mail the orders to the various manufacturers who produce and imprint the items and ship them directly to the purchasers.

The CHAIRMAN. Let me ask you this. You wanted us to print the entire statement. I see attachment B which runs about 20 pages and I see an attachment C here which is a brief. I hope you are not asking us to print this whole brief in the record?

Mr. MENDENHALL. No, sir.

The CHAIRMAN. We will of course print your statement. If you want to we can include attachment B, but I think C is a little too bulky.

Mr. MENDENHALL. I appreciate that because I think attachment B is very significant.

The CHAIRMAN. We will attach B because it does have some charts and tables which illustrate your point. I will not ask that we print attachment C because I think it would be too much of a burden for the record, but we will keep it in the committee files for those of us who want to use it.[1]

Mr. MENDENHALL. Yes. Thank you.

As I was saying, the manufacturers, after they produce and print the items, ship them directly to the purchaser. We don't manufacture or ship anything and we never even have title to the merchandise that is purchased.

The Louisiana courts have correctly held that these dealers are independent contractors but the Alabama courts have ambiguously

[1] Attachment C was made a part of the official files of the committee.

held that they are commissioned salesmen. So far we have had litigation on this point on Alabama, Georgia, Florida, Arkansas, and Louisiana.

The Louisiana case involves a parish tax of $1,179 for 3 years and is now pending on appeal in the U.S. Supreme Court even though the legal division of the Louisiana Department of Revenue advised Texas that it was not subject to any Louisiana tax. During the past 8½ years we have spent over $84,000 in attorneys' fees and expenses in five States and our in-office expense defending these claims exceeds $102,000.

The reason we let ourselves get into a mess like this is very simple. In 1965 the State of Florida filed a suit relying on its own *Scripto* case against Nationwide for $4,100. After interrogatories were filed and answered, the case was dismissed. Therefore we did not think that *Scripto* applied to us and we still don't think it applies to us even though later we were hung in Alabama based on *Scripto*.

On February 24 of 1959 the U.S. Supreme Court rendered its historic *Northwestern States Portland Cement Company* v. *Minnesota* decision and Justice Frankfurter, in his dissent, pointed strongly to the burden of State and local actions on interstate small businesses. I represent two of the small businesses that he referred to.

Congress apparently agreed with Mr. Justice Frankfurter because a Senate committee started hearings on April 8, 1959, which resulted in Public Law 86-272 which was signed by the President September 14, 1959, only 6 months after the *Northwest-Stockham* case decision.

After the *Scripto* decision, in 1969 Congress amended 86-272 to include sales and use taxes and other State taxes in its study that was to be made on State taxation of interstate commerce. But, Public Law 86-272 does not provide a uniform jurisdictional standard for doing business. It deals with State and local income taxes only. It leaves the matter of State and local sales and use taxes wide open for wholesale litigation. I do not think it is right that a company can be doing business within a State for purposes of being required to collect and remit State and local sales and use taxes and yet it is not "doing business" for income tax purposes.

For years the National Association of Tax Administrators and Multistate Tax Commission have been asking Congress to delay action on this matter supposedly so they can propose uniform legislation. After all of this time they apparently can agree only on further delaying congressional action. We recently mailed inquiries to 43 States in an attempt to determine what our tax liabilities would be in these States. After 90 days we have only had 34 replies. Six of these replies gave us an unqualified "yes" that we were required to collect sales and use taxes and one a possible "yes." Nine gave us an unqualified "no". Two gave us a possible "no". Six advised us to consult a private attorney. Three said that they had no sales and use tax law. Seven sent us copies of their tax laws with either an indefinite explanation or no comment.

The Willis subcommittee reported, in 1964, that there were 2,329 different governmental entities levying a sales and use tax. Today there are at least 8,111 such tax levying entities. According to the U.S. census there are 23,842 States, cities, towns, counties, et cetera, and all of these potentially may levy sales and use taxes.

Some States claim that any legislation in this field would cause a loss of revenue to the States. Actually a uniform use tax law would mean more money for the States, cities, et cetera. The Willis subcommittee reported that there is a 90-percent noncompliance under the existing system.

If there were one uniform set of sales and use tax rules for all of the 50 States, and 1 central collection authority for each State and if there were no requirement to breakdown our sales by local jurisdictions, there would be no serious problem for us to collect and remit the use tax to the 50 States. The present State situation, with 8,111 different sales and use tax laws is intolerable.

The Willis subcommittee recommends, regarding back taxes, that liability be barred for prior years if a company had no realty nor employee in the State and no deliveries in the State.

After the Alabama courts held that Nationwide must collect and remit the use tax, Nationwide paid $24,164 to Alabama in principal and interest for the 11 years of 1962 through 1972.

Now we are litigating against a completely erroneous and arbitrary assessment of $62,760 through 1964 through 1970.

Now, if Congress does not put a stop to this liability for back taxes, Nationwide and Texad and thousands of other small businesses will be driven out of interstate commerce and ultimately into bankruptcy.

Congress has been debating this question since 1959. We cannot survive another 14 years of hearings and studies.

We respectfully urge and request that, while this debate continues, the stopgap legislation, Public Law 86-272, be amended to cover sales and use taxes as well as income taxes.

We beg relief from this monster which is killing us and other small businesses in interstate commerce.

The CHAIRMAN. Thank you. You heard Mr. Traigle testify. What do you think about his plan?

Mr. MENDENHALL. I think Mr. Traigle's plan is the most realistic approach I have heard to this today and I have read it. Mr. Taylor gave me a copy of it and I read it. There is only one thing that I think is not covered in it that should be certainly considered and that is the possibility for "back taxes".

The CHAIRMAN. Well, it seems to me that the approach Mr. Traigle suggests is a good one and he appears willing to accept reasonable modification and I would think something to take care of back taxes could be incorporated if there is no great objection on his part to it.

I don't know precisely how such a provision should read but something could be drafted which would meet the needs of the States and at the same time make it possible for the small businessman to comply with it.

Mr. MENDENHALL. Yes, sir.

The CHAIRMAN. I do think this proposal, where all the taxpayer would have to do is pay the average State tax, with some limitations such as the tightening up I suggested, should be considered. For example, I think the States in fairness ought to be willing to limit themselves to no more than the average tax in the State. For example, if the State tax is 3 percent, as it is in Louisiana, and in New Orleans it goes up to 6 percent because of their additional local taxes, I do think in fairness it should be the average tax in the State so that the

State can't just pick the highest point existing anywhere in the State and say that is the tax rate out-of-State vendors would have to pay. If it were about the average tax paid in the State, collected only at the State level then you would probably have fewer compliance difficulties.

Mr. MENDENHALL. We wouldn't even if they mind picked the highest rate. We won't have any compliance problem then because this tax would be passed on. Even if we had to break ourselves down to 50 States it would still be no problem.

The CHAIRMAN. Well I think your position is most reasonable. You are not asking to avoid paying your share of taxes. You are only asking for a tax system with which you can comply and it seems to me that is perfectly reasonable.

Senator MONDALE. Now let's take the situation where one community has a 5-percent sales tax and another community has none within a given State and the State establishes, say, a 3-percent State sales tax. Then the State establishes a 6-percent average sales tax for out-of-State vendors and ask you to pay 6-percent on your sales in the State. What happens to the community that is only going to get the 3-percent sales tax where before, it was demanding a 5-percent sales tax? I wonder how you deal with that in Federal legislation?

Mr. MENDENHALL. Well, sir, as far as what the overall rate is, it won't be any concern of ours the way I see it except that people under those conditions might refuse to pay any tax.

Senator MONDALE. You see what I am getting at?

The CHAIRMAN. If I might suggest an answer? It seems to me this is a situation where Congress has the right, if it wants to, to forbid that State to collect that tax at all. Now it seems to me in resolving this impasse we are talking about taxing a transaction that is essentially one in interstate commerce. The States, as Mr. Traigle testified, feel 90 percent of this revenue is being lost by the States now. It seems to me we have here a taxpayer saying he is willing to pay but he would just like to know how he can comply with the various tax laws.

Now, if you say that we at the Federal level can tell the State, OK, you can collect sales and use taxes at an average rate, we then let the State worry about settling up with the local communities. We can then say to the businessmen, all right, we at the Federal level will give you a simplified way to comply and the State will collect that money. For instance, in the State of Louisiana, we at the Federal level would say that it is up to you to settle this Morgan City matter—that is the case that was referred to—and it is not our problem. You are having a problem dealing with Morgan City, I believe, and——

Mr. MENDENHALL. Mr. Chairman, I think you would have more uniform local tax rates if this comes about, because if somebody did not have a local tax where somebody else did, then I think they would all start passing more uniform local taxes.

The CHAIRMAN. It seems to me the States that have sales taxes would receive more money as far as this legislation is concerned, and it would be simple enough to ask the States to settle with the localities. We at the Federal level should say it is up to you to settle with Morgan City or New Orleans or Baton Rouge. That is how the plan would work, as I see it.

Senator MONDALE. Is it your position that it is not the tax that really bothers you, but is the compliance burden imposed by all these different taxing jurisdictions?

Mr. MENDENHALL. Yes, sir. I have 98 employees total.

Senator MONDALE. You have 98 what?

Mr. MENDENHALL. I have 98 employees. And we do not have computers. We just have adding machines and calculators, and we have to do everything by hand. I don't know how many people it would take if we had to break our sales down by every parish and school district and county and city, and in some cases what they call a police jurisdiction which is outside the city limits but within so many miles like you have in Alabama. I mean they are all so complicated that nobody could keep up with it.

The CHAIRMAN. According to your statement, you say 8,111 different sales and use tax laws have to be considered in trying to do business?

Mr. MENDENHALL. Yes, sir. I had my secretary go through the Commerce Clearing House Tax Service listings of State sales taxes, and count them.

The CHAIRMAN. Well, either she or you are entitled to some sort of reward for counting all of them.

Mr. MENDENHALL. Thank you.

The CHAIRMAN. Thank you very much, gentlemen.

[The statement of Mr. Mendenhall with attachments follows:]

STATEMENT OF L. WARD MENDENHALL, SECRETARY-TREASURER, NATIONWIDE ADVERTISING SPECIALTY CO. AND TEXAS SPECIALTY CO.

SUMMARY

1. Texad and Nationwide are two family-owned corporations in Arlington, Texas. They do nothing anywhere else except through the interstate mails.

2. They have 98 employees, and a combined net taxable income (for 1972) of $67,486; net after-tax income (for 1972) was $44,648.

3. They are jobbers in advertising specialty industry; they receive orders through the mails; forward same (through the mails) to manufacturers. The manufacturers ship directly to purchasers.

4. Because P.L. 86-272 fixed a minimum jurisdictional standard (or "nexus") as to state and local income taxes only, but left state and local USE TAXES open for wholesale litigation, these corporations have had litigation in five states; have incurred attorney's fees in the sum of $84,372. In-office (intra-company) expenses in fighting these matters has exceeded $100,000.

5. Nationwide (after unsuccessful litigation) has paid $24,000 to Alabama, for "back taxes" (1962-1972) and is litigating with the State of Georgia for taxes 1964-forward, the arbitrary assessment, 1964-1970, being $62,760.

6. Texad is now appealing to the U.S. Supreme Court from a decision of the Louisiana Courts that it must pay $1,179 in use tax moneys to one Louisiana parish, despite the fact that the Louisiana Collector of Revenue had ruled that (as to the State) no such taxes are due.

7. There are two harsh and inequitable aspects of the problem:

(1) *Lack of Uniformity* in use taxes. There are *8,111* "different" taxing entities (states, cities, counties, etc.) which now actually levy use taxes in various ways and at varying rates. Compliance is impossible. Potentially, the number of such tax levying entities exceeds 23,000.

(2) *The Matter of Liability for "Back Taxes"*; i.e., taxes for prior years. As can be seen from the figures stated above, if Congress does not put a stop to this liability for back taxes, and if all 50 states get into the act, Nationwide and Texad (and thousands of other small businesses) will be forced out of interstate business and into bankruptcy.

8. Congress has been debating this question since 1959. Nationwide and Texad (and others) cannot survive another 14 years of Hearings and Studies. They urgently request that, while this debate continues, the "stop-gap" legislation (P.L. 86-272) be amended to cover sales and use taxes, as well as income taxes.

STATEMENT

I am L. Ward Mendenhall, of Arlington, Texas. I am a Certified Public Accountant, employed as Secretary-Treasurer of two Texas corporations, Texad Specialty Company and Nationwide Advertising Specialty Company. These corporations are wholly owned by the widow and children of the late John W. Newbern, who founded the business in 1947.

Together, the two corporations have 98 employees, and a combined net taxable income (for 1972) of $67,486.27, and net income, after taxes (1972) of only $44,648. The corporations have their offices in Arlington, Texas, and do nothing anywhere else except through the United States mails.

These companies are two (of about 500) jobbers in the advertising specialty industry. Dealers in advertising specialty items (typically calendars, pens, match books, etc., with advertising printed on them), send orders to us (through the mails) for their customers, for acceptance and forwarding to (about 1600) various manufacturers, who produce and imprint the items. Then, the manufacturers ship the items directly to the purchasers. Our two companies neither manufacture nor ship anything. We never have title to the purchased items.

Upon request, we furnish manufacturers' catalogues and samples to these Dealers, for whatever the cost is to us.

The Louisiana trial court (duly affirmed) correctly held that these Dealers are "Independent Contractors." The Alabama courts have ambiguously held that they are "commission salesmen." [1]

The courts of Alabama have held that Nationwide must collect and remit the Use Tax on items shipped to Alabama purchasers, by the various manufacturers and (alternatively) must *pay* the Use Tax. The Supreme Court of the United States (in 1973) refused to review this case.[2]

So far, we have had litigation on this point in Alabama, Georgia, Florida, Arkansas, and Louisiana. The Louisiana case [3] (which involves a parish tax of only $1,179, for three years) is now pending on appeal to the United States Supreme Court, even though the Legal Division of the Department of Revenue had advised Texad Specialy Company that: ". . . the company will not be subject to any Louisiana tax." (See Syllabus No. IX on page 24 of Texad's Jurisdictional Statement to the Supreme Court of the United States, which is attached hereto, as *Attachment "C"*.[4]

During the past eight-and-a-half years, our companies have expended in excess of $84,372.19, in attorneys' fees and expenses, in these matters, in five states. Our in-office cost of defending these claims exceeds $31,821.91. An estimated 40% of my time has also been consumed in these controversies during this period. This would amount to additional expense of $70,813.35.

The reason we let ourselves get into a mess like this is very simple: In 1965, the State of Florida, relying on its own *Scripto* [5] case, filed suit against Nationwide for $12,000. After interrogatories were filed and answered by both sides, this case was dismissed. Therefore, we did not think the *Scripto* case applied to us. Even though we were "hung" in Alabama based on the *Scripto* case, we still do not think it applies to us.

That wording might seem a bit harsh; so let me acquaint you with the facts and let you be the judge.

Nationwide's case was heard in the circuit court of Montgomery, Alabama, in May, 1969. On June 11, 1969, the judge who heard the oral testimony held:

> "*Scripto* is quite different from this case. The Alabama statutes do not permit the Department (of Revenue) to make a Use Tax collector out of Nationwide. The legislature of Alabama never intended to do so, and if it had, the attempt would have violated the commerce and due process clauses of the Federal Constitution."

On June 27, 1969, I was advised that appeal had been taken directly to the Supreme Court of Alabama, which, at that time, was the only appellate court for civil cases. Then the Alabama Court of Civil Appeals was created by Act No. 987, Acts of Alabama, Regular Session, 1969, which was passed September 12, 1969, at 7:56 p.m., to become effective October 1, 1969. The Alabama Supreme

[1] See *Attachment "B"* for a listing of the myriad, different sales and use taxes levied in the State of Alabama alone.

[2] *Newbern v. Alabama*, 48 Ala.App. 265, 264 So.2d 189 (1971); Rehearing Den. 1/12/72; Cert. Den. 288 Ala. 747, 264 So.2d 190 (1972); App. Dismissed, 41 U.S. L.W. 3168 (U.S. 10/10/72; 34 L.Ed. No. 2, p. 69; Rehearing Den. 41 U.S.L.W. 3314 (U.S. 12/4/72); 34 L.Ed. No. 6, p. 503.

[3] *Parish of St. Mary Sales & Use Tax Dep't. v. Texad, Inc.* (*Texad Specialty Company*), 271 So.2d 549 (La. App. 1st Cir. 1972); Rehearing Den. 1/31/73; Writ refused 273 So2d 843 (La. 1973); No. 72-1670 on Docket of United States *Supreme Court*.

[4] This was made a part of the official files of the Subcommittee.

[5] *Scripto, Inc. v. Carson*, 362 U.S. 207, 4 L. Ed 2d 660, 80 S. Ct. 619 (1960).

Court then transferred Nationwide's case to this new court. Three judges were appointed in November, and when the third judge assumed office on December 17, 1969, Nationwide's was the first tax case heard. In its maiden effort in the field of taxation, this court's decision on January 5, 1970, said:

"We hold that the law as enunciated in Scripto is the law of this case; that the findings of the learned trial judge as to the law of the case were erroneous."

Then, the Alabama Supreme Court refused to review the findings of fact in the case.

On February 24, 1959, the U.S. Supreme Court rendered its historic decision in the cases of *Northwestern States Portland Cement Co.* v. *Minnesota*, and *Williams* v. *Stockham Valves & Fittings, Inc.*[1] Mr. Justice Frankfurter, in his dissent, felt strongly that small business would be burdened, and said:

"There are thousands of relatively small or moderate size corporations doing exclusively interstate business spread over several States. To subject these 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. This will involve large increases in bookkeeping, accounting, and legal paraphernalia to meet these new demands. 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, especially in the case of small companies doing a small volume of business in several States."

I represent two of these small businesses referred to by Mr. Justice Frankfurter.

Congress apparently agreed with Mr. Justice Frankfurter, and a Senate committee started hearings on April 8, 1959. This resulted in the enactment of P.L. 86-272, which was signed by the President on September 14, 1959, only six months after the *Northwestern-Stockham* decision was rendered.

After the *Scripto* decision in 1960, Congress amended this law to include Sales and Use Taxes and other forms of state taxes in the *STUDY* to be made on State Taxation of Interstate Commerce. But, P.L. 86-272 does not provide for a uniform jurisdictional standard for doing business within a state. P.L. 86-272 deals with state and local *income taxes* only. It leaves the matter of state and local *sales and use taxes* wide open for wholesale litigation. Therefore, at the present time, we have two sets of jurisdictional standards. It does not seem right to me that a company can be doing business within a state for purposes of being required to collect and remit state and local sales and use taxes and yet (under P.L. 86-272) it is not "doing business" for income tax purposes.

For years the National Association of Tax Administrators and the Multistate Tax Commission have been asking Congress to delay action on this matter, supposedly so they can propose uniform legislation. After all this time, they apparently can agree only on further delaying Congressional action.

In an attempt to determine what our tax status is in other states, we wrote exactly the same letter to 43 states, outlining the way we do business and inquiring if any of their state laws applied to us. Although this letter was mailed 90 days ago, we have had only 34 replies, of which only 6 gave an unqualified "Yes," that we were liable for collecting sales and use taxes, and one a probable "Yes." Nine gave an unqualified "No," 2 a probable "No," and 6 advised us to consult a private attorney. Three said they have no sales and use tax law, and the remaining 7 gave various indefinite answers or sent copies of their tax laws with no comment. A detailed summary of these replies is attached as *ATTACHMENT "A"* hereto.

ATTACHMENT A

The Willis Subcommittee[2] reported that, in 1964, there were *2,329* different governmental entities levying a sales and use tax. Today, there are at least *8,111* such tax levying entities (CCH All State Sales Tax Reporter). According to the U.S. Census, there are *23,842* states, cities, town, counties, etc., and all these, potentially, may levy sales and use taxes.

Some states claim that any legislation in this field would cause a loss of revenue to the states. Actually, a uniform use tax law would mean more money for the states, cities, etc. The Willis Subcommittee reported that there is a 90% noncompliance under the existing system.

[1] 358 U.S. 450, 79 S. Ct. 357, 3 L. Ed. 2d 421, 67 A.L.R. 2d 1292 (1959).

[2] Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 4 Volumes.

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The harshness and inequities of the now-existing situation may be divided into two parts:

First: The Lack of Uniformity.

If there were one uniform set of sales and use tax rules for all of the 50 states, and one central collection authority for each state, *and if there were no requirement that sales be broken down, segregated, and reported for various local taxing jurisdictions within the states,* there would be no serious problem for us to collect and remit the use tax to each of the 50 states. The present situation, with *8,111* different sales and use tax laws, is intolerable.

Second: Liability for Unassessed Sales and Use Taxes; i.e., "Back Taxes."

The recommendation of the Willis Subcommittee, with reference to "back taxes," is that liability would be ". . . barred for unassessed taxes for prior years for years in which the company had neither realty nor an employee in the State, nor made deliveries to private residences in the State." (Vol. 4, at p. 1138.)

After the Alabama courts held that Nationwide must collect and remit the use tax, Nationwide paid $24,164.06 to Alabama, in principal ($17,957.52), and interest ($6,206.54), for the 11 years 1962 through 1972.

Then, the Georgia authorities pounced upon Nationwide, and are now litigating their completely erroneous arbitrary assessment demand of $62,760.60, for Use Tax moneys and interest, for the years 1964 through 1970.

Georgia is demanding nine years' back taxes, plus interest. This must be "paid" by Nationwide, itself, because we did not collect the tax from the Georgia purchasers.

If Congress does not put a stop to this liability for "back taxes," and if all 50 states get into this act, Nationwide and Texad (and thousands of other small businesses) are going to be driven out of interstate business and ultimately into bankruptcy.

Congress has been debating this question since 1959. We cannot survive another 14 years of Congressional Hearings and Studies. The Willis Subcommittee recommended relief. We respectfully urge and request that, while this debate continues, the "stop gap" legislation (P.L. 86-272) be amended to cover "sales and use taxes" as well as income taxes. We beg relief from this monster which is killing us and other small businesses in interstate commerce.

The following recommendations of the Willis Subcommittee deal with income taxes, but are equally applicable to Sales and Use Taxes.

"4. LIABILITY FOR PAST YEARS

"Under the present system there are substantial numbers of corporations which have failed to file returns in States where they are legally required to do so. In these circumstances, the accumulation of back liabilities is generally not barred by statutes of limitations. Thus, companies that have failed to comply remain perpetually liable for taxes, interest, and penalties which in some cases may go back as far as the adoption of the tax by the State.

"Had the present system been found reasonable, the widespread nonfiling which was noted might be considered deliberate tax evasion on a broad scale. Under such circumstances there would be little reason for Congress to restrain the States from collecting back taxes from those noncomplying corporations which are eventually discovered. Indeed, so widespread is the noncompliance that were the system reasonable it would seem advisable for the Federal Government to play a more active role in assuring that interstate companies respect State income tax laws.

"The Committee's recommendations with respect to back liabilities, however, are based on its finding that the system is unreasonable because of the jurisdictional reach and fragmentation of liability resulting from the prevalence of market-oriented sales factors. If these features of the present system are eliminated by Congress as to the future there would appear to be little justification for the States to go on assessing liabilities on the basis of similar circumstances in the past. Accordingly the Committee recommends that if its proposals for a two-factor formula with congruent jurisdiction are enacted, a company which would not have been liable to a State had those rules been in effect in the past may not now be held liable to it, unless the tax has already been assessed."

(Vol. 4, p. 1157)

We believe that these recommendations are sound, and should be followed.

Attached hereto are the following:

(1) "A"—A Schedule showing the results of inquiries sent to 43 states in an attempt to determine our tax status in other states.

BEST COPY AVAILABLE

(2) "B"—A listing of the various Sales and Use Tax rates for Alabama, showing the multitude of *different* local sales and use taxes.

(3) "C"—A copy of Jurisdictional Statement filed in the U.S. Supreme Court by Texad, which extensively reviews the law in this field.

APPENDIX A

In an attempt to determine what our tax status is in other states, we mailed letters to the attorney generals of 43 states, outlining the way we do business and inquiring if any of their state tax laws applied to us. Although this letter was mailed 90 days ago, we have had only 34 replies, which are summarized below. Some of the replies came from the attorney general, some from the secretary of state, and some from the state tax department. All of these answers apply to sales and use tax except where indicated otherwise.

Nine not liable. (Iowa, Kentucky, Minnesota, North Dakota, Washington, Wyoming, Colorado [1], Tennessee,[1] Nevada [1]—five of these replies were from attorney general or assistant attorney general)

One probably not liable, but consult a private attorney. (Missouri [2]—from attorney general)

One probably not liable, but court would decide if question arose. (Virginia)

Three no sales and use tax law. (Montana,[3] New Hampshire, Oregon—one from attorney general)

Six liable. (Connecticut, Massachusetts, New Mexico,[4] Ohio,[5] South Carolina,[5] Mississippi [5])

One probably liable, but consult a private attorney. (Idaho [5]—from attorney general)

One liable, if sales to non-registered firms. (North Carolina)

One suggest we register on non-reporting basis. (New Jersey)

Six no opinion, consult a private attorney. (California, Louisiana, Maryland, New York, Utah, Vermont—five from attorney general or assistant attorney general)

Two no definite answer, but sent rules & said register if we do business in state. (Illinois, Wisconsin)

One wants more information regarding billing & whether we ever have title to goods. (Oklahoma)

One no comment because currently involved in lawsuit covering some of the precise issues we raised. (Kansas—from attorney general)

One we will not have to qualify as foreign corporation. (Nebraska—from Secretary of State)

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[1] Colorado, Tennessee & Nevada said we were not liable for sales or use tax, but suggested that we register as a convenience to the independent contractors if we bill and collect.

[2] Missouri said liable for income tax, but not sales or use tax.

[3] Montana has no sales or use tax law, but said liable for income tax.

[4] New Mexico said liable for both income tax and sales & use tax.

[5] Idaho, Mississippi & Ohio & South Carolina all quoted Scripto.

ATTACHMENT "B"

The Unbelievable Confusion

In the State of Alabama there are 22 counties, 190 cities and 134 police jurisdictions that have sales and use taxes. The state administers and collects the tax for 18 of the counties and 151 of the cities, which leaves 4 counties and 39 cities that require individual returns to be filed with each of them. All of these returns are filed monthly unless the amount of tax is less than $10, then the return may be filed quarterly.

The police jurisdiction for cities having 6,000 or more inhabitants covers all adjoining territory within 3 miles of the corporate limits, and for cities having less than 6,000 inhabitants the police jurisdiction extends 1½ miles from the corporate limits. The tax rate levied by police jurisdictions is ½ of the rate levied within the city limits. This would mean that on each sale the seller must determine whether the sale is made within the city limits, or outside the city limits but within the police jurisdiction, and the sale must be recorded according to the county in which it is sold.

In addition to the 4% state tax in Alabama, the local tax rates are: 1/16 of 1%, 1/8 of 1%, 1/6 of 1%, 1/4 of 1%, 1/3 of 1%, 3/8 of 1%, 1/2 of 1%, 3/4 of 1%, 1%, 1 1/2%, 2%.

These figures will be even more astounding when all 67 counties and 1,133 cities in Alabama decide to have a sales and use tax. Attached is a copy of the pages covering state and local rates in Alabama, from the Commerce Clearing House All-State Sales Tax Reporter.

ALABAMA

¶ 5-005

Gross Receipts (Sales) Tax

Receipts from sales of automotive vehicles, truck-trailers, semi-trailers and house trailers (Law, ¶ 20-040; 20-041).......................1½%

Receipts from sales of machines and machine parts used in mining, quarrying, compounding, processing and manufacturing of tangible personal property (Law, ¶ 20-039).................................1½%

Receipts of every person, firm or corporation engaged in the business of contracting to construct, reconstruct, or build any public highway, road, bridge or street (Law, ¶ 20-101)..........................5%

Receipts of every person, firm or corporation engaged in the business of selling at retail machinery and parts used in planting, cultivating and harvesting farm products (Law, ¶ 20-281)....................1½%

Receipts from all other type sales and admissions (Law, ¶ 20-037; 20-038)....4%

Bracket System: The Law sets forth the following bracket system for the collection of the 4% tax (Law ¶ 20-065):

$0.10 or less	No tax
$0.11 to $0.30	$0.01
$0.31 to $0.54	$0.02
$0.55 to $0.73	$0.03
$0.74 to $0.99	$0.04

The following bracket system is for the collection of the combined 4% state tax and 1% county tax, where applicable:

Sales Price	Tax
$.00 to 10¢	none
11¢ to 24¢	1¢
25¢ to 44¢	2¢
45¢ to 64¢	3¢
65¢ to 84¢	4¢
85¢ to $1.10	5¢

Discounts Allowed: The Law permits a discount for prompt payment of the Sales Tax (Law, ¶ 20-094), and the revenue department has consented that a discount of 5% of the first $100 of Sales Taxes due and payable and a discount of 2% of Sales Taxes in excess of $100 due and payable will be allowed on Sales Taxes when such taxes are paid before becoming delinquent (Reg., ¶ 20-745B).

Permit Fee: No license, registration or permit fee is required.

Use Tax

A tax is imposed on the sales price for the storage, use or other consumption in Alabama of any automotive vehicles, truck trailers, semi-trailers or house trailers purchased at retail at the rate of (Law, ¶ 20-218b)...1½%

A tax is imposed on the storage, use or other consumption in Alabama of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property and parts therefor purchased at retail at the rate of (Law, ¶ 20-218a)...............1½%

A tax is imposed on the storage, use or other consumption in Alabama of machinery used in planting, cultivating and harvesting farm products or used in connection with the production of agricultural produce, livestock or poultry on farms purchased at retail at the rate of (Law, ¶ 20-291) 1½%

A tax is imposed on the sales price for the storage, use or other consumption in Alabama of all other tangible personal property at the rate of (Law, ¶ 20-218) 4%

Bracket System: No bracket system is provided for the collection of Use Taxes.

Discounts Allowed: The Law provides that a discount of 3% shall be allowed on all Use Taxes paid before becoming delinquent (Law, ¶ 20-263).

Permit Fee: No license, registration or permit fee is required.

Leasing or Rental Tax

A tax is imposed on the gross proceeds derived by the lessor from the lease or rental of tangible personal property at the rate of (Law, ¶ 20-160) 4%

A tax is imposed on the gross proceeds derived by the lessor from the lease or rental of automotive vehicles or truck trailers, semi-trailers, or house trailers at the rate of (Law, ¶ 20-160) 1½%

A tax is imposed on the gross proceeds derived by the lessor from the leasing and renting of linens and garments at the rate of (Law, ¶ 20-160) . . 2%

Bracket System: Same as the sales tax.

Discounts Allowed: No provision is made for discounts.

Permit Fee: No fee is required for registration.

County and City Taxes

COUNTY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE

Act 34, Laws 1969 (as amended by Act 688, Laws 1969 *), authorizes the governing body of any county to levy, by ordinance, an excise tax to be in addition to any and all other county taxes already levied. Any sales tax levied under this Act must parallel, except for the rate of tax, the state law. The taxes so levied will be collected by the state.

Key to kind of tax:
ST—Sales Tax
UT—Use Tax
S & U—Sales and Use Tax

County	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Dale	S & U	6-1-71	1%	½ of 1%	½ of 1%
Jackson	S & U	10-1-69	1%	½ of 1%	½ of 1%
Winston	ST	11-1-71	1%	⅜ of 1%	⅜ of 1%

Act 405, Laws 1967 (amended by Act 977, Laws 1971), levied a tax upon all counties having a population of 500,000 or more, with parallel provisions and exemptions to the state tax. For details, see Jefferson County below.

* The State Department of Revenue does not have authority to collect sales and use taxes for a county levying such taxes under the provisions of Act No. 688, Act of Alabama 1969. The Department does legally collect sales and use taxes for sixteen counties under Local Acts of the Legislature specifically directing the Department to collect the taxes for the counties. The Department does not have the necessary authority under Sec. 131(a), Code, because the provision relates to property taxation and equalization. *Opinion of the Attorney General*, February 8, 1971.

CITY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE

Act 203, Laws 1965, 1st Special Session, effective April 20, 1965, (Law, ¶ 20-102), provides authority for the state revenue department, on request by a municipality, to collect local sales and use taxes. The municipal tax must parallel the state sales and use tax, except for the rate, if the tax is to be collected by the state. The request must be in the form of a resolution of the council or commission of the city or town, a certified copy of which is filed with the Alabama Department of Revenue. Amendments to the local taxing ordinance are without effect until the first day of the month following a period of 30 days after passage.

Some cities specify that the rate outside the city but within its police jurisdiction is ½ of the rate applicable within the city. The police jurisdiction in cities having six thousand or more inhabitants shall cover all adjoining territory within three miles of the corporate limits, and in cities having less than six thousand inhabitants, and in towns, such police jurisdiction shall extend also to the adjoining territory within a mile and a half of the corporate limits of such city or town.

Key to kind of tax:
ST—Sales Tax; S & U—Sales & Use Tax; PJ—Imposed in Police Jurisdiction; UT—Use Tax

City	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Abbeville	ST PJ*	8-1-66	1%	¼ of 1%	¼ of 1%
Addison	ST PJ*	12-1-63	1%	½ of 1%	½ of 1%
Alabaster	ST PJ*	5-1-69	1%	½ of 1%	1% [2]
Aliceville	S & U PJ*	10-1-61	½ of 1%	½ of 1%	½ of 1%
Altoona	ST PJ*	10-1-67	1%	¼ of 1%	¼ of 1%
Anniston	ST PJ*	4-1-68	2%	¼ of 1%	¼ of 1%
Ashland	ST PJ*	6-1-66	1%	½ of 1%	¼ of 1%
Ashville	ST PJ*	8-1-65	1%	¼ of 1%	¼ of 1%
Atmore	ST PJ*	2-1-68	1%	1%	1%
Attalla	ST PJ*	2-1-69	1%	½ of 1%	½ of 1%
Auburn	ST PJ*	4-1-68	1%	½ of 1%	1%
Bay Minette	ST PJ*	7-1-66	1%	¼ of 1%	¼ of 1%
Berry	ST UT	4-1-62	1% ½ of 1%	½ of 1% ½ of 1%	½ of 1% ½ of 1%
Bessemer	ST	11-1-65	1%	½ of 1%	½ of 1%
Brewton	ST PJ*	5-1-62	1%	½ of 1%	½ of 1%
Butler	ST PJ*	6-1-69	1%	½ of 1%	½ of 1% [1]

* Tax is levied in police jurisdictions at one-half the rates applicable in the corporate limits.

[1] Farm machine rate is ½ of 1%.

[2] Farm machine rate is 1%.

CITY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE—continued

City	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Camp Hill	ST	11-1-61	1%	½ of 1%	½ of 1%
Carbon Hill	ST PJ*	10-1-70	2%	½ of 1%	½ of 1%
Carrollton	ST PJ*	9-1-65	½ of 1%	⅛ of 1%	⅛ of 1%
Chatom	ST	5-1-65	1%	½ of 1%	½ of 1%
Cherokee	ST PJ*	1-1-69	1½%	¼ of 1%	½ of 1%[1]
Citronelle	ST PJ*	8-1-65	1%	¼ of 1%	¼ of 1%
Clanton	ST PJ*	5-1-69	1%	1%	1%[3]
Collinsville	ST PJ*	10-1-70	1%	½ of 1%	½ of 1%
Columbia	ST PJ*	5-1-72	1%	1%	1%
Columbiana	ST PJ*	1-1-67	1%	½ of 1%	1%
Dadeville	ST PJ*	9-1-61	1%	½ of 1%	½ of 1%
Daleville	ST PJ*	1-1-66	1%	¼ of 1%	¼ of 1%
Dora	ST PJ*	3-1-66	1%	¼ of 1%	¼ of 1%
Double Springs	ST UT	4-1-60	1% ½ of 1%	½ of 1% ½ of 1%	½ of 1% ½ of 1%
East Brewton	ST PJ*	9-1-63	1%	½ of 1%	½ of 1%
Eclectic	ST	10-1-71	2%	2%	2%
Elba	ST PJ*	2-1-68	1%	¾ of 1%	1%
Eufaula	ST PJ*	7-1-63	1%	½ of 1%	½ of 1%
Eutaw	ST PJ*	10-1-66	1%	¼ of 1%	¼ of 1%
Evergreen	ST PJ*	9-1-70	1%[7]	⅜ of 1%	⅜ of 1%[3]
Faundsdale	ST PJ*	1-1-70	1%	1%	1%[3]
Fort Deposit	ST	11-1-67	1%	¾ of 1%	¾ of 1%
Fort Payne	ST PJ*	5-1-69	2%	1%	1%
Frisco City	ST PJ*	12-1-68	1%	1%	1%
Fultondale	ST PJ*	7-1-69	1%	½ of 1%	½ of 1%
Gardendale	ST PJ*	1-1-69	1%	½ of 1%	½ of 1%
Geneva	ST	12-1-61	1%	½ of 1%	½ of 1%
Georgiana	ST PJ*	6-1-66	1%	¾ of 1%	¾ of 1%
Geraldine	ST PJ*	6-1-65	1%	½ of 1%	½ of 1%
Gilbertown	ST PJ*	11-1-70	1%[7]	½ of 1%	½ of 1%[1]
Glencoe	ST PJ*	7-1-69	1%	1%	1%[3]

* Tax is levied in police jurisdictions at one-half the rates applicable in the corporate limits.
[1] Farm machinery rate is ½ of 1%.
[3] Farm machine rate is 1%.
[7] A 1% lodgings tax is levied on transients.

CITY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE—continued

City	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Goodwater	ST	8-1-67	1%	½ of 1%	1%[1]
	PJ*				
Gordo	ST	10-1-68	1%	⅓ of 1%	¼ of 1%
	PJ		½ of 1%	⅛ of 1%	⅛ of 1%
Grant	ST	1-1-69	1%	1%	1%[3]
	PJ*				
Guin	ST	7-1-65	1%	½ of 1%	½ of 1%
	PJ		½ of 1%	⅛ of 1%	⅛ of 1%
Guntersville	ST	3-1-71	2%	1%	1%
	PJ*				
Hackleburg	ST	5-1-66	1%	½ of 1%	½ of 1%
	PJ		½ of 1%	⅛ of 1%	⅛ of 1%
Haleyville	ST	6-1-69	2%	½ of 1%	1%[3]
	PJ*				
Hamilton	ST	8-1-66	1%	½ of 1%	½ of 1%
	PJ		⅛ of 1%		⅛ of 1%
Hartselle	ST	9-1-62	2%	½ of 1%	1%
	PJ*				
Hayneville	ST	3-1-69	1%	¼ of 1%	¼ of 1%[4]
Headland	ST	1-1-69	1%	¼ of 1%	¼ of 1%
	PJ*				
Heflin	ST	6-1-65	1%	½ of 1%	½ of 1%
	PJ*				
Henagar	ST	1-1-67	1%	¼ of 1%	¼ of 1%
	PJ*				
Hoover	ST	1-1-70	1%	½ of 1%	½ of 1%[1]
	PJ*				
Hueytown	ST	3-1-69	1%	½ of 1%	½ of 1%[4]
	PJ*				
Hurtsboro	ST	12-1-71	1%	¼ of 1%	½ of 1%
	PJ*				
Jackson	ST	12-1-65	1%	⅓ of 1%	⅓ of 1%
	PJ*				
Jacksonville	S & U	9-1-70	2%	½ of 1%	½ of 1%
	PJ*				
Kennedy	ST	10-1-65	1%	½ of 1%	½ of 1%
Killen	ST	1-1-69	1%	¼ of 1%	¼ of 1%
	PJ*				
Kimberly	ST	10-1-67	½ of 1%	¼ of 1%	¼ of 1%
	PJ*				
Kinston	ST	10-1-66	1%	¼ of 1%	¼ of 1%
	PJ*				
Lincoln	ST	1-1-69	1%	¼ of 1%	¼ of 1%[4]
	PJ*				
Lineville	ST	6-1-66	1%	½ of 1%	¼ of 1%
	PJ*				
Littleville	ST	2-1-69	1½%	¼ of 1%	¼ of 1%
	PJ		¼ of 1%	1/16 of 1%	1/16 of 1%
Livingston	ST	6-1-69	2%	1%	1%[3]
	PJ*				
Louisville	ST	10-1-66	1%	¼ of 1%	¼ of 1%
	PJ*				
Loxley	ST	10-1-65	1%	1%	1%
	PJ*				
Marion	ST	10-1-67	1%	¼ of 1%	¼ of 1%
	PJ*				
McKenzie	ST	8-11-69	1%	½ of 1%	½ of 1%
	PJ*				
Midfield	ST	5-1-68	1%	½ of 1%	½ of 1%
Millport	ST	4-1-60	1%	½ of 1%	½ of 1%

* Tax is levied in police jurisdictions at one-half the rates applicable in the corporate limits.
[1] Farm machine rate is ½ of 1%.
[3] Farm machine rate is 1%.
[4] Farm machine rate is ¼ of 1%.

CITY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE—continued

City	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Millry	ST	1-1-67	1%	¼ of 1%	¼ of 1%
	PJ*				
Morris	ST	5-1-67	½ of 1%	¼ of 1%	¼ of 1%
	PJ*				
Moulton	ST	5-1-69	1%	½ of 1%	½ of 1%
	PJ*				
Newton	ST	8-1-65	1%	¼ of 1%	¼ of 1%
	PJ*				
Notasulga	ST	3-1-69	1%	¼ of 1%	¼ of 1%
	PJ*				
Omeonta	ST	3-1-69	1%	¼ of 1%	¼ of 1%
	PJ*				
Oxford	ST	4-1-70	2%	½ of 1%	½ of 1%
	UT	11-1-66	1%	¼ of 1%	¼ of 1%
	PJ*				
Parrish	ST	5-1-70	1%	1%	1%
	PJ		½ of 1%	½ of 1%	½ of 1%
Phil Campbell	ST	10-1-65	1%	¼ of 1%	¼ of 1%
	PJ*				
Piedmont	ST	1-1-70	1%	¾ of 1%	¼ of 1%
	PJ*				
Pine Hill	ST	6-30-69	2%	1%	1%
	PJ*				
Pisgah	ST	1-1-70	1%	½ of 1%	½ of 1%
	PJ*				
Pleasant Grove	ST	8-4-69	1%	1%	1% [2]
Powells	ST	8-1-68	1%	½ of 1%	½ of 1%
	PJ		½ of 1%	⅛ of 1%	⅛ of 1%
Prattville	ST	12-1-68	2%	2%	½ of 1%
	PJ*				
Ragland	ST	1-1-64	1%	¼ of 1%	¼ of 1%
	PJ*				
Rainsville	ST	5-1-68	1%	½ of 1%	½ of 1%
	PJ*		½ of 1%	⅛ of 1%	⅛ of 1%
Red Bay	ST	5-1-65	1%	½ of 1%	½ of 1%
	PJ*				
Reform	ST	2-1-66	½ of 1%	½ of 1%	⅛ of 1%
	PJ		¼ of 1%	1/16 of 1%	1/16 of 1%
Roanoke	ST	7-1-65	1%	½ of 1%	½ of 1%
	PJ*				
Rogersville	ST	4-1-68	1%	⅜ of 1%	⅜ of 1%
	PJ*				
Russellville	ST	1-1-69	1%	¼ of 1%	¼ of 1%
	PJ*				
Samson	ST	6-1-65	1%	¼ of 1%	¼ of 1%
	PJ*				
Scottsboro	ST	3-1-69	1%	½ of 1%	½ of 1% [1]
	PJ*				
Selma	ST	7-1-65	1%	¼ of 1%	¼ of 1%
	PJ*				
Silas	ST	1-1-70	1%	½ of 1%	½ of 1% [1]
	PJ*				
Siluria	ST	9-1-70	1%	½ of 1%	1%
	PJ*				
Slocomb	ST	7-1-65	1%	½ of 1%	½ of 1%
	UT	7-1-65	½ of 1%	½ of 1%	½ of 1%
	PJ*				

* Tax is levied in police jurisdiction at one-half the rates applicable in the corporate limits.

[1] Farm machine rate is ½ of 1%.

[2] Farm machine rate is 1%.

CITY SALES AND USE TAXES ADMINISTERED BY DEPARTMENT OF REVENUE—continued

City	Kind of Tax	Effective Date	General Rate	Automotive Rate	Machine Rate
Stevenson	ST PJ *	4-1-71	1%	½ of 1%	½ of 1% [4]
Sumiton	ST PJ*	4-1-69	1%	¼ of 1%	1% [3]
Tallassee	ST PJ*	10-1-66	1%	¼ of 1%	¼ of 1%
Thomasville	ST PJ*	2-1-69	2%	¼ of 1%	¼ of 1%
Toxey	ST PJ*	4-1-67	1%	½ of 1%	½ of 1%
Trafford	ST PJ*	4-1-66	½ of 1%	½ of 1%	½ of 1%
Troy	ST PJ*	9-1-65	1%	¼ of 1%	¼ of 1%
Tuscumbia	ST PJ	1-1-68	1½% ½ of 1%	⅛ of 1% ⅛ of 1%	¾ of 1% [5] ⅛ of 1%
Union Grove	ST	......	1%	⅓ of 1%	⅓ of 1% [6]
Uniontown	ST PJ*	4-1-66	1%	¼ of 1%	¼ of 1%
Valley Head	ST PJ*	8-1-66	1%	½ of 1%	½ of 1%
Vestavia Hills	ST PJ*	11-1-67	1%	¼ of 1%	¼ of 1%
Vincent	ST PJ*	8-1-67	1%	½ of 1%	1%
Wadley	ST PJ*	7-1-65	1%	½ of 1%	½ of 1%
Warrior	ST PJ*	11-1-67	1%	½ of 1%	½ of 1%
Wedowee	ST PJ*	5-1-67	1%	......	......
Wetumpka	ST PJ*	12-1-65	1%	¼ of 1%	¼ of 1%
Wilsonville	ST PJ*	3-1-67	1%	½ of 1%	1%

Act 917, Laws 1969, authorizes any incorporated city or town to levy a sales and/or use tax, parallel to the State levy of sales and use taxes, at the rate provided by the governing body of the municipality. Taxes levied in the police jurisdiction of any city that levies the tax shall not exceed one-half the amount levied within the corporate limits of the city. The governing body of any city may pass an ordinance or resolution requiring the State Department of Revenue to administer and collect the tax.

City	Effective Date	Kind of Tax	Rate
Albertville	11-1-70	S & U PJ *	2% general, admissions 1% machine, automotive, farm equip.
Alexander City	9-1-71	S & U	2% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Arab	7-1-72	S & U PJ *	3% general, admissions 1½% farm machinery, manufacturing machinery, automotive

* Tax is levied in police jurisdiction at one-half the rates applicable in the corporate limits.
[3] Farm machine rate is 1%.
[4] Farm machine rate is ¼ of 1%.
[5] Farm machine rate is ½ of 1%.
[6] Farm machine rate is ⅓ of 1%.

City	Effective Date	Kind of Tax	Rate
Ashford	12-1-70	S & U PJ *	1% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Bayou La Batre	11-1-70	S & U PJ *	2% general, admissions 1% machine, automotive, farm equip.
Boaz	2-1-71	S & U PJ *	2% general, admissions 1% machine, manufacturing machinery, automotive, farm machinery
Carrville	4-1-71	S & U PJ *	1% general, admissions, farm machinery ¼ of 1% manufacturing machinery, automotive
Clio	1-1-71	S & U PJ *	1% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Cottonwood	4-1-71	S & U PJ *	1% general, admissions ½ of 1% manufacturing machinery ¼ of 1% farm machinery, automotive
Eldridge	3-1-72	S & U[3] PJ*	2% general, admissions 1½% machinery, farm machinery, automotive
Enterprise	11-1-70	S & U PJ *	1% general, admissions ½ of 1% machine ¼ of 1% automotive, farm equip.
Florence	1-1-72	S & U[3] PJ	1½% general 1% admissions ⅜ of 1% manufacturing machinery, automotive, farm machinery
Fyffe	12-1-70	S & U PJ *	1% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Greenville	10-1-70	ST	2% general 1% on mfg. equip., motor vehicles, farm equip.
Gulf Shores[1]	2-1-70	S & U PJ *	1% general ½ of 1% on mfg. equip., motor vehicles, farm equip.
Leeds	11-1-70	S & U PJ *	1% general, admissions ¼ of 1% machine ½ of 1% automotive, farm equip.
Level Plains	3-1-71	S & U PJ *	1% general, admissions ¼ of 1% farm machinery, automotive ½ of 1% manufacturing machinery

* Tax is levied in police jurisdiction at one-half the rates applicable in the corporate limits.

[1] 2% lodgings tax effective 4-1-71.

[2] There is also a use tax on property purchased outside the corporate limits and police jurisdiction for use within such limits. The rates are the same as the sales tax, except for the general rate, which is 1%.

[3] There is also a use tax on property purchased outside the corporate limits and police jurisdiction for use within such limits. The rates are the same as the sales tax, except for the general rate, which is 1½%.

City	Effective Date	Kind of Tax	Rate
Monroeville	1-1-70	S & U PJ *	1% general ½ of 1% automotive, farm machine
Muscle Shoals	2-1-72	S & U[1] PJ*	1½% general, admissions ⅜ of 1% machinery, farm machinery, automotive
New Brockton	3-1-71	S & U PJ *	1% general, admissions ¼ of 1% farm machinery, automotive ½ of 1% manufacturing machinery
Ozark	7-1-70	S & U PJ *	1% general and admissions ¼ of 1% machine, automotive, farm equip.
Pelham	1-1-72	S & U	1% general, admissions, farm machinery ½ of 1% automotive
Phenix	1-1-71	S & U PJ *	1% general, admissions, farm machinery, manufacturing machinery, automotive
Prichard	4-1-72	S & U PJ *	2½% general and admissions ¾ of 1% machine, automotive, farm equip.
Sheffield	1-1-72	S & U	1½% general 1% admissions ⅜ of 1% manufacturing machinery, automotive, farm machinery
Sulligent	6-1-71	S & U PJ *	1% general, admissions ½ of 1% manufacturing machinery, motor vehicles, farm machinery
Sylacauga	12-1-70	S & U	2% general, admissions ⅓ of 1% farm machinery, manufacturing machinery, automotive
Talladega	12-1-70	S & U PJ *	2% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Tuskegee	8-1-72	S & U PJ *	1% general, admissions ½ of 1% automotive, manufacturing machinery ¼ of 1% farm machinery
Union Springs	1-1-71	S & U PJ *	1% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Vernon	3-1-71	S & U PJ *	1% general, admissions ½ of 1% farm machinery, manufacturing machinery, automotive
Weaver	12-1-70	S & U PJ *	2% general, admissions, farm machinery, manufacturing machinery, automotive

* Tax is levied in police jurisdiction at one-half the rates applicable in the corporate limits.

[1] There is also a use tax on property purchased outside the corporate limits and police jurisdiction for use within such limits. The rates are the same as the sales tax, except for the general rate, which is 1½%.

City	Effective Date	Kind of Tax	Rate
Winfield	5-1-72	S & U PJ*	2% general, admissions ½ of 1% machinery, farm machinery, automotive
York	1-1-71	PJ * S & U	1% general, admissions ¼ of 1% farm machinery, manufacturing machinery, automotive

CITY SALES AND USE TAXES NOT ADMINISTERED BY THE DEPARTMENT OF REVENUE

City	Rate	City	Rate
Athens	1%	Huntsville	2%
Birmingham	1%	Jasper	1%
Brilliant	1%	Leighton	1%
Brundidge	1%	Linden	2%
Camden	1%	Mobile	2%
Chickasaw	2%	Montgomery	2%
Childersburg	1%	Mountain Brook	1%
Clayton	1%	Northport	1%
Cordova	1%	Ohatchee	1%
Cullman	1%	Opelika	1%
Decatur	2%	Orrville	1%
Demopolis	2%	Pell City	1%
Detroit	1%	Rockford	1%
Dothan	1%	Saraland	1%
Fairfield	1%	Satsuma	2%
Fayette	1%	Tarrant	1%
Grove Hill	1%	Thomaston	1%
Hokes Bluff	1%	Tuscaloosa[1]	

All of the taxes not administered by the State are collected by the city or county administrator.

See below for county and additional city sales and use taxes.

County Taxes

Bibb.—The following taxes are levied: (1) on the gross proceeds from retail sales, 1%; (2) on the gross proceeds from operating places of entertainment and amusement, 1%; (3) on the gross proceeds from sales of machines, and parts therefor, used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds of sales at retail of any automotive

* Tax is levied in police jurisdiction at one-half the rates applicable in the corporate limits.

[1] The 1% Tuscaloosa city sales tax has been suspended and is being collected by the Tuscaloosa County Special Sales Tax Board.

vehicle, truck trailer or semi-trailer, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be levied on the price of the new or used vehicle sold, less the credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or consumption, 1%; (6) on the sales price of machines, and parts therefor, for mining, quarrying, compounding, processing and manufacturing of tangible personal property purchased at retail for storage, use or other consumption, ½ of 1%; (7) on the sales price of any automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less the credit for the used vehicle taken in trade. The exemptions provided by the state sales and use tax are applicable. Payment of the tax and reports are made to the State Department of Revenue at the same time as the state sales and use tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 17, Laws 1957, as amended by Act 474, Laws 1959; Act 584, Laws 1967; Act 864, Laws 1969.)

Blount.—The following taxes are levied: (1) on the gross proceeds from retail sales, 1%; (2) on the gross receipts from operating places of entertainment or amusement, 1%; (3) on gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%, provided that if a vehicle or trailer is traded in, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, ½ of 1%; (7) on the sales price of any new or used automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade. The taxes levied by this Act shall be subject to all definitions, exemptions, proceedings, rules, regulations, requirements, findings, penalties, punishments, and deductions as are provided in the state sales and use tax acts, except where inapplicable. The taxes levied by this Act shall be collected by the State Department of Revenue at the same time and along with the collection of taxes levied and collected for the state under the state sales and use tax acts. (CCH Alabama Tax Reporter at ¶ 74-010; Act 572, Laws 1961, effective October 1, 1961.)

Bullock.—The following taxes are imposed: (1) on the gross proceeds of retail sales, 1%; (2) on the gross receipts from admission to places of amusement and entertainment, 1%; (3) on gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, 1%; (4) on the gross proceeds from sales of automotive vehicles or truck trailers and semi-trailers, ½ of 1%; (5) on the gross proceeds from sales of used automotive vehicles or truck trailers and semi-trailers, where the vehicles are bought for the purpose of resale, ½ of 1%; (6) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (7) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, 1%; (8) on the sales price of new or used automotive vehicles, trucks, trailers or semi-trailers purchased at retail for storage, use or other consumption, ½ of 1%. The sales tax is due on or before the 20th day of each month and the use tax on or before the 20th day of the month next succeeding each quarterly period. (Quarterly periods end on the last days of March, June, September and December.) The tax is collected by the Court of County Commissioners of Bullock County or its officially designated agent. The Commissioners exercise the same powers, duties, and obligations as are imposed on the State Commissioner of Revenue. Copies of the reports made to the State Commissioner of Revenue with respect to state sales and use taxes must also be made to the Court of County Commissioners. (CCH Alabama Tax Reporter at ¶ 74-010; Resolution of March 24, 1958; amended by Act 523, Laws 1965, effective September 1, 1965.)

Chilton.—The following taxes are imposed: (1) on the gross proceeds from retail sales, 1%; (2) on the gross proceeds from operating places of entertainment or amusement, 1%; (3) on gross proceeds from re-

tail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds from retail sales of any automotive vehicle or truck trailer and semitrailer, ½ of 1%, provided that if a vehicle or trailer is traded in, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of any new or used automotive vehicle, truck trailer or semitrailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (7) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, ½ of 1%. Taxes levied hereunder shall be paid

to and collected by the state department of revenue at the same time and along with the collection of state sales and use taxes. Exemptions, deductions and exclusions conform to the state sales and use tax provisions. The tax shall terminate on September 30, 1995. (CCH Alabama Tax Reporter at ¶ 74-010; Act 471, Laws 1959, effective December 1, 1959; as amended to date.)

Choctaw.—Act 269, Laws 1961, which authorized the imposition of a sales and use tax in Choctaw County, was repealed by Act 63, Laws 1963, effective July 1, 1963.

Colbert.—The following taxes are imposed: (1) on gross proceeds from retail sales, ½ of 1%; (2) on gross receipts from operating places of amusement or entertainment, 1%; (3) on gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ⅜ of 1%; (4) on gross proceeds (less credits for trade-ins) from retail sales of any automotive vehicle, truck trailer, semi-trailer or house trailer, ⅛ of 1%; (5) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, purchased at retail for storage, use or other consumption, ⅜ of 1%; (6) on the sales price (less credits for trade-ins) of automotive vehicles, truck trailers, semi-trailers or house trailers purchased at retail for storage, use or other consumption, ⅛ of 1%; (7) on the sales price of any other tangible personal property purchased at retail for storage, use or other consumption in the county, ½ of 1%. Payment of the tax and reports are made to the State Department of Revenue at the same time as the state sales and use tax. This Act supersedes Act 485, Laws 1949. (CCH Alabama Tax Reporter at ¶ 74-010; Act 89, Laws 1961, effective October 1, 1962; as amended by Act 118, Laws 1963, 2nd Spec. Sess., effective June 1, 1963.)

Covington.—The following taxes are imposed: (1) on the gross proceeds of retail sales, 1%; (2) on the gross receipts from operating places of amusement or entertainment, 1%; (3) on the gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds (less credits for trade-ins) from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price (less credits for trade-ins) of any new or used automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%; (7) on the sales price of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, purchased at retail for storage, use or other consumption, ½ of 1%. Exemptions applicable to the state sales and use taxes apply to taxes levied under this Act. The taxes levied above shall be paid to and collected by the Department of Revenue at the same time and along with the collection of the state sales and use taxes. (CCH Alabama Tax Reporter at ¶ 74-010; Act 850, Laws 1961, effective January 1, 1962.)

Crenshaw.—The following taxes are levied: (1) on gross proceeds from retail sales, 1%; (2) on gross receipts from operating places of entertainment and amusement, 1%; (3) on the gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%, provided that, if a vehicle or trailer is traded in the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, ½ of 1%; (7) on the sales price of any automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that, where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade. Exemptions applicable to the state sales and use taxes shall apply to the taxes levied by this Act. Taxes shall be paid to and collected by the State Department of Revenue at the same time and along with the collection of the state sales and use tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 677, Laws 1961, effective October 1, 1961.)

Cullman.—There is levied a tax in Cullman County as follows: (1) on gross receipts from retail sales, 1%; (2) on the

gross receipts from operating places of amusement and entertainment, 1%; (3) on the gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds of sales at retail of any automotive vehicle, truck trailer or semi-trailer, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be levied on the price of the new or used vehicle sold, less the credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of any new or used automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold, less a credit for the used vehicle taken in trade; (7) on the sales price of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing tangible personal property purchased at retail for storage, use or other consumption, ½ of 1%. Exemptions applicable to the state sales and use taxes apply to the taxes levied by this Act. The taxes levied hereunder shall be collected by the Department of Revenue at the same time and along with the collection of the state sales and use taxes. (CCH Alabama Tax Reporter at ¶ 74-010; Act 66, Laws 1963, 2nd Spec. Sess., effective October 1, 1963, amended by Act 108, Act 591 and Act 845, Laws 1969.)

Fayette.—The following taxes are imposed: (1) on the gross proceeds of retail sales, 1%; (2) on the gross receipts from operating places of amusement or entertainment, 1%; (3) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (4) on the gross proceeds from retail sale of any automotive vehicle or truck trailer or semi-trailer, ⅓ of 1%; (5) on the gross proceeds from sale of any used automotive vehicle or truck trailer or semi-trailer, where such vehicles are bought for resale, ⅓ of 1% (not applicable to trade-ins); (6) on the sales price of any new or used automotive vehicle or truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ⅓ of 1%. Exemptions applicable to the state sales and use tax apply to taxes levied under this Act. The taxes are paid to the State Department of Revenue at the same time and in the same manner as the state sales and use taxes. (CCH Alabama Tax Reporter at ¶ 74-010; Act 278, Laws 1957, effective February 1, 1962.)

Franklin.—There is levied a privilege or license tax in Franklin county as follows: (1) on gross proceeds from retail sales, 1%; (2) on gross receipts from operating places of entertainment and amusement, 1%; (3) on gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%, provided that if a vehicle or trailer is traded in, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (5) on the gross proceeds of retail sales of farm machinery, including parts, ½ of 1% less any trade-in; (6) on the sales price of tangible personal property purchased at retail for storage, use or consumption, 1%; (7) on the sales price of any new or used automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (8) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, ½ of 1%; and (9) on the sales price of farm machinery, including parts, ½ of 1%. Taxes levied hereunder shall be paid to and collected by the State Department of Revenue at the same time and along with the collection of the state sales tax and the state use tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 441, Laws 1969, effective October 1, 1969.)

Hale.—The following taxes are imposed: (1) on the gross proceeds from the sale at retail of tangible personal property, 1%; (2) on the gross proceeds from admission to places of amusement and entertainment, 1%; (3) on the gross proceeds from sales at retail of machines used in mining, quarrying, compounding, processing and manufacturing of tangible personal property and the parts therefor, ½ of 1%; (4) on the gross proceeds (less credits for trade-ins) of sales at retail of any automotive vehicle or truck

trailer and semi-trailer, ½ of 1%. All taxes levied hereunder shall be paid to and collected by the state department of revenue at the same time and along with the collection of state sales and use taxes. (CCH Alabama Tax Reporter at ¶ 74-010; Act 472, Laws 1959, effective December 1, 1959, as amended by Act 492, Laws 1965, effective August 20, 1965.)

Jefferson.—Act 405 (H. B. 823), Laws 1967, levied a sales and use tax upon all counties having a population of 500,000 or more. It is applicable to all persons engaged in the business of selling tangible personal property at retail, conducting a place of amusement or entertainment, or engaged in any business subject to the state sales tax, and upon the storage, use or other consumption of tangible personal property purchased at retail.

The tax is levied at ¼ the rate of the state sales tax.

The tax is due and payable on or before the twentieth day of the month next succeeding the month in which the tax accrues. If monthly liability does not exceed $10, a quarterly return may be remitted on the twentieth of the month following the quarter. The use tax returns and remittances are due quarterly. The returns are to be remitted to the Commissioner of Licenses. The discount allowed is the same as the state allows (Law, ¶ 20-094, Reg., ¶ 20-745B).

Exemptions and administration of the law parallel the state law. A 5% bracket system was issued and is reproduced above under "Gross Receipts (Sales) Tax" (Note: The bracket does not reflect the tax collected in Birmingham.) (CCH Alabama Tax Reporter at ¶ 74-010; Act 387, Laws 1965, amended by Act 405, Laws 1967, effective October 1, 1967.)

Jefferson. — Any individual, corporation, partnership, association, stock company, business trust, unincorporated organization, and the like, which conducts or engages in any of the enumerated business activities or occupations in Jefferson County must pay an annual license tax to the Director of Revenue. A license is required for each separate business or occupation and each separate location thereof even though the same person may own more than one taxable activity.

Where no single flat fee is provided, the tax is determined in accordance with a scheduled set of fees based upon either: gross annual receipts; investment in plant, equipment, supplies and fixtures; market value of goods removed from inventory during the previous year; number of employees, vehicles, or rooms; amount of space occupied; or aggregate amount of loans made. Where the license fee is based on gross annual receipts, such term means the entire receipts for the preceding calendar year including all sales, regardless of the place where the sale was solicited, the place where the contract was consummated or the place where delivery was effected and the amount of any federal excise tax or any tax imposed on sales or services. Moreover, in the case of fees based on gross annual receipts, the amount of all state, county and municipal sales and use taxes, and other taxes paid thereto, may be deducted from the tax base. Finally, in the case of fees based on gross annual receipts, the licensee may either: (1) deduct from the entire receipts the amount of receipts derived from the sale of merchandise or services covered by state and county license or licenses issued under Secs. 450—617, Tit. 51; or (2) deduct from the license tax due amounts paid to the state and county under these sections for such licenses excluding fees, interest and penalties. Where the license fee is based on investment in plant, equipment, supplies and fixtures the basis is the average of such investment for the calendar year next preceding the current year.

A basic issuance fee of $1 is charged for all licenses. Annual fees for certain of the taxed businesses which are of a more general interest are set forth below. In the case of businesses whose basis is either gross receipts or capital investment and which did not commence until after October 1, 1968, or any subsequent October 1, liability is limited to the minimum license fee for that license year. For such businesses commencing after April 1, 1969, or any subsequent April 1, only ½ the minimum license fee is payable for the remainder of that license year.

1. Dress, Clothing, Shoe, or Hat Shops Merchandise (Retail Sales or Leasing) Merchandise (Storing for Retail Sales)

Annual gross receipts		Fee
less than $1,000		$ 2.50
$ 1,000—$	5,000	3.00
5,000—	10,000	3.50
10,000—	15,000	6.00
15,000—	20,000	10.00
20,000—	40,000	13.00
40,000—	60,000	16.00
60,000—	100,000	25.00
100,000—	150,000	33.00
150,000—	200,000	41.00
200,000—	250,000	50.00
250,000—	300.000	58.00
300,000—	350,000	66.00
350,000—	400,000	75.00
400,000—	500,000	83.00

From	To	Fee
500,000—	600,000	100.00
600,000—	700,000	116.00
700,000—	800,000	133.00
800,000—	900,000	150.00
900,000—	1,000,000	166.00
1,000,000—	1,200,000	183.00
1,200,000—	1,400,000	200.00
1,400,000—	1,600,000	216.00
1,600,000—	1,800,000	233.00
1,800,000—	2,000,000	250.00
2,000,000—	5,000,000	333.00
5,000,000—	10,000,000	416.00
1,000,000 and over		500.00
Each additional location where business is conducted in same name or by wholly-owned subsidiary		100.00

If gross business at any such additional location would result in a license fee of less than $100.00, the lower amount would prevail.

2. Contractors

Annual gross receipts		Fee
less than $10,000		$ 15.00
$ 10,000—	$ 20,000	22.50
20,000—	50,000	37.50
50,000—	100,000	75.00
100,000—	150,000	225.00
150,000—	200,000	300.00
Over $200,000		375.00

3. Food Stores (Retail)

Annual gross receipts less		Fee
than $1,000		$ 2.50
$ 1,000—	$ 5,000	3.00
5,000—	10,000	3.50
10,000—	15,000	6.00
15,000—	20,000	10.00
20,000—	40,000	13.00
40,000—	60,000	16.00
60,000—	100,000	25.00
100,000—	150,000	33.00
150,000—	200,000	41.00
200,000—	250,000	50.00
250,000—	300,000	58.00
300,000—	350,000	66.00
350,000—	400,000	75.00
400,000—	500,000	83.00
500,000—	600,000	100.00
600,000—	700,000	116.00
700,000—	800,000	133.00
800,000—	900,000	150.00
900,000—	1,000,000	166.00
1,000,000—	1,200,000	183.00
1,200,000—	1,400,000	200.00
1,400,000—	1,600,000	216.00
1,600,000—	1,800,000	233.00
1,800,000—	2,000,000	250.00
2,000,000—	5,000,000	333.00
5,000,000—	10,000,000	416.00
10,000,000 and over		500.00
Each additional location where business is conducted in same name or by wholly-owned subsidiary		$100.00

If gross business at any such additional location would result in a license fee of less than $100.00, the lower amount would prevail.

4. Manufacturing, Processing, Fabricating, Assembling

Investment in plant, equipment, supplies and fixtures less than		Fee
$15,000		$ 15.00
$ 15,000—	$ 25,000	30.00
25,000—	50,000	45.00
50,000—	100,000	75.00
100,000—	500,000	150.00
500,000—	1,000,000	225.00
Over $1,000,000		300.00

5. Oils (Wholesale of Lubricants, Illuminants, Fuel Gasoline, Benzol and Benzol Products, Linseed or Turpentine Oils)

Annual gross receipts up to		Fee
$20,000		$ 30.00
$ 20,000—	$ 40,000	40.00
40,000—	60,000	50.00
60,000—	100,000	75.00
100,000—	250,000	150.00
250,000—	500,000	250.00
500,000—	1,000,000	500.00
1,000,000—	2,000,000	750.00
2,000,000—	5,000,000	1,000.00
5,000,000—	10,000,000	1,250.00
10,000,000 and over		1,500.00

6. Wholesalers

Annual gross receipts less		Fee
than $1,000		$ 2.50
$ 1,000—	$ 5,000	3.00
5,000—	10,000	3.50
10,000—	15,000	6.00
15,000—	20,000	10.00
20,000—	40,000	13.00
40,000—	60,000	16.00
60,000—	100,000	25.00
100,000—	150,000	33.00
150,000—	200,000	41.00
200,000—	250,000	50.00
250,000—	300,000	58.00
300,000—	350,000	66.00
350,000—	400,000	75.00
400,000—	500,000	83.00
500,000—	600,000	100.00
600,000—	700,000	116.00
700,000—	800,000	133.00
800,000—	900,000	150.00
900,000—	1,000,000	166.00
1,000,000—	1,200,000	183.00

		Fee
$ 1,200,000—$	1,400,000	$200.00
1,400,000—	1,600,000	216.00
1,600,000—	1,800,000	233.00
1,800,000—	2,000,000	250.00
2,000,000—	5,000,000	333.00
5,000,000—	10,000,000	416.00
10,000,000 and over		500.00

Each additional location where business is conducted in same name or by wholly-owned subsidiary 100.00

If gross business at any such additional location would result in a license fee of less than $100.00, the lower amount would prevail.

7. Merchandise (Retail Sales or Leasing)

		Fee
Annual gross receipts less than $1,000		$ 2.50
$ 1,000—$	5,000	3.00
5,000—	10,000	3.50
10,000—	15,000	6.00
15,000—	20,000	10.00
20,000—	40,000	13.00
40,000—	60,000	16.00
60,000—	100,000	25.00
100,000—	150,000	33.00
150,000—	200,000	41.00
200,000—	250,000	50.00
250,000—	300,000	58.00
300,000—	350,000	66.00
350,000—	400,000	75.00
400,000—	500,000	83.00
500,000—	600,000	100.00
600,000—	700,000	116.00
700,000—	800,000	133.00
800,000—	900,000	150.00
900,000—	1,000,000	166.00
1,000,000—	1,200,000	183.00
1,200,000—	1,400,000	200.00
1,400,000—	1,600,000	216.00
1,600,000—	1,800,000	233.00
1,800,000—	2,000,000	250.00
2,000,000—	5,000,000	333.00
5,000,000—	10,000,000	416.00
10,000,000 and over		500.00

Each additional location where business is conducted in same name or by wholly-owned subsidiary 100.00

If gross business at any such additional location would result in a license fee of less than $100.00, the lower amount would prevail.

8. Merchandise (Storing for Retail Sales)

		Fee
Market value of goods removed from storage less than $1,000		$ 2.50
$ 1,000—$	5,000	3.00
5,000—	10,000	3.50
10,000—	15,000	6.00
$ 15,000—$	20,000	$ 10.00
20,000—	40,000	13.00
40,000—	60,000	16.00
60,000—	100,000	25.00
100,000—	150,000	33.00
150,000—	200,000	41.00
200,000—	250,000	50.00
250,000—	300,000	58.00
300,000—	350,000	66.00
350,000—	400,000	75.00
400,000—	500,000	83.00
500,000—	600,000	100.00
600,000—	700,000	116.00
700,000—	800,000	133.00
800,000—	900,000	150.00
900,000—	1,000,000	166.00
1,000,000—	1,200,000	183.00
1,200,000—	1,400,000	200.00
1,400,000—	1,600,000	216.00
1,600,000—	1,800,000	233.00
1,800,000—	2,000,000	250.00
2,000,000—	5,000,000	333.00
5,000,000—	10,000,000	416.00
10,000,000 and over		500.00

Each additional location where business is conducted in same name or by wholly-owned subsidiary 100.00

If gross business at any such additional location would result in a license fee of less than $100.00, the lower amount would prevail.

On or before October 1 of each year all licensees, except those for whom a single flat fee is prescribed, will render to the Director of Revenue a sworn statement showing the previous year's gross receipts, capital investment, or whatever basis is required by the tax schedule. In addition the amount of license tax due must be stated. License fees are due and payable on October 1 of each year or the day on which business is commenced if after October 1. In the first effective year of the tax payment is delinquent if not received before January 1, 1969; thereafter the date is November 1 of each year. Regardless of delinquent dates, payment may be enforced immediately after the due date. (CCH Alabama Tax Reporter at ¶ 73-050; Ordinance No. 1, effective September 30, 1968, as authorized by Act 405, Laws 1967; amended by Ord. Nos. 5, 6, 7 and 9, effective October 1, 1968.)

Lauderdale.—The following taxes are imposed: (1) on gross proceeds from retail sales, 1%; (2) on gross proceeds from amusement places, 1%; (3) on gross proceeds from sales of automotive vehicles, truck trailers **and semi-trailers, ¼ of 1%; (4) a use tax** of 1% except of automotive vehicles, where

it is ¼ of 1%. Returns and payment of tax are made to the probate judge of Lauderdale County in the same manner as for the state tax. (Rates in the City of Florence equal ½ of 1% on retail sales and 1% on gross receipts of amusements, etc.) (CCH Alabama Tax Reporter at ¶ 74-010; Act 296, Laws 1949; as amended by Act 470, Laws 1959, effective November 13, 1959.)

Lawrence.—The following taxes are imposed: (1) on the gross proceeds of sale at retail of tangible personal property, 1%; (2) on the gross proceeds from operating places of amusement and entertainment, 1%; (3) on the gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds (less credits for trade-ins) from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use, or other consumption, ½ of 1%; (7) on the sales price (less credits for trade-ins) of any automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%. Payment of the tax and reports are made to the State Department of Revenue at the same time as the state sales and use tax. The exemptions provided for by the state sales and use taxes are applicable. (CCH Alabama Tax Reporter at ¶ 74-010; Act 25, Laws 1959; as amended by Act 493, Laws 1959, effective December 1, 1959.)

Lee.—There is levied in that part of Lee County outside the corporate limits of the cities of Auburn and Opelika (one-half of the following rates are levied in the police jurisdiction of Opelika) the following taxes: (1) on the gross proceeds of sales at retail, 1%; (2) on the gross receipts from the business of operating amusements or entertainment, 1%; (3) on the gross proceeds of sales at retail of machines used in mining, quarrying, compounding, processing and manufacturing tangible personal property, ⅜ of 1%; (4) on the gross proceeds of sale of any automotive vehicle, truck trailer, semi-trailer, or house trailer, less any trade-in, ⅜ of 1%; (5) on the sales price of tangible personal property purchased for storage, use or consumption, 1%; (6) on the sales price paid for machines used in mining, quarrying, compounding, processing, and manufacturing of tangible personal property purchased at retail for storage, use or consumption, ⅜ of 1%; and (7) on the sales price of automotive vehicles, truck trailers, semi-trailers, or house trailers purchased at retail for storage, use or consumption, ⅜ of 1%.

Sales tax payments are due on the 20th of every month; use tax payments are due quarterly on the 20th of the following month. The State Department of Revenue will collect and enforce the tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 1254, Laws 1969, effective October 1, 1969.)

Limestone.—The following taxes are imposed: (1) on the gross proceeds from retail sales, 1%; (2) on the gross receipts from operating places of entertainment and amusement, 1%; (3) on the gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1%; (4) on the gross proceeds from retail sales of any automotive vehicle or truck trailer and semi-trailer, ½ of 1%, provided that, if a vehicle or trailer is traded in, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of machines used in mining, quarrying, compounding, processing and manufacturing and parts therefor for storage, use or other consumption, ½ of 1%; (7) on the sales price of any new or used automotive vehicle, truck trailer or semi-trailer purchased at retail for storage, use or other consumption, ½ of 1%, provided that, where any used vehicle or trailer is taken in trade, the tax shall be paid on the price of the new or used vehicle sold less a credit for the used vehicle taken in trade. Taxes levied hereunder shall be paid to and collected by the State Department of Revenue at the same time and along with the collection of the state sales and use taxes. The same requirements, exemptions and deductions provided for under the state sales and use tax apply to the county tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 68, Laws 1957, effective August 1, 1957, as amended by Act 491, Laws 1959, Act 443.)

Macon.—The following taxes are imposed: (1) on the gross proceeds of sales at retail, 1%; (2) on the gross receipts from operating places of amusement or

entertainment, 1%; (3) on the gross proceeds of sales of automotive vehicles or truck trailers, semi-trailers or house trailers, less any trade-in, ¼ of 1%; (4) on the gross proceeds of the sale at retail of machines used in mining, quarrying, compounding, processing and manufacturing of personal property, ¼ of 1%; (5) on the sales price of tangible personal property purchased at retail for storage, use or other consumption, 1%; (6) on the sales price of the storage, use or other consumption of any automotive vehicle or truck trailer, semi-trailer, or house trailer, less any trade-in, ¼ of 1%; and (7) on the sales price of the storage, use or other consumption of any machines used in mining, quarrying, compounding, processing, and manufacturing of tangible personal property, purchased at retail, ¼ of 1%. Taxes are due and payable on the 20th of every month and shall be paid to and collected by the State Department of Revenue. Quarterly returns are also required. All provisions of the state sales tax statutes with respect to administration of the law apply to the county tax. (CCH Alabama Tax Reporter at ¶ 74-010; Act 818, Laws 1969, effective November 1, 1969.)

Marion.—The following taxes are imposed: (1) on gross proceeds from retail sales, 2%; (2) on the gross receipts from operating places of amusement or entertainment, 2%; (3) on the gross proceeds (less credits for trade-ins) of sales at retail of any automotive vehicle, truck trailer, semi-trailer or house trailer, 1½%; (4) on the sales price of tangible personal property purchased at retail for storage, use or other consumption in Marion County, 2%; (5) on the sales price (less credits for trade-ins) of any automotive vehicle, truck trailer, semi-trailer or house trailer purchased at retail for storage, use or other consumption in Marion County, 1½%. Exemptions applicable to the state sales and use taxes apply to the tax levied under the above acts. In addition, the gross proceeds from the sale and the storage, use or other consumption of machines and parts therefor used in mining, quarrying, compounding, processing, and manufacturing of tangible personal property are exempt from the Marion County tax. The storage, use or consumption of ammonium nitrate used for blasting in the coal mine industry is exempt. The tax is paid to the State Department of Revenue at the same time as the state sales and use taxes. (CCH Alabama Tax Reporter at ¶ 74-010; Act 115, Laws 1949, as amended by Act 151, Laws 1956, 1st Spec. Sess.; Act 39, Laws 1963, 1st Spec. Sess.; Act 9, Laws 1967; Act 647, Laws 1967, effective February 1, 1968.)

Monroe.—The rate of the gross proceeds tax on retail sales and amusements and the rate of the excise tax on the storage, use or other consumption of tangible personal property purchased at retail are both 1%. In addition to the exemptions allowed under the state sales and use tax statutes, the gross proceeds of the sales of automotive vehicles, truck trailers, semi-trailers and house trailers, farm machinery and equipment, and mining and manufacturing machinery and equipment and the storage, use or consumption of such materials are exempt. Sales and use taxes are due monthly on the 20th and payable along with state sales and use taxes to the State Department of Revenue. (CCH Alabama Tax Reporter at ¶ 74-010; Act 503, Laws 1971, effective October 1, 1971.)

Pickens.—The following taxes are imposed: (1) on the gross proceeds from retail sales and amusements, ½ of 1%; (2) on the gross proceeds of the sale of automotive vehicles, or truck trailers and semi-trailers, ⅙ of 1%; (3) on the storage, use or other consumption of tangible personal property purchased at retail, ½ of 1%; (4) on vehicles purchased at retail for storage, use or other consumption, ⅙ of 1%.

The tax is paid to the State Department of Revenue at the same time as the state tax. In addition to the exemptions allowed under the state sales and use tax statutes; the gross proceeds of the sale of machines used in mining, compounding, processing and manufacturing of tangible personal property and the storage, use or other consumption of such machines; and the gross proceeds of sales of laboratory materials, dentures, appliances and other therapeutic devices sold or dispensed by a licensed dentist in conjunction with his services as well as all eyewear, including lenses, frames and eyeglasses, or other therapeutic devices sold or dispensed by a licensed optometrist as part of his services and the storage, use or consumption of such materials, are exempt. (CCH Alabama Tax Reporter at ¶ 74-010; Act 171, Laws 1965, effective July 30, 1965; as amended by Act 171, Laws 1965, Act 372, Laws 1966.)

Tuscaloosa.—The following taxes are imposed: (1) on gross proceeds from retail sales made within the county, 2%; (2) on gross receipts from operating places of entertainment and amusement, 2%; (3) on

gross proceeds from sales of automotive vehicles, truck-trailers and semi-trailers, ½ of 1%; (4) on gross proceeds from retail sales of machinery used in mining, quarrying, compounding, processing and manufacturing tangible personal property, ¾ of 1%; (5) on the storage, use or consumption of tangible personal property, 2%; (6) on the storage, use or consumption of automotive vehicles, truck-trailers or semi-trailers, ½ of 1%; and (7) on the storage, use or consumption of machinery used in mining, quarrying, compounding, processing and manufacturing tangible personal property, ¾ of 1%. In addition to the exemptions allowed under the state sales and use tax statutes, the gross proceeds from any business engaged in by a city or town in Tuscaloosa County and gross proceeds from the sale of school lunches by public and private schools in the county are exempt from the sales and use taxes levied by this act. Returns and payment of tax are due on or before the 20th of the month next succeeding the month in which the tax accrues. Any person obligated to furnish materials under a construction contract entered into prior to May 1, 1967, is entitled to a refund of 50% of any tax paid after such date on account of materials purchased in accordance with the contract. The tax is enforced by the Tuscaloosa County Special Tax Board. (CCH Alabama Tax Reporter at ¶ 74-010; Act 56, Laws 1953; as amended by Act 290, Laws 1959; Act 112, Laws 1967, 1st Spec. Sess., effective May 1, 1967.)

City Taxes

Auburn.—A privilege or license tax is levied on every person, firm or corporation engaged in the business of (1) selling at retail any tangible personal property—1% of the gross proceeds of sales, (2) selling any automotive vehicle or truck trailer and semi-trailer —½ of 1% of the gross proceeds, (3) selling any used automotive vehicle or truck trailer and semi-trailer bought for the purpose of resale—½ of 1% of the gross proceeds, provided where any used automotive vehicle or truck trailer or semi-trailer is taken in trade as a credit or part payment on the sale of a new or used vehicle, the tax shall be paid on the price of the new or used vehicle sold less the credit for the used vehicle taken in trade, (4) operating any place of entertainment or amusement—2% of the gross receipts, and (5) selling at retail machines, and parts therefor, used in mining, quarrying, compounding, processing and manufacturing of tangible personal property—½ of 1% of the gross proceeds. Rates for doing business outside the corporate limits of Auburn, but within its police jurisdiction, shall be ½ of the amounts levied for doing business within the corporate limits.

Itinerant vendors selling at retail within the city must give bond in the sum of $50 or deposit $50 in cash.

A discount of 5% of the first $100 and 2% in excess of $100 of the total amount of any monthly installment of the tax shall be allowed upon the filing of the monthly report. On or before the 20th day of each month, every person shall file a statement showing the gross sales, the gross proceeds of sales or gross receipts of his business for the next preceding month; returns are due with the reports. Unless other forms are prescribed, forms prescribed and used by the state under the State Sales Tax Law

may be used. (CCH Alabama Tax Reporter at ¶ 72-075; Ord. No. 238, effective January 1, 1961.)

Birmingham (Sales Tax).—The following taxes are levied on every person, firm or corporation engaged in the business of: (1) selling tangible personal property at retail—1% of the gross proceeds of sales; (2) operating any place of amusement or entertainment—1% of the gross receipts; (3) selling at retail any automotive vehicle, truck trailer, semi-trailer or house trailer—½ of 1% of the gross proceeds, provided, where any used automotive vehicle or truck trailer or semi-trailer or house trailer is taken in trade as a credit or part payment on the sale of a new or used vehicle, the tax shall be paid on the price of the new or used vehicle sold less the credit for the used vehicle taken in trade; and (4) selling at retail machines, and parts therefor, used in mining, quarrying, compounding, processing and manufacturing of tangible personal property—½ of 1% of the gross proceeds.

A $5 "in lieu of tax" fee applies to each vehicle withdrawn from a dealer's stock in trade for use in the operation of his business.

The following tax brackets are suggested for retailers electing to add the combined tax to retail sales made:[1]

Sales	Tax
$ 0.00 through $0.10	$0.00
0.11 through 0.20	0.01
0.21 through 0.36	0.02
0.37 through 0.54	0.03
0.55 through 0.70	0.04
0.71 through 0.85	0.05
0.86 through 1.10	0.06
1.11 through 1.20	0.07
1.21 through 1.36	0.08
1.37 through 1.54	0.09
1.55 through 1.70	0.10
1.71 through 1.85	0.11
1.86 through 2.10	0.12
5.00	0.30
8.00	0.48
10.00	0.60

Itinerant vendors selling at retail within the City of Birmingham must give bond in the sum of $50 or deposit $50 in cash with the Director of Finance.

Reports and payments are due and payable to the City on or before the 20th day of the month next succeeding the month in which the tax accrues. A discount of 1½% of the total amount of monthly installment of tax due is allowed for timely filing of reports and payments. (CCH Alabama Tax Reporter at ¶ 72-110; Ord. No. 64-11, effective March 1, 1964, as amended to date.)

Birmingham (License Tax).—The following taxes are imposed: (a) Each person engaged in the business of offering for sale, taking or soliciting orders for sale, or selling merchandise of any description, including any such products stored in a warehouse for sale, distribution or delivery, whether as owner, dealer, agent or consignee, shall pay a license as follows:

Where value of stock, fixtures, and all equipment used in the business averages:	
Less than $500.00	$ 12.00
$500 and less than $1,000	18.00
$1,000 and less than $1,500	24.00
$1,500 and less than $2,000	30.00
$2,000 and less than $2,500	36.00
$2,500 and less than $3,000	42.00
$3,000 and less than $3,500	48.00
$3,500 and less than $4,000	54.00
$4,000 and less than $5,000	60.00
$5,000 and less than $6,000	72.00
$6,000 and less than $7,500	90.00
$7,500 and over	100.00

Retail and wholesale dealers whose stock and fixtures and all equipment used in the business average $7,500 or more, and/or whose gross receipts for the year, less sales returns and allowances, exceed $100,000, are liable for a tax of $100 plus a tax equal to 3/40ths of 1% upon all such receipts in excess of $100,000; (b) Manufacturers, fabricators, and/or processors by hand, machinery, or otherwise of ware or material of any kind are liable for a tax of 3/40ths of 1% of the gross receipts from sales or stock transfers thereof, less adjustments and returned goods, for the year next preceding the current license tax year, on all products manufactured, fabricated, or processed, with a minimum license of $60 in any case; and (c) Each person, firm or corporation engaged in the business of selling, issuing, or otherwise distributing any trading stamps, coupons, certificates or other similar devices redeemable or purporting to be redeemable in partial or full payment for goods, wares, merchandise, services or other things of value shall pay an annual license equal to 3% of the gross receipts of such business for the next preceding year with a minimum license in any case of $600.00.

License fees may be prorated as follows: three-fourths of the annual license for businesses commencing after April 1 and before July 1; one-half of the annual license for businesses commencing after July 1 and

[1] Act 387, Laws 1965, effective October 1, 1965, imposed a Jefferson County sales and use tax. The suggested tax bracket schedule shown above incorporates the state, county and city tax rates.

before October 1; and one-fourth of the annual license for businesses commencing after October 1. Outside Birmingham city limits but within the police jurisdiction, the rate is one-half of the above. Returns and payment of tax due annually on or before January 1, but semi-annual returns allowable, the second being due July 1. (CCH Alabama Tax Reporter at ¶ 72-100; Ord. 64-54, effective January 1, 1965.)

Chickasaw.—The following taxes are imposed for the privilege of selling tangible personal property at retail—1% of the gross proceeds of sales; operating places of amusement—at the rate of 1% of the gross receipts; selling new or used automotive vehicles, truck trailers or semi-trailers (except used vehicles acquired as part of the consideration for sale, trade or exchange) —at the rate of ¼ of 1% of gross proceeds. Rates for persons outside the city but within the police jurisdiction are ½ of the above rates. A discount of 3% of the total amount of any monthly installment of the tax is allowed to each taxpayer upon the filing of monthly reports. Reports and payments are due and payable on or before the 20th day of the month next succeeding the month in which the tax accrues. (CCH Alabama Tax Reporter at ¶ 72-130; Ord. of July 17, 1958, effective August 1, 1958.)

Decatur.—A privilege tax is levied on every person, firm or corporation engaged in the business of (1) selling at retail any tangible personal property—at the rate of 2% of the gross proceeds of sales; (2) selling any automotive vehicle or truck trailer or semi-trailer—at the rate of ½ of 1% of the gross proceeds, provided, where any used automotive vehicle or truck trailer or semi-trailer is taken in trade as a credit or part payment on the sale of a new or used vehicle, the tax shall be paid on the price of the new or used vehicle sold less the credit for the used vehicle taken in trade; (3) operating any place of amusement or entertainment—at the rate of 2%; (4) construction business—1.2% of the greater of: (a) gross payments received and/or due to be received for such activity or (b) the reasonable market value or gross purchase price, whichever is greater, of materials purchased for use or consumption in such business plus the cost of labor hired in such business.

Reports and payment of tax are due on or before the twentieth day of the month next succeeding the month in which the tax accrues. There is a 3% discount for paying taxes before they become delinquent. (CCH Alabama Tax Reports, ¶ 72-150; Ord. No. 733, effective March 1, 1954, as amended to date.)

Dothan.—The following taxes are levied: (1) on the gross proceeds from selling at retail, 1%; (2) on the gross receipts from operating places of amusement, 1%; (3) selling at retail machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing—½ of 1% of the gross proceeds; (4) on the gross proceeds from the sale of any automotive vehicle or truck trailer and semi-trailer (excluding those acquired as trade-ins by the dealer), ¼ of 1%; (5) renting or furnishing rooms, lodging or accommodations to transients—1% of the room occupancy charge. Outside Dothan city limits but within the police jurisdiction, the rate is one-half of the above.

Persons subject to these provisions may add the amount of the tax to the sales price of the goods sold and collect the same from the purchaser but this is not mandatory. A discount of 3% of the total amount of any monthly installment shall be allowed to each taxpayer.

Reports and payments are due on the 20th day of each month next succeeding the month in which the tax accrues. (CCH Alabama Tax Reporter at ¶ 72-175; Ord. No. 2157, effective January 1, 1958, as amended to date.)

Gadsden.—Any person engaging in or following any trade, occupation or profession must pay license fees for the privilege of engaging in or following such trade, occupation or profession. The tax shall be measured by gross receipts and paid at the rate of 2% of the gross receipts.

Employers are required to make returns at the same time as payments are made for taxes withheld. The city may request an employer to file a return on or before January 31, 1959 and on or before January 31 in each year thereafter showing the gross compensation of each employee and amount of the license fees deducted. When a satisfactory quarterly return has not been filed by an employer and the tax paid, the employee for whom no return has been filed and no payment made must file on or before the last day of the month next following the end of each such quarterly period and on or before January 31 in each year thereafter a return showing his gross receipts subject to license fees.

Employers are required to withhold the tax and must make payments of taxes with-

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held quarterly to the city for periods ending March 31, June 30, September 30 and December 31 of each year, on or before the last day of the month next following the end of each quarterly period. (CCH Alabama Tax Reporter at ¶ 72-350; Ord. No. 1777, effective January 1, 1958, as amended to date.)

Homewood.—A privilege or license tax is imposed as follows: (a) on gross proceeds from retail sales, 1%; (b) on gross receipts from operating places of amusement or entertainment, 1%; (c) on gross proceeds (less credits for trade-ins) from retail sales of any automotive vehicle, truck trailer, semi-trailer or house trailer, ½ of 1%; (d) on gross proceeds from retail sales of machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing tangible personal property, ½ of 1%. A $5 "in lieu of tax" fee applies to each vehicle withdrawn from a dealer's stock in trade for use in the operation of his business. The fee is payable for each 12-month period (or fractional part), following the date of withdrawal, that the vehicle remains in the possession of the dealer or his employee.

Itinerant vendors selling at retail within the City of Homewood are required to give a $50 bond or deposit $50 in cash with the City Clerk for each 5-day selling period.

A 1½% discount is available to taxpayers filing the monthly report and paying the tax on time. On or before the 20th day of each month, a statement must be filed with the City Clerk showing the gross sales, gross proceeds or gross receipts of sales for the preceding month; the tax is payable on the 20th. Any taxpayer having cash and credit sales may report cash sales only and then include in each monthly report all credit collections made during the preceding month. In the event a taxpayer ends his business, the monthly statement must be submitted within 30 days after the termination of the business. (CCH Alabama Tax Reporter at ¶ 72-374d; Ord. No. 872, effective October 1, 1965, as amended.)

Huntsville.—The following taxes are imposed: (1) selling at retail tangible personal property—2% of the gross proceeds; (2) selling any automotive vehicle, truck trailer, semi-trailer or house trailer (less credits for trade-ins)—1% of gross proceeds; (3) amusements—2% of gross receipts; (4) selling at retail agricultural machinery or parts (less credits for trade-ins)—1% of gross proceeds; (5) purchasing tangible personal property at retail for storage, use or consumption in the city—2% of sales price; (6) purchasing any automotive vehicle, truck trailer, semi-trailer or house trailer for storage, use or consumption in the city (less credits for trade-ins)—1% of sales price; and (7) purchasing agricultural machinery or parts for storage, use or consumption in the city (less credits for trade-ins)—1% of sales price. The tax on retail sales subject to the 2% rate must be collected by means of the following tax bracket schedule (if the 1% rate is applicable, an amount equal to 1% of the sales price is collected from the purchaser): Sales of 1¢ through 10¢, no tax; sales of 11¢ through 59¢, 1¢ tax; sales of 60¢ through 99¢, 2¢ tax, plus the 2¢ tax on whole dollars.

Itinerant vendors are required to post a bond with the city, effective for one year, of an amount equal to their estimated tax liability (but not less than $100 nor more than $1,000). Outside the Huntsville city limits but within the police jurisdiction of the city, the rates are one-half of the above.

Reports and payment of sales tax are due on or before the twentieth day of the month next succeeding the month in which the tax accrues. Use tax returns must be filed by the twentieth day of the month following each calendar quarter. A discount of 3% of the tax paid shall be allowed upon timely payment of tax. (CCH Alabama Tax Reporter at ¶ 72-375; Ord. Nos. 65-360 and 65-361, effective December 1, 1965, as amended.)

Jasper.—The following taxes are imposed: (1) selling at retail any tangible personal property, within the city—1% of the gross proceeds of sales; (2) operating places of amusement or entertainment, within the city—1% of the gross receipts; and (3) selling at retail any new or used automotive vehicle or truck trailer and semi-trailer, within the city—¼ of 1% of the gross proceeds, except that no tax applies to the sale of a used vehicle acquired as part of the consideration for the sale, trade or exchange of any new or used motor vehicle. Rates for doing business outside the corporate limits of Jasper, but within its police jurisdiction, are ½ of the rates levied for doing business within the corporate limits. The rate for selling automotive vehicles within the police jurisdiction but without the corporate limits is ⅛ of 1%. Itinerant vendors selling at retail within the city's police jurisdiction must give bond in the sum of $50 or deposit $50 in cash. Returns and payments of tax are due monthly on or before the 20th day of each month. A 5% discount

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is allowed for timely returns. (CCH Alabama Tax Reporter at ¶ 72-400; Ordinance of December 26, 1950, effective January 1, 1951, as amended.)

Mobile.—The following taxes are levied: (1) selling at retail any tangible personal property—2% of the gross proceeds of sales, (2) operating any place of entertainment or amusement—2% of the gross receipts, (3) selling at retail machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing—1% of the gross proceeds, and (4) selling any automotive vehicle, truck trailer or semi-trailer —1% of the gross proceeds. The rate of the tax within the police jurisdiction of Mobile and beyond the corporate limits thereof shall be one-half of the rates applicable within the city. Reports and payments are due on or before the twentieth day of the month next succeeding the month in which the tax accrues. (CCH Alabama Tax Reporter at ¶ 72-410; Ord. effective October 1, 1959.)

An annual license tax is imposed on all persons, firms or corporations using the public streets to deliver goods or merchandise on which a 2% privilege tax has not been paid to the city. The tax in the amount of 2% of the value of the goods or merchandise delivered may be paid by the deliverer at the time of delivery or prior thereto, or, in the alternative, the use of such property within the corporate limits of the City or its police jurisdiction will be considered a retail sale by the recipient who is then required to report the transaction and pay the tax on the reasonable and fair market price of the goods or merchandise at the time and place so used. The rate of tax within the police jurisdiction, but beyond the corporate limits of the City, is 1%. (CCH Alabama Tax Reporter at ¶ 72-413; Ord. No. 50-184, adopted October 1, 1963.)

Montgomery.[1]—The following taxes are levied: (1) on the gross proceeds from sales at retail, 2%; (2) on the gross receipts from amusement places, 2%; (3) on gross proceeds from sales of automotive vehicles, truck trailers and semi-trailers, ½ of 1%; (4) on gross proceeds from sales of used automotive vehicles, truck trailers, or semi-trailers, ½ of 1%; (5) on the gross proceeds from sales of farm machinery, 1%. Outside the city limits of Montgomery but within the police jurisdiction of the city, the rates of tax are one-half of the above. Reports and payment of tax are due on or before the twentieth day of the month next succeeding the month in which the tax accrues. A discount of 3% of the total amount of any monthly installment of tax is allowed upon timely payment. (CCH Alabama Tax Reporter at ¶ 72-415; Ord. 25-57, as amended.)

Opelika.—The following taxes are imposed: (1) selling at retail any tangible personal property, 1% of the gross proceeds of sales, (2) operating any place of entertainment or amusement, 1% of gross receipts, (3) selling at retail any automotive vehicle or truck trailer and semi-trailer ½ of 1% of the gross proceeds, (4) selling any used automotive vehicle or truck trailer and semi-trailer bought for the purpose of resale, ½ of 1% of the gross profits, provided, where any used automotive vehicle or truck trailer or semi-trailer is taken in trade as a credit or part payment on the sale of a new or used vehicle, the tax shall be paid on the new or used vehicle sold less the credit for the used vehicle taken in trade, and (5) selling at retail machines and parts therefor used in mining, quarrying, compounding, processing and manufacturing of tangible personal property, ½ of 1% of the gross proceeds. Rates for doing business outside the corporate limits of Opelika, but within its police jurisdiction, shall be ½ of the amounts levied for doing business within corporate limits.

Itinerant vendors selling at retail within the city's police jurisdiction must give bond in the sum of $50 or deposit $50 in cash. Reports and payments are due on the 20th day of the month next succeeding the month in which the tax accrues. A discount of 5% of the first $100 and 2% of the amount in excess of $100 of the total amount of any monthly payment of the tax shall be allowed upon the timely filing of reports and payments. (CCH Alabama Tax Reporter at ¶ 72-422; Ord. No. 104-59, effective November 1, 1959, Ord. No. 106-59, effective November 3, 1959.)

Prichard.—The following taxes are levied: (a) sales of tangible personal property at retail—2% of the gross proceeds, (b) conducting or operating places of amusement or entertainment—2% of the gross receipts, (c) the sale of any automotive vehicle or truck trailer and semi-trailer—½ of 1% of the gross proceeds and (d) the sale of any used automotive vehicle or truck trailer and semi-trailer, where such vehicle is bought for the purpose of resale, except sales,

[1] The Montgomery gross receipts tax ordinance was upheld as being valid. *Al Means, Inc. et al. v. City of Montgomery et al.*, Alabama Supreme Court, August 28, 1958.

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trades or exchanges where the used vehicle is part of the consideration for the sale—½ of 1% of the gross proceeds. Rates outside the corporate limits but within the police jurisdiction are ½ of the above.

Returns and payments are due on the twentieth day of the month next succeeding the month in which the tax accrues. A 3% discount is allowed for timely reports. (CCH Alabama Tax Reporter at ¶ 72-425; Ord. No. 777, effective July 10, 1958, as amended to date.)

Talladega.—A privilege tax of 1% is levied on the gross proceeds of sales derived from selling at retail any tangible personal property and on the gross receipts derived from conducting or operating places of amusement or entertainment for a fee, and a tax of ¼ of 1% is levied on the gross proceeds of sales derived from selling any automotive vehicle or truck trailer and semi-trailer or from selling any used automotive vehicle or truck trailer and semi-trailer, where such vehicles are bought for the purpose of resale. However, within the police jurisdiction of the city and beyond the corporate limits, the rates of tax are ½ the above.

Reports and payment of tax are due on or before the twentieth of the month next succeeding the month in which the tax accrues. A discount of 3% of the total amount of the monthly installment of tax due is allowed for prompt remittance. (CCH Alabama Tax Reports, ¶ 72-450; Ord. No. 715, effective June 1, 1953.)

Winfield.—The following taxes are imposed: (1) on gross proceeds from retail sales, 1%; (2) on gross proceeds from amusement places, 1%; (3) on gross proceeds from sales of automotive vehicles, ¼ of 1%; (4) a use tax of 1%. Another ordinance which applies to areas within the police jurisdiction of the city provides for ½ of the above rates in such areas. Payment is due on or before the 20th day of each month; no reports are required. (CCH Alabama Tax Reporter at ¶ 72-600; Ord. No. 6-1 effective June 7, 1956.)

The following digests of decisions, opinions, etc., formerly presented as New Developments, have particular bearing on the city sales taxes listed on the preceding pages.

.20 General.—The seller of a truck is not liable to a city for the sales tax when delivery is made outside of the city in such a way as to pass title outside the city's jurisdiction. When the seller negotiates the sale by telephone from the city, but makes delivery outside, or when the seller takes the truck without the city and makes the sale there, the facts would indicate that title is passed outside the city's taxing juridiction. In the absence of special circumstances, the general rule is that title passes upon delivery. *Opinion of the Attorney General*, February 26, 1965.

Sec. 3, Tit. 51, Code, which authorizes exemptions for certain classes of plants and factories, applies only to ad valorem taxes. No exemption from an excise tax, such as a county use tax, can be granted under its authority. Thus, a resolution by a Court of County Commissioners attempting such an exemption is effective only with respect to property taxes, and has no effect on liability for a use tax. *Opinion of the Attorney General*, April 4, 1966.

The city in which a purchaser resides may not collect a sales tax when the seller makes his sales F. O. B. point of origin, the point of origin being outside of the city attempting to levy the sales tax, and the purchaser has the right to designate which carrier should handle the goods as well as the duty to pursue any claims arising out of loss or damage in transit. Under such circumstances, the sale is not made within the taxing city or its police jurisdiction. The general rule is that when the contract of sale is F. O. B. initial point, title to the merchandise passes on delivery to the carrier. *State of Alabama v. Matthews Electric Supply Company, Inc.*, Alabama Supreme Court, March 27, 1969.

A local tax law imposing sales and use taxes at rates different than the rates shown in the published advertisement of the bill is invalid. A local law is unconstitutional and void if it varies materially and substantially in its enacted form from its form as published in entirety in newspapers. The tax rate of a local law, which taxes the gross proceeds of sales of machines and machine parts, is a material and substantial element of the law. Also, the fact that the taxes were not paid under protest is not a bar to a refund of the taxes paid under a law declared unconstitutional. *The B. F. Goodrich Co., et al. v. Tuscaloosa County Special Tax Board*, Circuit Court of Tuscaloosa County, November 25, 1970.

Senator MONDALE. Our final witness today is Mr. Frank H. Roberts, partner in the law firm of Pillsbury, Madison & Sutro, San Francisco, Calif.

Mr. Roberts, we will place your statement in the record as though read and you may read from it or highlight it or proceed in any way you wish.

STATEMENT OF FRANK H. ROBERTS, PARTNER, PILLSBURY, MADISON & SUTRO, SAN FRANCISCO, CALIF.

Mr. ROBERTS. Thank you, Senator Mondale.

I appear here today as spokesman for a number of California-based corporations concerned with State income taxation of multistate and multinational businesses. I will mention some of them: Standard Oil Co. of California, Bank of America, Del Monte Corp., Southern Pacific Railroad, Union Oil Co., Southern California Edison, Safeway Stores, Kaiser, and a group of other companies——

Senator MONDALE. Just a series of small businesses?

Mr. ROBERTS. Some of them are small. These companies and other California-based corporations have strongly endorsed a bill now pending before the California legislature to enable California to become a member of the Multistate Tax Compact. Their reasons for doing so coincide directly with the views set forth in my statement on Federal legislation in this field.

I can summarize that statement quickly by making three points. My first point is a preliminary one. We are here concerned primarily with rules governing the division of income among States, the distribution of a corporation's net income to a particular State. While some of the pending bills do provide for certain exemptions from tax, by and large there is not before the Congress any proposal to deal extensively with items of income, deductions, exemptions, assessment procedures, accounting methods, and so forth. I address myself solely to the division of income question.

My second point is that I and the taxpayers for whom I speak believe that it is fundamental in this division of income area for the States to have laws and administration which treat corporations similarly situated alike. We oppose tax rules based upon artificial disparities or technicalities such as where a corporation is domiciled or whether it operates through divisions or subsidiaries. We think that the pending bills are deficient in this regard in a number of respects. The most egregious deficiency is the provision in S. 1245 requiring the full allocation of taxable dividends—in other words, the provision that all taxable dividends must be attributed only to the State of commercial domicile of the corporation.

We submit that this provision directly contradicts the basic theme of S. 1245 that all income shall be apportioned by formula. It also disregards the fact that in many cases dividends do indeed constitute business income and are as integrated with the business operations as any other type of income. We think this rule is a discriminatory rule and that its practical effect is to create tax havens.

We ask only that dividends be subjected to the same rule as any other income, be it the full apportionment rule or Professor Hellerstein's interdependency test.

There are other examples in the pending bills where equality is not provided but I go on to my third point in order to save time. My third point is correlative to the equality point. We think that taxpayers are entitled to ask that in the division of income area the States provide uniform rules and uniform administration. We don't think that this obtains today to the degree that it should. The question is how best to obtain it, through cooperative State action or through Federal legislation?

We are wary of Federal legislation at this stage. Also we think that the pending bills do not really deal with the problem in depth and that to do so would require a massive bill and administrative setup. We believe that the Multistate Tax Commission has made great progress toward uniformity through the adoption of the uniform act. About half of the States have the uniform act.

The commission has, after a great deal of trouble, promulgated regulations which we think will establish uniform administration of the uniform act.

We would urge Congress to adopt a consent bill for the Multistate Tax Compact.

Thank you. That completes my testimony.

Senator MONDALE. It is your position that the best way to deal with apportionment questions would be to ratify the determinations of the Multistate Tax Commission?

Mr. ROBERTS. I think the Multistate Tax Commission should be encouraged to operate freely. That is to say, the attack on its constitutionality ought to be eliminated. I don't know that by doing that Congress is endorsing any particular action that is taken but it would endorse the theory of joint State action. I think the commission, as I say, has made progress, and if it can solve its financial difficulties, and constitutional difficulties, it would make a lot of progress.

Senator MONDALE. Did you say the State of California is considering legislation which would permit the State to become a member?

Mr. ROBERTS. Yes.

Senator MONDALE. They are not a member now?

Mr. ROBERTS. No.

Senator MONDALE. Why has California not previously become a member of the Multistate Tax Compact?

Mr. ROBERTS. There has been no legislation that has been introduced until recently. The California Franchise Tax Board has introduced the legislation and it has received support and has passed the assembly (which is the lower house) by 64 to 8. It is now pending before the Senate.

Senator MONDALE. Why has California proceeded so slowly in getting into this?

Mr. ROBERTS. Well, I will give you my own judgment on that. I think it is because it has taken some years for the California franchise tax administrative people to become convinced that the Multistate Tax Commission in its concept of regulations for administration was on the right track. They are now convinced.

I believe that in the early days the California franchise tax administration people did support the concept of the commission and have endorsed all along joint State action.

Senator MONDALE. The present system then is one of substantial anarchy, I take it?

Mr. ROBERTS. I don't think it is anarchy. The corporations that I described do business in a great many States and we are here telling you that we are not dissatisfied. We think there is a lot of room for improvement, but we won't call it anarchy. We are more concerned about the possibility that unequal rules will be adopted than we are about delay in State cooperation directed toward achieving uniformity. Our corporations at least are having no difficulty in complying with State tax rules.

Senator MONDALE. Do you object to the so-called full apportionment approach?

Mr. ROBERTS. I have no strong feelings in favor of the unitary concept as opposed to the full apportionment concept. The full apportionment concept has a practical advantage to a tax administrator. The unitary concept has a little more elegant theory and perhaps carves out the really rare case in which full apportionment produces bizarre results. But by and large under the regulations adopted by the Multistate Tax Commission and under the California decisions, the unitary approach is very broad, and in most cases the same results are obtained under the unitary approach as under the full apportionment approach.

Senator MONDALE. There are some corporate leaders and the chamber of commerce which testified today contrary to your position, who basically support the principles of the Mathias proposal, S. 1245, which contains certain exemptions. How do you explain this apparent conflict?

Mr. ROBERTS. There are some provisions of the Mathias bill that deal with exemptions from tax, and I am not addressing myself to them because the corporations that I listed might have opposite views on that subject. There are other provisions of the Mathias bill that I strongly oppose because, as I say, I think they create tax discriminations. I mentioned the allocation-of-dividends point. I would also mention the rules in that bill on combined reports.

The corporations I speak for are so accustomed to combined reports that we have come to think that it is a sensible taxing method. I would also say that I generally oppose tight jurisdictional standards for the same reasons that Professor Hellerstein and Mr. Dorgan mentioned. I think it is quite unsound to create a tax haven system, and I don't support that aspect of 1245.

Generally, I think congressional legislation is not necessary or deisrable at this time, but you should keep the heat on.

Senator MONDALE. I can recall taking a course in law school, constitutional law, which included the subject of interstate taxation. That was the most artificial and unbelievably complex area we studied. I wonder if that is inevitable, or do you think there are some simple rules here to save us?

Mr. ROBERTS. Senator Mondale, you and your colleagues have a similar problem at the Federal level, and look what you have done. There can be simple rules in the State tax field, just as there can be simple rules at the Federal level, but simple rules do not provide equality. They create discriminations, and they are not fair.

Senator MONDALE. Thank you very much, Mr. Roberts, for your testimony.

[The statement of Mr. Roberts follows:]

STATEMENT OF FRANK H. ROBERTS REGARDING STATE TAXATION OF INTERSTATE COMMERCE

SUMMARY

1. Federal legislation on state corporate income taxation is neither necessary nor desirable.

(a) As a matter of policy, state corporate income taxation should be left to the states.

(b) In any event Congress cannot deal adequately with the staggering minutiae of state taxation.

2. Cooperative state action will provide uniformity.

(a) The Uniform Division of Income for Tax Purposes Act (UDITPA) enjoys growing acceptance.

(b) The Multistate Tax Commission is an excellent forum for administering UDITPA and has a solid record of accomplishments.

(c) Congress should consider a Consent Bill for the Multistate Tax Compact.

3. All proposals for the specific allocation of dividends should be rejected.

(a) Specific allocation of dividends is incompatible with the full apportionment of income concept.

(b) Full allocation of dividends does not take the actual facts into account.

(c) Full allocation of dividends brings about a tax preference for some corporations and a tax penalty for others; no good reason for such discrimination can be found.

STATEMENT

This statement is filed with the Subcommittee on State Taxation of Interstate Commerce, Senate Finance Committee, in accordance with the telegram dated September 7, 1973, from Tom Vail, Chief Counsel, Senate Finance Committee, advising that the undersigned has been scheduled to testify on Tuesday, September 18, 1973, at the hearings to be held before the Subcommittee concerning proposals for legislation bearing on the state taxation of interstate commerce.

The focus of this statement will be on the following issues:

1. Is Federal legislation on state corporate income taxation necessary or even desirable?

2. What is the proper role for the states in this arena?

3. Assuming Congress finds that a Federal law has to be imposed on the states, how should the allocation-apportionment question be approached?

The views expressed herein are supported by a number of corporations headquartered in California. These corporations, which together represent a strong cross section of the corporations headquartered in California, also have endorsed proposed legislation to enable California to become a regular member of the Multistate Tax Commission. On April 12, 1973, at the behest of the California Franchise Tax Board, A.B. 1304 was introduced in the Assembly to the State of California; if enacted, A.B. 1304 will incorporate the Multistate Tax Compact into the California Revenue and Taxation Code. On September 5, 1973, the California Assembly voted 64 to 8 in favor of A.B. 1304. The views expressed herein not only pertain to the matter of Federal legislation but also form the basis for support of A.B. 1304 by taxpayers headquartered in California.

FEDERAL LEGISLATION

Taxing corporate income is an extremely complex undertaking. A mere glance at the Internal Revenue Code points to this conclusion, and a lifetime of study confirms it. Despitae the persistent clamor for Federal tax reform, the simplification of the Code has remained an unattainable goal—and not without reason. Earnest and dedicated efforts of Congress over many years to achieve a degree of fairness while promoting national policy have produced an extremely detailed and complicated law. The result is comprehensible only to the accomplished expert, a fact that many a frustrated law student will confirm. This situation, however, is inevitable, the many reform efforts notwithstanding. It is inevitable because taxpayers as a group are anything but homogeneous; they labor under a myriad of different facts and conditions. Therefore, the simple prescription that will solve all problems must necessarily be elusive. Faced with the choice between

a Code that covers a multitude of divergent cases and sacrifices simplicity to comprehensiveness on the one hand and a deceptive panacea on the other, Congress had to opt for the former. The latter solution is obviously unacceptable, and a third alternative—complete abstention—was not available. Someone had to legislate on Federal taxation, and only Congress had jurisdiction.

The background of state corporate taxation is similar. Congress again has a limited number of choices, but there is one crucial difference: abstention is possible. State taxes are within the states' legislative jurisdiction, and they are an area of special concern for the states. Historically, state taxes have always been dealt with by the states rather than by Congress. Congress, therefore, need not choose between the complexity of another Code and the inequities of a superficial cure.

What has been said above about Federal corporate income taxation applies *a fortiori* to state taxation. In fact, the complications are even greater because numerous taxing jurisdictions and their tax administrators are involved, and their individual characteristics and divergent interests would have to be taken into consideration if Congress decided to impose its tax scheme upon the states. Among the fifty states, some do not tax corporate income at all in order to encourage corporations to make their home there, others tax only certain types of income, and some have very comprehensive income tax laws. These tax statutes implement divergent interests and revenue collection policies. These policies were carefully considered by the states' elected representatives, and it is not for Congress to usurp the states' authority in this field; they should not be forced to abdicate their responsibility.

Furthermore, Congress cannot deal adequately with the staggering minutiae of state taxation, even if it saw no obstacle in the principle of state preeminence in this area. As pointed out above, the unavoidable result of frustration with infinite details is a superficial "solution" that sacrifices equity and flexibility to simplicity. As will be seen, the provisions on taxation of dividends in S. 1245 and S. 2092 are an obvious instance of this syndrome.

The states, however, are not the only parties who are far from homogeneous. Multistate corporations—which are, after all, immediately affected by the tax laws—also do not have uniform interests. The panel discussion in August before the Staff of the Subcommittee brought out the conflicting views of corporations that are situated differently. A business with headquarters in a state that does not tax all classes of corporate income is understandably tolerant of enactments that would not affect it at all or result in reduced taxes. The same law, however, could have a very painful impact on a business with headquarters in a state that has a more comprehensive tax scheme. In other words, any Congressional "solution" to the problem would necessarily counteract the policies of many states and accord some corporations preferential treatment to the detriment of others. It is not, I submit, the proper function of Congress to sanction tax havens among the states or to alleviate the tax burden of some corporations at the expense of others.

COOPERATIVE STATE ACTION

The case against Federal intervention might be less persuasive if there were no other response to the demand for more uniformity among the states and for an end to conflicting rules. There *is* another answer, however: cooperative state efforts. In recent years, the states have made significant progress in this area, and their corporate income tax laws are becoming more compatible. Some two-thirds of the states imposing corporate income taxes have adopted the Uniform Division of Income for Tax Purposes Act (UDITPA). The Multistate Tax Commission (MTC) and the National Association of Tax Administrators (NATA) are making great efforts to reconcile the conflicting views that still persist, and they are frequently successful in resolving differences of opinion through a gradual process of education and compromise.

The development of detailed regulations under UDITPA is a case in point. After exhaustive study and hearings extending over a period of more than two years, the MTC recently adopted such regulations. They are expected to be approved by NATA in the near future and give much promise of being adopted, without significant change, by the great bulk of states employing UDITPA. The new regulations cure serious defects in earlier versions considered by NATA and the MTC and adopted in a few states. Progress of this sort will continue, if only the specter of Federal interference is laid to rest. In short, there is no vacuum in this area and therefore no need for help from the Federal Government.

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Any program for uniformity among the States' corporate income tax laws will have to deal with minutiae. But, as Professor Hellerstein has pointed out, "a Congressional body is not equipped to carry out in detail or adequately implement the application of a national policy of achieving uniformity of base and division of income among the States" (Hellerstein, Allocation and Nexus in State Taxation of Interstate Business, 20 Tax L.Rev. 259 at 282).[1] The area of state corporate income taxation simply does not lend itself to regulation by Congressional fiat.

What is needed to achieve uniform practices on the division of income is a statute of general principles, not a compendium of detailed rules. UDITPA is a model statute in this regard and serves the uniformity objective better than can any Federal law. UDITPA sets forth the broad principles and leaves to interpretive regulations the application of these principles to the innumerable different fact situations that will present themselves. The MTC is an eminently suitable agency for issuing such interpretive regulations. It is flexible enough to accommodate the concerns of different states while taking into account the idiosyncracies of different industries. Its staff is rapidly gaining experience in applying UDITPA and the regulations to various fact situations. The MTC can resolve details as the need arises and overcome minor obstacles as they are encountered. This is in marked contrast to Federal legislation that would attempt, in vain, to anticipate every problem. The MTC has already accumulated considerable experience, which would be annulled if Congress decided to impose a different scheme upon the states.

Moreover, the MTC is an ideal forum for taxpayers—as well as tax administrators—to present their views concerning rules and regulations. The MTC has regularly solicited and given sympathetic consideration to suggestions and comments of taxpayers. Of course, the MTC has not accepted every proposal advanced by a taxpayer, just as it has not accepted every proposal put forth by a state tax administrator, but no one can deny that all interested parties have been given a full hearing. I submit that the MTC is better equipped to establish detailed uniform rules relating to the division of income among the states than Congress, the various state legislatures, or any other administrative agency.

If Congress desires to act, it is suggested that it pass a Consent Bill for the Multistate Tax Compact. Such legislation would enhance the stature of the MTC and make it possible for more states to unite behind the Compact. Although a Consent Bill is probably not necessary, it would dispell any constitutional objections to the Compact. Above all, it would encourage the states to make further progress in solving this problem on their own. In enacting a Consent Bill Congress might appropriately prescribe a period of time—perhaps five years—after which it would reexamine the state corporate income tax situation to see whether further Congressional action is needed.

ALLOCATION AND APPORTIONMENT

The observations in the preceding sections were primarily addressed to the problem of Federal intervention as a matter of principle and to the advantages of cooperative state action. Now the focus will shift to a discussion of allocation and apportionment as methods of distributing corporate income among states. The perspective will be historical at first, and then the apportionment and allocation rules in S. 1245 and S. 2092 will be considered.

The use of an apportionment formula for distributing the income of a corporation among taxing states raises numerous issues, and they have been exhaustively discussed in the tax literature. At one time, the debate focused primarily on the relative merits of apportionment formulae and the separate accounting procedure, and this is an issue even today for certain businesses (e.g., heavy construction).[2] Similar issues arose in other contexts, where the superiority of apportionment over allocation—or vice versa—was much debated. The Bills now pending, however, involve only two aspects of the apportionment-allocation question. One is the "full apportionment" proposal, and the second involves the treatment of dividends.

The theoretical and practical justifications for using an apportionment formula are that the business activities of a corporation carried on in two or more states usually are interrelated and interdependent; accordingly, it can be said that all the activities of the business have a connection (or "nexus") with each taxing state. The apportionment formula provides a fair and consistent method for

[1] Professor Hellerstein concluded that if a uniform state corporate income tax law were enacted by Congress it would be necessary to establish yet another Federal administrative agency to tell the states in detail how they should tax corporations under such law. None of the pending Bills incorporate this proposal.

[2] *Utah Construction and Mining Co.* v. *State Tax Commission* (1970) 225 Or. 228, 465 P. 2d 712.

dividing the income of the business among the states and avoids the difficulties inherent in using separate accounting procedures or other specific allocation methods. Where combined reports [3] are used, formula apportionment also avoids distinctions based solely on the formalities of corporate organization. It has always been recognized, however, that a corporation may engage in certain out-of-state activities that are in no way related to or interdependent with the corporation's business activities in the taxing state. In that case, the rationale of the apportionment formula is not applicable. Therefore, the leading decisions [4] on this subject developed the "unitary business" concept, where the formula is applied only to income derived from the "unitary business." Other corporate activities are allocated directly to the state in which they occur. Although recent opinions have defined "unitary business" in very broad terms,[5] there remains an area of nonunitary income that is not subject to the apportionment formula and therefore has to be distributed among the states under specific allocation rules. It may be noted also that it is possible for a corporation to conduct more than one unitary business and that in such cases the income of each unitary business is apportioned separately by formula.

UDITPA follows the unitary business theory, although its language is that of "business income" and "nonbusiness income" rather than "unitary" and "nonunitary" income. In accordance with recent decisions, the UDITPA Regulations recently promulgated by the Multistate Tax Commission define "business income" in very broad terms. At the same time, these Regulations recognize—as the language of UDITPA mandates—that nonbusiness income does exist and must be allocated among the states in accordance with the specific allocation rules that are also set forth in UDITPA.[6] These rules cover nonbusiness rents and roaylties from real or tangible personal property; nonbusiness capital gains and losses from sales of real and personal property; nonbusiness interest and dividends; and nonbusiness patent and copyright royalties.

It is abundantly clear that under UDITPA the specific allocation rules do *not* apply to rents and royalties, capital gains and losses, interest and dividends, and patent and copyright royalties which constitute business income. As the Multistate Tax Commission's Regulations make clear, the question whether particular items of income constitute business or nonbusiness income depends upon the circumstances of each individual case. If a particular item of income—be it rents, interest, dividends, or whatever—is in fact related to the business activities of the corporation (in other words, if such income is part of the unitary business conducted by the corporation), then the income is business income subject to apportionment by formula. On the other hand, if particular rents, dividends, interest, gains, royalties, etc., are in fact entirely unrelated to the business activities of the corporation, then they are nonbusiness income which is governed by the specific allocation rules.

The fundamental point is that under UDITPA, as well as the leading decisions, the choice between apportionment and allocation is dictated by the facts of the situation and not by the labels sometimes applied to various types of income. This principle is clearly consistent with the theoretical and practicla considerations that led to the adoption of the formula apportionment method in the first place.

FULL APPORTIONMENT OF INCOME

The pending Bills would change these well-established apportionment principles and practices in two respects. First, the Bills would impose—with the exception discussed in the ensuing section of this statement—a so-called "full apportion-

[3] A number of states require a "combined report" if the business activities of two or more affiliated corporations are interrelated and interdependent. Such a report combines the net income and the apportionment factors of all the affiliated corporations. The rationale behind this method is to eliminate the need for a reallocation of income resulting from transactions within the combined-report group.

[4] *Butler Bros.* v. *McColgan* (1942) 315 U.S. 501, 86 L.Ed. 991, 62 S.Ct. 701; *Edison California Stores* v. *McColgan* (1947) 30 Cal. 2d 472, 183 P. 2d 16; *John Deere Plow Co.* v. *F.T.B.* (1951) 38 Cal. 2d 214, 238 P. 2d 569; appeal dismissed 343 U.S. 939; *Superior Oil Co.* v. *F.T.B.* (1963) 60 Cal. 2d 406, 34 Cal. Rptr. 545, 386 P. 2d 33; *Honolulu Oil Co.* v. *F.T.B.* (1963) 60 Cal. 2d 417, 34 Cal. Rptr. 552, 386 P. 2d 40; *Zale-Salem, Inc.* v. *State Tax Commission* (1964) 237 Or. 261, 391 P. 2d 601.

[5] *Superior Oil Co.* v. *F.T.B.* (supra); *Honolulu Oil Co.* v. *F.T.B.* (supra); *Household Finance Corp.* v. *F.T.B.* (1964) 230 Cal. App. 2d 926, 41 Cal. Rptr. 565; *RKO Teleradio Pictures, Inc.* v. *F.T.B.* (1966) 246 Cal. App. 2d 812, 55 Cal. Rptr. 299; *Chase Brass and Copper Co.* v. *F.T.B.* (1970) 7 Cal. App. 3d 99, 86 Cal. Rptr. 350; certiorari denied 400 U.S. 961; *Appeal of Cutter Laboratories*, S.B.E. 11/17/64 1 CCH Cal. Tax Rep., New Matters Transfer Binder, ¶ 202-695; *Appeal of Monsanto Co.*, S.B.E. 11/6/70 2 CCH Cal. Tax Rep., New Matters Transfer Binder, ¶ 204-430; *Appeals of Harbison-Walker Refractories Co., S.B.E.* 2/15/72 4 CCH Cal. Tax Rep. ¶ 204-741; *Appeals of the Anaconda Companies*, S.B.E. 5/11/72 4 CCH Cal. Tax Rep. ¶204-759; *Appeal of F. W. Woolworth Co.*, S.B.E. 7/31/72 4 CCH Cal. Tax Rep. ¶ 204-806.

[6] In general, the specific allocation rules of UDITPA require that nonbusiness income shall be allocated to the state in which the property giving rise to such income has its situs. In the case of intangible property, the situs is in the state of the owner's commercial domicile.

ment" rule. Under the full apportionment method all income of a corporation is subject to the apportionment formula, the allocation rules are cast aside, and all distinctions between business and nonbusiness income are eliminated. This would be a departure from the apportionment-allocation procedures prescribed in UDITPA; however, in the vast majority of cases the entire corporate income will be subject to apportionment under either the full apportionment method or under the broad "unitary business" concept enunciated by recent decisions and incorporated in the MTC's new UDITPA regulations. Under these decisions and regulations only a relatively few, unusual situations will occur in which taxpayers will have nonbusiness income subject to specific allocation, and it is only in such situations that the full apportionment method would produce a different result.

Some state tax administrators support the full apportionment method on grounds of administrative simplicity, and no doubt the method would moot some disputes between taxpayers and administrators. The advocates of the full apportionment method find theoretical justification for this method in the proposition that common ownership and management alone are sufficient to establish "unity" among all the activities of a corporation (or affiliated corporations in the case of combined reports). Modern management techniques and instantaneous communications do indeed enable widespread business operations to be integrated—i.e., operated as a "unit"—to a much greater degree than was possible a few years ago, and this accounts in large part for the development of the broad concept of unitary business set forth in recent decisions and the MTC's new UDITPA regulations.

It is to be emphasized that since the full apportionment method is founded upon the theory that all corporate activities are interdependent, it necessarily follows that *all* corporate income must be distributed by means of the apportionment formula. There is no conceivable basis for excluding particular types of income from the operation of the full apportionment rule. This brings us to the second—and very peculiar—departure from current apportionment and allocation practices contained in the pending Bills.

FULL ALLOCATION OF DIVIDENDS

Paradoxically, the second change in current apportionment and allocation practices that the pending Bills would bring about is the "full allocation" of dividends. The Bills would require that *all* taxable dividends be separated from the apportionable income and allocated solely to the state in which the recipient of the dividends has its commercial domicile. Under this proposal the question whether dividends are in fact related to the other business affairs of the taxpayer would be disregarded, and all dividends would be treated as if they were completely isolated from all other sources of income. Thus full allocation of dividends is the direct antithesis of full apportionment. When the two are combined, we get the bizarre result that all income sources of a corporation are deemed interrelated (by reason of common management) with the sole exception of dividends.

In many instances, it is beyond question that dividends constitute business (i.e. unitary) income. Consider, for example, the case of two logging companies who own all the stock of a railroad corporation whose revenues are derived from transporting the shareholders' logs at rates fixed by a government agency; the dividends received from the railroad corporation are obviously as much a part of each shareholder's business income as its income from lumber sales. The same is true of the dividends received by five oil companies who own a pipeline company that derives its revenues from the transportation of oil or gas supplied by the shareholders. Another example are the dividends received by the four shareholders of a corporation whose only activities are the extraction of raw materials and their sale to the shareholders. In all these instances it is absurd to treat the dividends as a return on an investment unrelated to the other business activities of the recipient.

The contradictions inherent in the "full apportionment except for dividends" scheme stand out when the treatment of dividends is compared with that of interest. Dividends of the type described in the preceding paragraph would be allocated to the state of the recipient's commercial domicile, yet interest on a convertible debenture held solely for investment and unrelated to the taxpayer's business activities would be a part of the apportionable income. ***This does not make sense.***

The "full allocation of dividends" proposal can be understood only in light of the fact that some states have excluded dividends from the corporate income tax base. Corporations headquartered in such states (e.g., New York, Texas, and

Pennsylvania) seek to shelter the dividends they receive from all state income taxation. Needless to say, they are not concerned with the correlate of this proposal, which is that dividends received by corporations domiciled in other states would be taxed *in full* by the domiciliary states, even if those dividends in fact constitute a part of the recipient's normal business income. If the proposal for the full allocation of dividends were enacted, a number of corporations would be forced to move their corporate headquarters to another state in order to avoid discriminatory tax burdens. In some instances, the tax benefits from maintaining headquarters in a tax-haven state would be so significant as to create a risk of a shareholders' derivative action to compel a move.

For the reasons set forth in the first sections of this statement, Congress ought not to act in the state corporate income tax field (other than to sanction the Multistate Tax Compact). If, however, the members of the Senate Finance Committee conclude that Federal legislation in this field is necessary, all proposals for the specific allocation of dividends should be rejected.

Senator MONDALE. We will stand in recess until tomorrow morning at 10 o'clock.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 10 a.m., Wednesday, September 19, 1973.]

STATE TAXATION OF INTERSTATE COMMERCE

WEDNESDAY, SEPTEMBER 19, 1973

U.S. SENATE,
SUBCOMMITTEE ON STATE TAXATION
OF INTERSTATE COMMERCE
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2221, Dirksen Senate Office Building, Senator Walter F. Mondale (chairman of the subcommittee) presiding.

Present: Senators Mondale and Packwood.

Senator MONDALE. The committee will come to order.

This morning I regret to say we must begin on a sad note. Last night the chief counsel of the Finance Committee, Tom Vail, whom many of you in this room knew, passed away. Tom was a tax lawyer himself, a man of extraordinary ability who would undoubtedly have made a strong contribution to these hearings. His tragic death deprives us not only of his exceedingly valuable and wise counsel and advice, but also, and perhaps most importantly his friendship. He will be greatly missed by all of us, not only by the members and the staff of the committee, but everyone else who was privileged to know and work with this remarkable man.

This morning the chairman of the committee, Mr. Long, called me and told me of Tom's death and he said, I am sure, knowing Tom, and his devotion to this committee, the last thing he would want us to do is to suspend its work. He said, so you go ahead with the State Taxation of Interstate Commerce Subcommittee hearings, and we will proceed with the pension bill, which came out of this committee and is to be considered on the floor today and do what I think Tom would want us to do. We all will miss him.

Because of this tragedy, several members of the committee, including Chairman Russell Long, who had planned to be here, will not be with us, but I am sure you will understand.

I have an additional announcement to make. On September 12, H.R. 2096, which has been adopted by the House, dealing with State taxes imposed upon interstate shipments of wine was referred to the Committee on Finance. I would like to announce that written statements of views on this bill will be received for consideration by our Subcommittee.

The first panel represents the National Association of Manufacturers, Committee on State Taxation of the Council of State Chambers of Commerce, and the National Association of Wholesalers-Distributors.

Roland Bixler is the chairman of NAM State Taxation of Interstate Commerce Subcommittee; Paul Courtney is vice chairman of the board of the National Association of Wholesaler-Distributors; C. R. Cahoon, legislative adviser to the Mobil Oil Corp.; Burns Stanley, manager, State and local taxes, Ford Motor Co.; James F. Devitt, manager, State income taxes, Montgomery Ward & Co.; and James H. Peters, chief tax attorney, Long Lines Department, American Telephone & Telegraph Co.

We are pleased to have you with us this morning. If you will proceed in accord with your plan for presenting your testimony.

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE, AND THE NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS; PANEL: ROLAND M. BIXLER, PRESIDENT, J-B-T INSTRUMENTS, INC., AND CHAIRMAN OF NAM'S STATE TAXATION OF INTERSTATE COMMERCE SUBCOMMITTEE; PAUL L. COURTNEY, VICE CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS; C. R. CAHOON, LEGISLATIVE ADVISER, MOBIL OIL CORP.; BURNS STANLEY, MANAGER, STATE AND LOCAL TAXES, FORD MOTOR CO.; JAMES F. DEVITT, MANAGER, STATE INCOME TAXES, MONTGOMERY WARD & CO.; JAMES H. PETERS, CHIEF TAX ATTORNEY, LONG LINES DEPARTMENT, AMERICAN TELEPHONE & TELEGRAPH CO.

Mr. Bixler. My name is Roland M. Bixler, and I am the chairman and cofounder of J-B-T Instruments, Inc., of New Haven, Conn. Our company is a modest-size independent manufacturer of electrical instruments and electronic components.

I am here, as you have said, as chairman of the subcommittee on interstate taxation of the National Association of Manufacturers, and as a participant in a panel which hopes to reflect the mainstream of the business community views on the critical issue of interstate taxation. We are indeed pleased that your subcommittee has been established, that a roundtable study has been held by your staff and that these hearings are going forward despite other major Senate activities and the sad announcement you have just made. We urge action on the problems of interstate taxation which have proved to be increasingly difficult over the last 15 years.

Appearing with me today are the members of the panel that you have already identified.

I might say that Mr. Cahoon also represents the NAM, as vice chairman of the subcommittee on State taxation of interstate commerce, and Mr. Courtney, of course, is vice chairman of the board of the National Association of Wholesaler-Distributors. And the other

four gentlemen are representatives of the committee on State taxation of the Council of State Chambers of Commerce.

We have filed with the subcommittee, a comprehensive 40-page statement which we request be included in the formal hearing record.

Senator MONDALE. It will be so included following the conclusion of this panel's testimony.

Mr. BIXLER. Thank you.

This statement explains in detail why we believe that S. 1245, the legislation introduced by Senators Mathias, Ribicoff, and Humphrey, is the preferred method to relieve the problems of interstate taxation. This statement has been read and subscribed to by 129 organizations representing a wide range of business operations.

Among those 129 sponsors are the Connecticut Business & Industry Association, the Texas Manufacturers Association, the Wisconsin State Chamber of Commerce, the Minnesota Association of Commerce & Industry, the Maryland State Chamber of Commerce, the California Association of Employers in San Francisco, the Illinois Manufacturer's Association, and the National Small Business Association, 129 organizations, in total.

It is fair to say that the great majority of the business firms engaged in interstate commerce are represented by one group or another endorsing this statement.

I would stress that the legislative solution we are supporting is not large and small enterprises. Speaking for the National Association of Manufacturers, for example, 80 percent of its members, including my own company, have less than 500 employees, and I know Mr. Courtney can speak to the matter of size perhaps with more pertinence.

In listening to the hearings yesterday, it seems to me that perhaps there were not quite enough case examples of why legislation is really necessary now, So, I would just like to use the remainder of my few minutes to touch on those, since the explanation of the legislation is our statement.

In New Haven, a neighboring company spent $300 to send a $5 payment to one State for sales tax. I have personal knowledge of an Ohio company selling through sales manufacturer representatives, having no property, no employees in an eastern State, where they were arbitrarily billed over $20,000 for past franchise taxes. They finally settled for $700, even though they felt that their products were entirely for resale, and yet they spent over $7,000 in defense costs, between Ohio and New York.

In our own company, and many, many companies like it, we do not even know what our sales are in any given State because we are essentially resale manufacturers and we sell to resale representatives covering territories that do not represent States.

For example, the Kansas City territory may have part of Missouri, part of Nebraska, certain portions of Iowa. We can cite this example in a great many places where we keep all our business records by territories and not by State.

In Connecticut, for example, the predecessor of the Connecticut Business and Industry Association was the Connecticut Manufacturers Association. It had the largest response, over 600 companies (out of 2,000 members) on the matter of the problems of State taxation of interstate commerce, so I can say it is not an academic question that was looked at just 15 years ago. And Public Law 86-272 has not resolved nearly all of the problems involved.

Then finally, I would like to just again remind us of Mr. Mendenhall's text yesterday on the Texas case, in the part where he said that they sent out inquiries to 43 States asking whether they were liable for tax or not; 34 replied, and only 6 said definitely yes, and 9 said definitely no, and the rest ranked all the way through, including just sending a copy of the tax laws so he could figure it out for himself.

So, we are in the position of being taxpayers wanting to do what we ought to, but we just do not really have knowledge of what it is that is expected of us. And we are making business decisions to avoid becoming subject to the tax laws of other States because of the complications that ensue.

Now, there are two approaches to the solution of the problem. They are the theoretical approach and the practical approach and we hope that the emphasis can be on the practical above all else. We hope that in making the technical decisions, which my much more knowledgable colleagues will comment on, that the basic long-range objectives of reform will not be lost sight of, and that we can speedily reach, in the words of the Willis Committee Report of several years ago, a general solution which substitutes order and realism for chaos and impracticality.

Now, we would like to proceed in this order, Mr. Chairman. First, with Mr. Stanley, of Ford, and then with Mr. Peters of A.T. & T., and then Mr. Cahoon, of Mobil, and Mr. Devitt of Montgomery Ward, and finally Mr. Courtney of the National Association of Wholesaler-Distributors.

Senator MONDALE. That is fine. If you will proceed.

STATEMENT OF BURNS STANLEY, CHAIRMAN, COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE

Mr. STANLEY. Mr. Chairman, my name is Burns Stanley. I am appearing in my capacity as chairman of the Committee on State Taxation of the Council of State Chambers of Commerce.

The Committee on State Taxation is very much opposed to the enactment by the Congress of a consent bill which would give the blessing of the Congress to the multistate tax compact and its administrative arm, the Multi-State Tax Commission. The reason for this position, and it certainly is one, that has not been lightly taken, is the fact that the Committee on State Taxation, COST, for short, is dedicated to the belief that the only answer to the problem of interstate commerce taxation must be reached through Federal legislation, reasonably arrived at which will nevertheless mandate the handling of certain important issues insofar as the taxation of interstate commerce is concerned.

Believing that, we must then be opposed to any effort aimed at defeating all Federal legislation in this field, and we are convinced that the multistate tax compact exists primarily to see that there is no Federal legislation of significance in the interstate commerce field. It came into existence originally in 1967 for that purpose, and as far as we can determine that purpose has never changed in the intervening years.

To be sure, the compact states in its terms, certain very desirable objectives to which COST and all taxpayers would subscribe, but we say that those objectives are actually not possible of realization through the efforts of the multistate compact.

For over 6 years, since August of 1967, the compact has struggled to become a representative force for the States in the interstate commerce area. We believe that the compact has not succeeded in this effort. We see no viable hope that the compact can possibly succeed. And therefore, we are definitely opposed to its efforts in this direction. After 6 years, the compact has 21 States as full members. There are 50 States with whom we deal and we can see no way that 21 States can bring unanimity and order into a field that is marked by the absence of uniformity, yet a field in which we must have uniformity if there is to be a solution to the many and complex issues that exist.

One brief illustration. We heard yesterday that by and large the compact supports the full-apportionment concept with respect to dividends. Most States in this Nation follow the commercial domicile attribution of dividends. With this, what amounts significantly to a new effort to bring about full apportionment, and with some States dedicated to retaining the commercial domicile concept, it is inevitable that many taxpayers will pay on more than 100 percent of their dividends, taxes on 100 percent in States in which they may have the commercial domicile, if that State uses the commercial domicile approach, and then taxed again, over and above the 100 percent, by the States that follow the full apportionment concept. This we believe is illustrative of the fact that the concept itself cannot possibly be the medium to which a solution to interstate problems can be arrived at.

Now, there is a better way. For over 18 months the Committee on State Taxation, through its executive committee, has met in joint conference on a number of occasions and regularly with the executive committee of the National Association of Tax Administrators; that is the executive committee of COST and NATA——

Senator MONDALE. And you have been active in these negotiations, have you not?

Mr. STANLEY. From the very first, sir. I attended every meeting.

Senator MONDALE. Would you tell us what progress is being made there?

Mr. STANLEY. We have in good faith, and I think with very significant results, Senator, attacked all of the major issues; the consolidation-combination issue, the sales and use tax situation, the apportionment and allocation problems. And I feel very strongly, as was expressed yesterday by the president of the NATA, that in most of these areas, the area of difference that originally separated the business community from the States, has been lessening—that is, we have grown much closer together.

For example, in the sales and use tax area, the COST members representing approximately 100 large corporations have worked very hard to try to bring together the States and the smaller businesses that have this problem more pronouncedly than the large businesses have. So we are very optimistic in this resolve. We think that by continuing these meetings with the NATA, which represents the 50

States, as distinguished from 21 States, that with good will and effort on both sides, that has been as I have said, been manifest throughout, it will produce a viable solution to these problems.

Senator MONDALE. Do you have any time frame within which we might anticipate an agreement or something approaching an agreement?

Mr. STANLEY. We recognize, sir, that if we are going to have congressional legislation in this field that our time limits are relatively short, and that we must be productive, and let me say, in the near future. We are aiming our efforts at producing a product that will meet the time frame of action by the Congress.

Senator MONDALE. As you know, neither this committee nor the Congress can abandon its responsibility to make independent judgments, but we have stated several times that we would hold off to see if the negotiations now underway could produce an agreement so we would have a unified compromise proposal supported by business and the States to help us chart a compromise that would be fair to all parties.

The progress you have indicated is encouraging.

Mr. STANLEY. I would just say one other thing, Senator, in this respect as well, and that is that we will never, we will never come together with complete unanimity on these issues, on certain of the issues, certainly, and there will always be some States, and no doubt some businesses that will be opposed to this type of a solution. The only thing that I would respectfully do would be to extend the caution, that the fact that there are some disclaimers in this area, should not discourage the committee to the point of saying that there can be no agreement, and so on, because I think there can be, if we have a substantial group behind agreed solutions.

Senator MONDALE. Very good.

Mr. STANLEY. Thank you very much, sir.

Senator MONDALE. That is encouraging.

Mr. BIXLER. Mr. Peters is next.

STATEMENT OF JAMES H. PETERS, CHIEF TAX ATTORNEY, LONG LINES DEPARTMENT, AMERICAN TELEPHONE & TELEGRAPH CO.

Mr. PETERS. Mr. Senator, Mr. Chairman, I am James Peters and I am appearing as chairman of the Subcommittee on Uniform Apportionment of the Committee on State Taxation, and I will discuss very briefly the jurisdictional provisions of S. 1245 with respect to income and capital stock taxes and gross receipt taxes and the allocation and apportionment provisions of S. 1245.

S. 1245 provides that no State or political subdivisions of the State shall have power to impose a net income tax or capital stock tax, or gross receipts tax with respect to a sale of tangible personal property on a corporation or a seller unless the corporation or seller has a business location in the State or political subdivision. The definition of business location prescribes jurisdictional tests that are substantially the same as those found in Public Law 86-272 with one minor exception.

The business location test defines the practical limits of State and local taxing jurisdiction with respect to net income, capital stock, and gross receipts taxes. This, we feel, was made abundantly clear in the

study of the Special Subcommittee of the House Judiciary Committee in 1964. The study found that when a corporation does not have sufficient contacts with a State so as to have a business location, noncompliance is common and enforcement haphazard.

The design of S. 1245 is to prescribe rules of allocation and apportionment that represent a reasonable approach to State taxation of interstate commerce, and at the same time recognize the importance of preserving the taxing powers of the States by permitting them to pursue their own tax policies within the limitations or ceiling of federally prescribed allocation and apportionment provisions.

The inclusion of allocation and apportionment provisions as a limitation or ceiling on State taxing powers will protect multi-State businesses from overtaxation and will reduce existing uncertainty and diversity to manageable proportions.

S. 1245 provides for an optional three-factor formula to be applied to a corporation's apportionable income, or to its entire capital, reduced by investments in and advancements to subsidiaries, determined under State law. In the case of a tax measured by income, the limit on the amount of income attributable to a taxing jurisdiction includes the amount of income apportioned to it by the optional formula, and in addition income allocated to it.

Apportionable income is taxable income as determined under State law, but does not include foreign source income or dividends received, unless the taxpayer's principal business activity is dealing in securities.

Allocable income consists of dividends received which do not constitute foreign source income and which are received from corporations in which the taxpayer owns less than 50 percent of the voting stock. Such dividends are allocted directly to the State of commercial domicile of the taxpayer.

There are a number of ways to divide net income between taxing jurisdictions. Some comply with constitutional principles of due process; some do not.

S. 1245 directly allocates dividends to the State of commercial domicile primarily because that is the only State, we submit, that can lay claim to dividends with any foundation in economic fact. Dividends have little or no relationship to the three factors of the apportionment formula because dividends are not the product of tangible property used in the production of the taxpayer's goods or services, very little payroll is normally associated with them and only by coincidence would dividends be related to the destination of the goods and services of the taxpayer.

There has developed a fairly extensive body of law in State supreme courts that support the claim of the State of domicile to the taxation of dividends. We believe it is questionable whether the Congress can restrict the right of a State of domicile to tax dividends in their entirety. Dividends, lastly, are easily segregated from business income.

The most perfect example of this method of taxation in a State with a supreme court that has spoken out on this issue is California. Undoubtedly that is why you will find California taxpayers seeking relief from this through California joining the compact, which, as we have heard, has proposed the doctrine of full apportionment.

Senator MONDALE. What happened in California? Did the California Supreme Court rule on this question?

Mr. PETERS. Yes, sir.
Senator MONDALE. What was the ruling?
Mr. PETERS. The California Supreme Court ruled that if California is the commercial domicile of the corporation receiving the dividends it had the right to tax those dividends in full in California.
Senator MONDALE. I see. Does California also take the position with respect to dividends coming into the State from corporations domiciled elsewhere that they have the authority to tax those dividends too?
Mr. PETERS. They do not.
Senator MONDALE. They do not?
Mr. PETERS. They do not. My corporation is domiciled in New York and they do not take the position that those dividends are taxable there.
Senator MONDALE. How many States take the position they can tax A.T. & T. dividends going into the nondomicile States?
Mr. PETERS. In nondomicile States?
Senator MONDALE. Yes.
Mr. PETERS. At the moment I would say very few but I would like to point out that the State of Washington has up for approval a referendum, a constitutional referendum, a statute that would do exactly that, and there has been a movement, I feel in State legislatures. I think it will be a movement that would gather momentum.
Senator MONDALE. Are there any States that now assert this right and seek to tax such dividends?
Mr. PETERS. Yes.
Senator MONDALE. Which States, for example?
Mr. PETERS. Idaho and Michigan.
Senator MONDALE. Alaska?
Mr. PETERS. Alaska and Montana.
Senator MONDALE. OK, proceed.
Mr. PETERS. But, it is still the distinct minority of the States.

I would like to make one other remark on the apportionment of dividends in that it was mentioned that this was the more sophisticated manner in which to treat dividend income.

My response to that is that it shows much less sophistication with respect to constitutional principles than the concept that dividends belong in the State of commercial domicile.

Today there is an urgent need for compatibility in State rules for allocation and apportionment and an urgent need for protection from duplicative taxation of income and capital, an urgent need to head off practices by the States that will cause businesses to resort to awkward and uneconomic business practices.

And lastly, there is an urgent need to bring predictability and certainty to the taxation of interstate business.

Adam Smith, in the "Wealth of Nations" lists four maxims with regard to taxes in general. They are equality, certainty, convenience of payment, and economy in collection.

With respect to certainty he makes the following observation: "The certainty of what each individual ought to pay is, in taxation, a matter of some great importance that a very considerable degree of inequality is not so great an evil as a very small degree of uncertainty."

In many instances it is impossible today to advise the multistate business on a proper way to allocate for apportionment.

Senator MONDALE. Does Adam Smith support S. 1245?

Mr. PETERS. I think he would have. The problem of uncertainty, Mr. Chairman, is one that I think is of great aggravation to the large- and medium-sized businesses, and that is why I stress that point. No number of tax attorneys or tax accountants can resolve that kind of a situation for a company, and it is, it is a burden on interstate commerce.

Senator MONDALE. Thank you very much.

Mr. BIXLER. Mr. Cahoon is next.

STATEMENT OF C. R. CAHOON, LEGISLATIVE ADVISER, MOBIL OIL CORP.

Mr. CAHOON. Mr. Chairman, my name is C. R. Cahoon, legislative adviser to the Mobil Oil Corp.

Today I am representing both the Committee on State Taxation and the Tax Committee of the National Association of Manufacturers.

Much of yesterday's testimony would lead one to believe that most of our interstate tax problems relate to the sales and use tax area and the effect of those taxes among small business. This is just not the complete story.

In the view of many taxpayers, the State taxation of intercorporate dividends, both foreign and domestic, as well as foreign source income generally, are the two most important elements in the current controversy in State taxation.

It is also the view of these taxpayers that the sections of S. 1245 dealing with these items of income are needed to make the State tax requirements compatible with present Internal Revenue provisions dealing with these types of income at the Federal level.

Recognizing constitutional limitations, it is often the expressed intent of State income tax laws to tax only that income derived from sources within that State. However, some of these same States are reaching well beyond that scope and taxing foreign source income by either taxing a foreign source dividend received by a taxpayer or in the alternative by requiring that income of foreign companies doing no business in the taxing States have to be included in the State's apportionable tax base, whether or not such income has been received by the taxpayer in the form of dividends.

In regard to the taxation of income, States generally take a different approach to the determination of the source of income than does the Federal Government.

First, States generally do not have provisions in their income tax laws comparable to those in the Internal Revenue Code in the subchapters which are generally known as the sourcing provisions of the code.

Another important difference between State and Federal rules is the fact that only one State, Alaska, provides a mechanism similar to the foreign tax credit provisions contained in sections 901 through 906 of the Internal Revenue Code. In fact, in many State cases, States do not even provide a deduction for foreign taxes paid.

A few States aggregate further the burden on taxpayers with regard to foreign source income by invoking the so-called unitary business concept of taxation. Under this concept domestic or foreign companies not doing business in the State, but which are related to a

taxpayer with a business location in the State, by application of a 50-percent ownership test, can be included in that taxpayer's income base, to be apportioned to that State.

Senator MONDALE. Is this an issue that the U.S. Supreme Court has had before it for consideration?

Mr. CAHOON. No, sir. There have been some cases on it that came up through the State courts.

Senator MONDALE. But no——

Mr. CAHOON. We have tried to get it into the U.S. Supreme Court, and they would not take it on appeal.

Senator MONDALE. One of the things that occurs to me as you speak, and of course this point has come up before, is, in your opinion, would it not be preferable if the Supreme Court were to deal with these issues rather than the Congress?

Mr. CAHOON. Well, sir, in the absence of legislation from the Congress, several attempts have been made to have the Supreme Court take this, but——.

Senator MONDALE. So, you have tried to resolve it and you cannot get it up there?

Mr. CAHOON. In a long litany of decisions they have said this is an area for the Congress to act, so we have gotten no relief through the courts, through the U.S. Supreme Court.

Senator MONDALE. Yes.

Mr. CAHOON. There is another difference in the State and Federal laws too, in that some State laws do not provide for elimination of so-called gross-up or of foreign source dividends from the Federal starting point. They use the Federal starting point, but then they pick up what we call gross-up. Since this amount grossed up is equivalent to foreign taxes paid before the payment of dividends and is included in the Internal Revenue Code, merely as a mechanism, as I am sure you well know, Senator, for arriving at the proper amount of income to which the foreign tax credit will apply, the inclusion of this gross-up in the State tax basis can result in a taxation of fictitious income.

It is the foregoing differences between Federal and State rules which create the need for compatibility, which can be achieved by the enactment of a new interstate taxation act by Congress.

At this point it may be beneficial to refer to hypothetical examples, which we have included in our written testimony, which gives a comparison of the different approaches to taxation of dividends and foreign source income now prevalent among various States, which in some cases result in overtaxation. We have selected four States as being representative of four different alternatives in the hypothetical case which we show in the written testimony.

We have assumed a U.S. operating company domiciled in New York and also doing business in the States of Michigan, California, and Maine. We have assumed that the corporation received dividends from three wholly owned subsidiaries whose earnings are completely outside of the United States. For the purpose of simplicity and comparing tax burdens in the four States we have assumed identical operating factors as to sales, payroll, and property in these States.

Also we have computed the State taxes at a standard rate of 10 percent, as well as showing the taxes at the actual rates. The four

States selected for our example represent four different approaches to the taxation of foreign source income by States. In the example you will see that Michigan requires, and of course we will not go through these examples and take that much time, Senator, but it will show that Michigan includes foreign subsidiary dividends in the income base and apportionment of that income.

In the case of California, the technique known as the unitary business concept is followed. This technique requires the consolidation of all affiliated companies, 50 percent or more owned by a common parent. As indicated in the examples we have given for California, many taxpayers are presently bearing an unreasonable burden in that State, with respect to taxation of foreign source income.

The third State, Maine, follows the practice of allocated dividends, including foreign dividends to the State of commercial domicile. In the case of the U.S. parent company, which in our example is domiciled in New York, only the parent's domestic operating income would be apportioned to Maine, but if the parent company were domiciled in Maine instead of New York, all of the foreign dividends would be included in the income base, together with the apportioned operating income of the parent. And again, sir, without going through these rather lengthy examples——

Senator MONDALE. We will put those in the record, of course.

Mr. CAHOON. They are all in the written testimony. I would just like to conclude by giving a quick summary.

The effect of these different approaches to taxation in this hypothetical case is summarized as follows. Using the standard 10-percent rate, New York excludes the foreign source dividends from the income base as does Maine, with the result that the tax liability in both States would be $25,000. But if the parent were domiciled in Maine, instead of New York, the Maine tax would be increased by $300,000 as a result of allocation of $3 million of dividends to that State. Because of bringing foreign dividends into base of apportionment, Michigan's tax is increased by $67,320 above the $25,000 liability, which would result with the dividends excluded.

By including income of the foreign subsidiary and applying the unitary concept to the U.S. parent, California increases the tax liability by $123,500 above the foreign liability.

Of the above examples, the Michigan approach followed the regulations developed by the Multi-State Tax Commission. As member States in the MTC, with these regulations, they can expect to use the Michigan approach.

While only Oregon has so far adopted the California unitary business concept, pressures are mounting in several other States to adopt it. The examples illustrate how foreign source income and foreign investments are burdened by State taxation of foreign source income, and foreign investments are burdened by State taxation of foreign source income, with the trend being that more and more States are taxing such income.

It is the position of those of us who support S. 1245, that the enactment of sections 207, 208, 209, and 522 of that measure will accomplish the results of eliminating discriminatory taxation of foreign source income, and achieving the compatibility of State income taxes with Federal income taxes, which we feel is needed, making them similar to the provisions of the Internal Revenue Code. Thank you.

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Senator MONDALE. Thank you. Now, your company, Mobil Oil, operates in all or nearly all of the States of the Union.

Mr. CAHOON. All of the States of the Union and all of the countries of the free world; yes, sir.

Senator MONDALE. Yes. What do you do now with these different State's formulas? Do you just accept them, or do you challenge them?

Mr. CAHOON. We follow strictly the State laws.

Senator MONDALE. But it is your judgment that in some States you are being double taxed or unfairly taxed?

Mr. CAHOON. That is right.

Senator MONDALE. The same income from one source is being used duplicatively?

Mr. CAHOON. Right. The technical term we use in trade, Senator, is taxation of extraterritorial values.

And there is an economic point in here, because when you tax those values, you bring into the apportionment formulas elements in either your sales, your property, or your payroll, which is a different set of economic values than would be true in the State. For example, a payroll or property value in California is vastly different from one of the underdeveloped countries of South America or Africa or so forth. So, when you bring in the whole income mass to be apportioned, and then apply those factors, you get a great amount of slippage, and it is a geometric increase in the amount of base which ends up in the tax base.

Senator MONDALE. Well, are the States getting more assertive, in your judgment, in broadening the definition of jurisdiction for State income tax purposes?

Mr. CAHOON. In some cases, yes, sir. The assertion of this unitary business concept, coupled with the push for apportionment rather than allocation of dividends. Understand, our first view on dividends, sir, is that entire corporate dividends should not be taxed at all in the claim that it has already been taxed once as operating income of that affiliated company. However, if it were to be taxed, our second claim is, as Mr. Peters has pointed out, that there are court cases, and as well as we think constitutional interpretations, which would indicate that they should be allocated to commercial domicile.

Senator MONDALE. Thank you.

Mr. CAHOON. Thank you very much.

Mr. BIXLER. Now we have Mr. Devitt of Montgomery Ward.

STATEMENT OF JAMES F. DEVITT, MANAGER, STATE INCOME TAXES, MONTGOMERY WARD & CO.

Mr. DEVITT. My name is James F. Devitt, and I am manager of the States income taxes for the Montgomery Ward & Co., and I am going to discuss the topic of consolidation and combined reporting.

First, in any discussion of consolidation, it requires that it be reconciled with the phrase "combined reporting," and it refers to the joint income factors of more than two related corporations for the determination of the State income for one or more corporations. For both terms as I have used them in this discussion, I will confine myself to the term "consolidation," but it is to include both the philosophies of the combined reporting as well as consolidation.

The majority of States have statutes that authorize some degree of consolidation, but as a practical matter, only about a dozen States either require or permit consolidation of any type. There are basically four practices among the States. They are that the consolidation would be permitted or required; that it would be required, but not permitted; that it would be permitted but not required; or that it be prohibited.

To the extent that any Federal legislation recognizes consolidation, identical options then should be available to both the taxpayers and the States. Consolidation must not be a one-way street.

There are approximately five alternatives available under consolidation.

First, the one I would like to cover is that where consolidation would be based on ownership only, this is the concept contained in S. 2092, the so-called ad hoc bill, which was a consensus bill between some members of industry and some members of the States, and its basic asset is simplicity of knowing what companies would be included, since only ownership is determinative. Its defects are that it can produce some ridiculous results because of the varying natures of the companies coming under a common ownership. Their combination could produce distortions that would be either acceptable or desirable.

The next method could be classified as the unitary method, and that method is now used by principally the States of California and Oregon. Under this concept, you attempt to determine the higher departmental relationships between the organizations under a common ownership. It requires a great deal of sophistication to determine not only what members should belong, but when and for how long. It requires a great deal of judgment, and as a result, varying results could be reached through the view of the same facts by either the same State or by different States. That results in the defect to the companies of the lack of predictability as to what their tax may be in the future, and a great deal of uncertainty as to what they may have done being acceptable. It would also lead, if it were a national rule, to potentially different interpretations by the States and a great deal of litigation.

A third concept of consolidation, that which is used by some States, is that it should be confined to only those companies which are taxpayers within the given State. This is used by a number of States. It has no great theoretical accuracy, but it has a practical value in that it coincides somewhat to the philosophies of the Internal Revenue Service in its consolidation, in that only those of common ownership that are taxpayers in the United States would be included. Its defects are that of theory, and its advantages are predictability and ease of determination.

A fourth concept is that contained in S. 1245, that where consolidation would be confined to those instances where there was proof of a lack of nonarm's length transactions between related parties. S. 1245 also confines that consolidation to only those parties that are guilty of the so-called nonarm's length.

Senator MONDALE. Can you give me an example of how S. 1245 would work?

Mr. DEVITT. S. 1245?

Senator MONDALE. On that specific point you have just made.

Mr. DEVITT. Well, it could be determined that, let us say, a manufacturer was selling to related subsidiaries, as well as selling to inde-

pendent manufacturers and to its related subsidiary it has sold at a price less than what it has sold to the independent contractors.

Senator MONDALE. All right.

Mr. DEVITT. Then that could be construed to be less than arm's length transactions. He is giving benefits to the company which he owns.

Senator MONDALE. And you could consolidate them?

Mr. DEVITT. Then you would be able to consolidate them.

Senator MONDALE. If it were a transaction by corporation A to a totally independent corporation B, they could not?

Mr. DEVITT. They could not because of the lack of ownership of corporation B. It requires the relationship of ownership, and then a proof, well, of less than arm's length, less than a fair return. Now, the concept there is that consolidation——

Senator MONDALE. Now, the State tax administrators apparently want to consolidate, or a lot of them do. How would they view the problem you have just referred to?

Mr. DEVITT. I would like to sort of correct the first statement.

Senator MONDALE. All right.

Mr. DEVITT. The majority of States do not consolidate.

Senator MONDALE. I see.

Mr. DEVITT. Either by statute or by administrative device, they do not consolidate. These are less than a dozen States that currently require consolidation.

Senator MONDALE. Are the number of States that are requiring consolidation increasing?

Mr. DEVITT. I would predict that it would be increasing because of activities of the multistate tax commission. They are inured to the concept, unitary tax concept.

Senator MONDALE. Let us take one of those States then. How would they approach that same problem?

Mr. DEVITT. Well, let us take the State of California. Would that be acceptable?

Senator MONDALE. Fine.

Mr. DEVITT. They currently use the unitary theory. In approaching it on the S. 1245, they would have a great deal of difficulty in determining if they were nonarm's length transactions, and this is among the major defects of S. 1245 because of the lack of expertise on the part of the States and the fear on the part of some, and myself included, that a State would indicate that any transaction between related parties was a prima facie nonarm's length transaction. There is some judicial precedent for that. There was a Federal excise tax and sales tax between related parties which was considered by the Internal Revenue Service to be nonarm's length, and similar presumptions could be made by the States.

On the other side, if a taxpayer wanted a particular subsidiary to be included, he could create an arm's length transaction, thereby under the law drawing it into consolidation. Consolidation has generally been a device to attempt to prevent the shifting of income between related parties from a taxing State to a nontaxing State.

One of the alternatives that I have not mentioned is that of a prohibition.

Senator MONDALE. In other words, if you have a State A with a State income tax, and State B with no income tax at all, then State A would say, well, you are trying to shift your income over to B to avoid income tax; therefore we are going to consolidate your operations in B in State A, and hit you with what we think is our fair share? Is that usually how it arises?

Mr. DEVITT. That is generally the concept. Now, that concept was rather valid years ago. We had a great number of States that did not have State income taxes, and there were corporate organizations that would devise the ABC Co. of Illinois, and the ABC Co. of Iowa, and so forth. Well, today we have but five States that do not have income tax, and those of Washington, Texas, and South Dakota, which will probably fall by the wayside in the next few years, leaving Nevada and Wyoming, so that type of tax haven is really no longer existent. If consolidation is confined to domestic corporations, which to date it has not been since California will include foreign corporations which are not even subject to the Federal income tax, but if consolidations were to initially be philosophically confined to the United States, then for all practical purposes the need for it is vanishing because all it would do is shift the income from one taxing State to another taxing State, and the variance in rates would not truly justify a corporation trying to adjust its operations through the use of multiple subsidiaries to avoid State taxation. There would not be that great a value any longer.

Another relationship with consolidation is that with the taxation of dividends, if the dividends are going to be subject to apportionment, as is the increasing tendency, particularly as generated by the Multistate Tax Commission, then consolidation must be had, because then the States would be taxing the dividends without giving any factor reflection in its taxation, and the income of the payer corporations would always be subject to the income tax. Therefore, among the proposals would be the elimination from taxation of entire corporate dividends, and potentially elimination of any consolidation of any kind.

Senator MONDALE. I think we are going to have to move on. Thank you very much.

Mr. BIXLER. Now Mr. Courtney of the National Association of Wholesaler-Distributors.

STATEMENT OF PAUL L. COURTNEY, VICE CHAIRMAN OF THE BOARD, NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS

Mr. COURTNEY. My name is Paul L. Courtney, vice chairman of the board of the National Association of Wholesaler-Distributors. Our people are primarily small business people, like those that Mr. Bixler is speaking for, members of NAM, many of whom are also small business people.

I want to switch the pitch, so to speak, here for the next few minutes and talk about sales and use taxes. Public Law 86–272 really solved the problems of the small business community insofar as income taxes are concerned, but the proliferation of income taxes by local political

subdivisions in recent years, since the enactment of Public Law 86–272, means that down the line, in the future, we will have some additional problems, all of us, both large and small. Most of the States have not been bothering the so-called small business people on income tax matters since Public Law 86–272 was enacted, in 1959.

We would agree with Senator Mathias and others who have preceded us, yesterday and this morning, that there should not be a separation of the problem of sales and use taxes and income taxes as separate legislation. The total problem cries for an answer, and the time to do is now, we think. The urgency of the situation was questioned yesterday by yourself, I think, Mr. Chairman, and also Senator Long. There are 110,000 political subdivisions with the power to tax in the United States of America. According to the House study, which is now 6 or 7 years ago, when that study was finished, there were approximately 3,000 of those 110,000 political subdivisions that were levying various income, sales, and use taxes and so forth. Today there are over 8,100, who are levying sales, use, income, property taxes, and franchise taxes of one sort or another.

Yesterday Mr. Traigle apologized for Louisiana's 156 local cities and parishes tax problems. He said it was one of the worst in the country. Well, actually during the round table discussion, we furnished the staff with the situation with respect to Alabama which has 185 taxing jurisdictions, cities, counties, and police jurisdictions, and we gave them a list. I have for Mr. Morris and the staff here today an up-to-date list, dated May 1973. We have checked it out, since the roundtable discussion, and we find that in those 185 taxing jurisdictions in Alabama who levied sales and use taxes, from one-eighth of 1 percent on automotive or machinery, or farm machinery and so forth, up to as much as 3 percent, and these rates are all over the lot, 150 of those rates in those jurisdictions have been changed since that presentation that we gave you, which was dated about 1967. So, in about 6 years in the State of Alabama alone, in 185 taxing jurisdictions, there have been 150 changes. And this is typical of the type of problem that the small businessman is trying to keep up with in 50 States and 8,000 local jurisdictions.

Senator MONDALE. You were here yesterday when the tax collector from the State of Louisiana suggested a new system where the 50 States would each file a single average statewide tax rate for State and local sales and use taxes, with the Department of Commerce?

Mr. COURTNEY. Yes.

Senator MONDALE. Then firms doing business in that State would simply send a single check to, I assume, the commissioner of taxation or something like that and the State somehow would split the tax revenues between the State and the local jurisdictions. Does that compromise make sense to you?

Mr. COURTNEY. I would not know. I would not call it a compromise. It is an entirely different approach. It is an entirely different concept.

Senator MONDALE. As you may recall, the testimony of one of our earlier witnesses, Mr. Mendenhall, was that he does not mind collecting and paying the State taxes due. He says what bothers his company is that it impossible to keep up with the number of local taxing jurisdictions and with frequently changing rules. This seems to be the sort of thing you are talking about, suggesting that compliance just cannot be obtained under these circumstances.

Mr. COURTNEY. This is the burden.

Senator MONDALE. He also said if there could be some kind of simple rule, his company would gladly collect and pay its taxes. He then said he thought most of his colleagues would too. Now, I do not know. Does this appeal to you?

Mr. COURTNEY. Well, it appeals to our people in that it is a concept that moves in the direction of simplicity.

Senator MONDALE. Yes.

Mr. COURTNEY. And would certainly reduce the compliance burden some. However, it is hard to say. Mr. Traigle's proposal has been furnished to us in very rough draft form. We have been discussing it with him. We are doing so and we are continuing to do so. We are interested in that concept.

Senator MONDALE. Why don't you——

Mr. COURTNEY. We have some serious questions about it, and actually our lawyers are——

Senator MONDALE. Why don't you——

Mr. COURTNEY. Questioning the constitutionality possibly.

Senator MONDALE. That might be.

Mr. COURTNEY. You have two different types of taxpayers that would be competing with one another and subject to the interstate taxation. One would be paying the local rate because he had a business location in the State, and the other would be paying the average rate, which might be higher or lower.

Senator MONDALE. If you get a chance to, you might respond in some more detail to that proposal. I know the chairman thinks it has merit.

Mr. COURTNEY. We certainly intend to do so.

Senator MONDALE. After you have had a chance to analyze it, you might provide your views in writing to the subcommittee.

Mr. COURTNEY. We will, because legislation is badly needed, and simplicity is what we are all seeking, uniformity is what we are all looking for, and the burden of compliance is just unconscionable.

Our people estimate that at least $350 is the absolute minimum cost of preparing and filing a form, regardless of the dollars involved, and in many, many instances, in the vast majority of instances, as a matter of fact, the amount of tax involved would be less than equal to that or very little more than the cost of compliance, and the burden of preparing the form.

One of the efforts that we have made toward getting along with the State people, and negotiating with the State people is contained in section 304 of S. 1245. Several years ago we were talking with some of the people from the Multistate Tax Commission, and the suggestion was made that perhaps compulsory registration of interstate buyers, and notification to the States as to who they were might be a solution. It was for that reason that we talked to Senators Mathias and Ribicoff and incorporated section 304, and those provisions in the Mathias bill, or the Mathias, Ribicoff, Humphrey bill. But we now find not one single State is supporting that concept. We thought there would be several States, we thought at the time that we were talking to the Senators about the incorporating of this in the bill that there would be several States that would support it. So, as a matter of fact, as of today, we withdraw from that position and recommendation, and the provisions of section 304, and go back to the Rodino bill, jurisdictional

position, which is where we started. I cite that only to show that we are flexible, we are willing to talk to anyone about a concept that will help us get out from under this burden. We are not trying to get anyone out of paying any taxes in the sales and use tax area. The amount of tax due from the taxpayer is not the question. The in-State buyer, whether he is a business buyer or consumer of a household product, owes the tax under State law. The out-of-State vendor is being looked to by the State tax administrator to collect the State tax, and this is one of the problems that I know many people misunderstand when it comes to sales and use taxes. We are not recommending in any way that anyone get out of paying any tax. The question is how it is to be collected and by whom?

Senator MONDALE. I think at this point, since we planned to take 40 minutes with this panel, and we have now taken about 55, it would be appropriate to go on to our next scheduled witness. There are several witnesses standing by. I think we will have to stop at this point. I thank you very much. All of your statements will appear in the records as though read. If there are further comments you would like to submit in writing, we would be happy to receive them for our consideration.

Mr. BIXLER. Senator Mondale could I also ask to enter in the record an article by Mr. Peters on the distinction between business and nonbusiness income, which amplifies this statement?

Senator MONDALE. Yes, of course. That will appear at this point in the record.

Mr. BIXLER. Thank you.

[The statement of Mr. Peters and the prepared statement submitted by the preceding witnesses follow. Hearing continues on page 284.]

THE DISTINCTION BETWEEN BUSINESS INCOME AND NONBUSINESS INCOME

(By James H. Peters [1])

Two steps are ordinarily required in applying state income tax laws to a multistate business. First, certain items of income and expenses are specifically assigned to the state. Items of income commonly treated in this manner are dividends, interest, gains, rents and royalties. Second, all remaining income is apportioned to the state by means of a formula. The most frequently used formula includes the three factors of tangible property, payroll and sales. In the Uniform Division of Income for Tax Purposes Act (Uniform Act) and in a number of state income tax laws the distinction between business income and nonbusiness income determines whether an item of income will be treated one way or the other. The inherent complexity of a system that requires one to determine what income to specifically assign rather than apportion, then to ascertain where that income is to be assigned and lastly to identify the expenses related to that income has concerned many tax administrators and others and legitimately raises a question as to the propriety of such a statutory scheme.

A subject as broad as the distinction between business income and nonbusiness income cannot be adequately treated in the time which can be devoted to the subject here. What is attempted here is to survey the subject in an organized manner so that anyone wishing to go deeper into some aspect of it will have a starting point and a sense of direction.

For purposes of this article, the term specific allocation will be used to refer to the assignment of certain income (such as dividends, interest, gains and rents) on the situs basis or by some other specific means and the term apportionment will be used to describe the assignment of income by means of a formula.

The subject has been divided into four main headings: (1) The Reason for a Distinction Between Business Income and Nonbusiness Income—Constitutional

[1] Firm: Chief Tax Attorney, Long Lines Department, American Telephone and Telegraph Company, New York City.

Limits on State Taxation of Interstate Commerce; (2) Application of the Distinction Between Business Income and Nonbusiness Income by the Courts to Specific Items of Income; (3) The Distinction Between Business Income and Nonbusiness Income in the Uniform Division of Income for Tax Purposes Act; (4) Modern Day Interpretation of the Distinction Between Business Income and Nonbusiness Income.

THE REASON FOR A DISTINCTION BETWEEN BUSINESS INCOME AND NONBUSINESS INCOME—CONSTITUTIONAL LIMITS ON STATE TAXATION OF INTERSTATE COMMERCE

From the beginning, a distinction between income to be specifically allocated and income to be apportioned has been a part of state income tax laws. This was true of the Model Business Income Tax developed in 1920. The distinction is described in a report of the Committee on the Apportionment Between States of Taxes on Mercantile and Manufacturing Business of the National Tax Association which had been assigned the task of working on the model law:

"Items of interest, rents and dividends come from a definite source which it is entirely feasible to allocate specifically to one state or another; but this is not true of the great mass of the income of a manufacturing or mercantile company—that is, the profit derived from the sale of goods. Where material and goods are collected and purchased by an office in one state, converted by manufacture at a factory in a second state, and distributed and sold through an office in a third state, it is evident that the investment and activities in all three states have yielded a certain trading profit." [1]

The report acknowledges a certain arbitrariness in apportioning the trading profit by means of a formula—"the cutting of the Gordian knot." However, it also finds adequate safeguards in constitutional limits on state taxing powers as expressed by the court in *Underwood Typewriter Co.* v. *Chamberlain* [2] to the effect that a state may tax only that portion of total net income "reasonably attributable" to the state. The report concludes: "The words 'reasonably attributable' will be the starting point for many court decisions in the future and that may well be the starting point of any rule of apportionment." [3]

A study conducted by the Controllership Foundation, Inc. in 1954 [4] contains an exhibit that describes the manner in which certain types of income were specifically allocated in state income tax laws. With few exceptions they required the specific allocation of dividends, interest, rents, royalties and capital gains. The body of the report accounts for this practice as required by the jurisdictional limitations placed on the taxing powers of the state by the Federal Constitution. Let us examine the cases which have defined the limits of the power of states to tax.

A clear distinction evolved between the right of a state to tax intangible and tangible property. In *Fric v. Pennsylvania*,[5] it was held that the state in which a decedent resided could not impose death taxes on the transfer of real estate located in another state. Some years earlier, it had been decided that a state in which a corporation was domiciled could not impose a tax on that part of the corporation's capital with respect to property located outside the state.[6] In *Standard Oil Company v. Peck*,[7] it was held that the state of taxpayer's domicile could not impose an *ad valorem* personal property tax upon all of the property of the taxpayer. Apportionment was found necessary in order to avoid multiple taxation of interstate operations and to avoid a tax having no relation to the opportunities, benefits or protection which the taxing state affords those operations.

The power of a state to tax intangibles is much broader. In *Curry v. McCanless*,[8] the question for decision was whether the states of Alabama and Tennessee might each constitutionally impose death taxes upon the transfer of an interest in intangibles held in trust by an Alabama trustee but passing under the will of a beneficiary domiciled in Tennessee. The court concluded that both states might impose a transfer tax. Double taxation posed no problem with respect to intangi-

[1] Proceedings of National Tax Association, 1922.
[2] 254 U.S. 113 (1920).
[3] See N. 1 *supra*, p. 202.
[4] Cohen, "Apportionment and Allocation Formulae and Factors Used by State in Levying Taxes Based on or Measured by Net Income of Manufacturing, Distributive, and Extractive Corporations; A Research Report Prepared for Controllership Foundation, Inc."
[5] 268 U.S. 473 (1923).
[6] Delaware, Lackawanna and Western R.R. v. Pennsylvania, 198 U.S. 341 (1905).
[7] 342 U.S. 382 (1952).
[8] 307 U.S. 357 (1939).

bles although that result was studiously avoided with respect to the taxation of tangible property.

The power of a state to tax income rests upon its relationship to the taxpayer (residence or domicile) or its relationship to the income being taxed (source of the income). Unlike the situation with respect to tangible property, the same income may be taxed by the state of residence or domicile and the state in which it has a source. In *Maguire v. Trefry,*[9] a state in which resided a beneficiary of a trust created and administered under the laws of another state was permitted to impose a tax on the beneficiary's income from the trust, the theory being that the beneficiary was domiciled in the state and had the protection of its laws and there received and enjoyed the income from the trust property. In *Lawrence v. State Tax Commission,*[10] it was held that the state of a taxpayer's domicile could impose a tax on income earned by the taxpayer from the construction of public highways in another state. Again, it is the receipt and enjoyment of income in the state of domicile, the protection afforded the recipient in his right to receive the income, and his enjoyment of it once received that provide the required jurisdictional connection. The court concluded:

"We can find no basis for holding that taxation of the income at the domicile of the recipient is either within the purview of the rule now established that tangibles located outside the state of the owner are not subject to taxation within it, or is in any respect so arbitrary or unreasonable as to place it outside the constitutional power of taxation reserved to the state." [11]

In *New York ex rel. Cohn v. Graves,*[12] a tax on the entire net income of a resident was upheld. Enjoyment of the privilege of residence in the state and the attendant right to invoke the protection of its laws were held to be inseparable from responsibility for sharing the cost of government. Lastly, the case of *Chestnut Securities Company v. Oklahoma Tax Commissioner* [13] dealt with an income tax law that treated a corporation as a resident if its principal business was carried on within the state. The court held that there was not a violation of constitutional principles in taxing a foreign corporation as a resident when the activities of the foreign corporation reached such dominant proportions that it was for all practical purposes carrying on or transacting its principal business in the state. The court also held that, as a resident, such a corporation could be taxed on income from intangibles wholly managed and controlled within the state although such intangibles may be physically located outside the state.

The virtually unlimited power of a state to tax income of a resident or a domiciled corporation raises an intriguing question with respect to the several bills that have been introduced in Congress to regulate state taxation of interstate commerce. Can the Federal Government restrict the right of a state to tax income from intangibles received by a domiciled corporation where the intangibles are held and managed in that state? This question has not yet been answered.

The scarcity of authority with respect to the power of Congress to restrict or preempt the taxing power of the states requires that we look elsewhere. The Fair Labor Standards Act of 1938 fixed minimum wages and maximum hours for employees engaged in the production of goods for interstate commerce. It was sustained on the grounds that while manufacture is not itself interstate commerce, the shipment of manufactured goods interstate is such commerce, and the prohibition of such shipment by Congress is a lawful regulation of interstate commerce.[14] This represented a significant intrusion upon the sovereign powers of the states.

Public Law No. 86-272 restricted the taxing power of the states with respect to interstate commerce. In a case attacking the validity of that federal statute, it was argued without success that state income tax laws did not constitute a regulation of interstate commerce.[15] The court held that Congress has power to determine whether the burden of a tax adversely affects interstate commerce and, if it finds that it does, to take such measures as it deems effective to suppress it.

In spite of the cases discussed above, there may be some state taxing power which the Federal Government cannot restrict because it does not represent a regulation of interstate commerce. A city license tax on the manufacture of goods has been upheld as a tax on a local incident and a valid regulation of interstate

[9] 253 U.S. 12 (1920).
[10] 286 U.S. 276 (1932).
[11] *Id.* at 281.
[12] 300 U.S. 308 (1937).
[13] 125 F. 2d 571, *cert. denied* 316 U.S. 668 (1942).
[14] United States v. Darby, 312 U.S. 100 (1941).
[15] International Shoe Co. v. Cocreham, 246 La. 244, 164 So.2d 314 (1964).

commerce.[16] A state was permitted to classify property for *ad valorem* tax purposes without running afoul of the Fourteenth Amendment on the grounds that states have the freedom of a sovereign both as to objects and methods of taxation.[17] A gross income tax was upheld notwithstanding the fact that it was based in part on sales in interstate commerce. In *International Harvester Co. v. Department of Treasury*,[18] the court found that a state was doing no more than asserting its authority over the fruits of a transaction consummated wholly within its borders by imposing a gross receipts tax on the following classes of sales of a foreign corporation doing business in the state: (1) sales by out-of-state branches to local dealers and users, where delivery is taken in the state, (2) sales to out-of-state buyers who take delivery within the state, and (3) sales in the state to local buyers where the goods are shipped from out-of-state points.

For a period of time there was a question as to whether a state might tax income derived from interstate commerce by a domiciled corporation. In *United States Glue Co. v. Oak Creek*,[19] it was decided that the Wisconsin income tax might be imposed upon income of a domiciled corporation derived from interstate commerce without placing a burden upon that commerce in contravention of the Commerce Clause of the Constitution of the United States. The Wisconsin statute imposed a tax upon, among other things, such income as is derived from business transacted and property located within the state. The decision drew a distinction between taxes which represent a direct burden on interstate commerce (gross receipts taxes) and taxes which represent an indirect burden on interstate commerce (franchise and property taxes). The reasoning of the court is summed up in the following statement:

"Such a tax, when imposed upon net incomes from whatever source arising, is but a method of distributing the cost of government, like a tax upon property, or upon franchises treated as property; and if there be no discrimination against interstate commerce, either in the admeasurement of the tax or in the means adopted for enforcing it, it constitutes one of the ordinary and general burdens of government, from which persons and corporations otherwise subject to the jurisdiction of the States are not emexpted by the Federal Constitution because they happen to be engaged in commerce among the States." [20]

In order to determine what part of the income of a corporation engaged in business within and without the State was to be taxed as income from business transacted and property located in the State, the statute prescribed a formula for apportioning such income. The court did not indicate whether it would have reached a different conclusion if the statute had imposed the tax on all of the corporation's income from interstate commerce. It simply held that, as applied to the taxpayer, the Wisconsin income tax law could not be deemed to be so direct a burden as to amount to an unconstitutional interference with or regulation of interstate commerce.

The question of taxation of interstate receipts was answered similarly with respect to out-of-state corporations doing business within the taxing State. *International Harvester Co.* v. *Evatt* [21] involved a franchise tax measured in part by the value of products sold outside of the State. It was held that the tax was not nullified merely because the result was achieved through a formula which included consideration of interstate and out-of-state transactions. *West Publishing Co.* v. *McColgan* [22] concerned the measure of an income tax and the right of California to impose such a tax upon a foreign corporation engaged exclusively in interstate commerce. On the authority of *United States Glue Co., supra*, the tax was found not to violate the Commerce Clause of the Constitution for the United States by fact of its being imposed upon a corporation engaged in interstate commerce. Although the court did not pass upon the reasonableness of the measure of the tax, it made it clear that interstate receipts could validly be included in such measure. The taxpayer argued that its income was subject to tax in full by the state of its domicile and that by apportioning some income into California it became subject to double taxation. The court disposed of this argument citing *Curry* v. *McCanless, supra*, for the proposition that both States provided benefits and advantages which allowed them to tax the income in question.

The most recent case to be decided on this subject is *Northwestern States Portland Cement Co. v. Minnesota*.[23] An income tax imposed upon a foreign corporation

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[16] American Manufacturing Co. v. St. Louis, 250 U.S. 459 (1919).
[17] Michigan Central R.R. v. Powers, 201 U.S. 245 (1906).
[18] 322 U.S. 340 (1944).
[19] 247 U.S. 321 (1918).
[20] *Id.* at 329.
[21] 329 U.S. 416 (1947).
[22] 27 Cal.2d 705, 166 P.2d 861, *aff'd per curiam* 328 U.S. 823 (1946).
[23] 358 U.S. 450 (1959).

engaged exclusively in interstate commerce within the state was upheld. It was noted that the tax was levied only on that portion of the taxpayer's net income which arose from its activities within the taxing state. Those activities were found to form a sufficient nexus between the tax and the transactions for which the tax was an exaction. Justice Harlan in a concurring opinion states the reasoning which supports the decision:

"The thrust of these statutes is not hostile discrimination against interstate commerce, but rather a seeking of some compensation for facilities and benefits afforded by the taxing States to income-producing activities therein, whether those activities be altogether local or in furtherance of interstate commerce." [24]

The court reasoned that the founders did not intend to immunize interstate commerce from carrying its fair share of the costs of state government in return for the benefits it derives from within a state.

The question of multiple taxation was raised by the taxpayer pointing out the possibility of the domiciliary state taxing the entire net income. The court did not confront this issue because there was nothing to show that multiple taxation was present in the cases at hand.

From the foregoing cases it is evident that a state may impose an income tax which is measured by income derived from interstate transactions and levy a tax upon a foreign corporation, even one engaged only in interstate commerce within the state, as long as the tax bears a reasonable relationship to business transacted and property located within the state.

There appears to be no clear-cut distinction between the power to tax income of out-of-state corporations conducting a mixed intrastate-interstate business in a state, and out-of-state corporations conducting an exclusively interstate business in a state. In both instances, the tax must be reasonably related to business done or property located in the taxing state. The next series of cases apply the test of reasonableness to particular situations.

Shaffer v. *Carter*[25] involved an Oklahoma income tax law which subjected incomes of nonresidents to the payment of the tax. The plaintiff, a nonresident carrying on an oil business in Oklahoma, attacked the statute as a taking of property without due process of law and a burden upon interstate commerce. The court held that a state, as a necessary consequence, may levy a net income tax upon incomes accruing to nonresidents from their property or business within the state. The court said:

"The first section of the act, while imposing a tax upon inhabitants with respect to their entire net income arising from all sources, confines the tax upon nonresidents to their net income from property owned and business, etc., carried on within the State." [26]

In *Underwood Typewriter Co. v. Chamberlain*, *supra*, the taxpayer was a nondomiciled corporation engaged in manufacturing in Connecticut. The Connecticut income tax law contained an apportionment formula composed of a single property factor to be applied if a company's net profits were derived principally from the ownership, sale, rental, or use of real or tangible property. A gross receipts factor was provided for companies whose net profits were derived principally from intangible property. The court found that the profits of the corporation involved were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sales in other states. Under those circumstances, it was impossible to allocate, specifically to Connecticut, the profits earned by the processes conducted within that state. Therefore, a method of apportionment by formula was adopted whereby only such net income as was reasonably attributable to activities in the state was assigned to the state. Accordingly, the statute was found not to violate constitutional principles.

Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission[27] concerned a New York franchise tax based on net income. Net income was apportioned to the state on the basis of a single assets factor. The court held:

"So in the present case we are of the opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the company from such unitary business." [28]

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[24] *Id.* at 469.
[25] 252 U.S. 37 (1920).
[26] *Id.* at 53.
[27] 266 U.S. 271 (1924).
[28] *Id.* at 282.

Apportionment formulas are not always found to be appropriate. A company that processed and manufactured leather goods in one state but sold its products in many states and some foreign countries successfully attacked a single property factor of the nature discussed in *Underwood, supra.* In *Hans Rees' Sons, Inc.*,[29] the taxpayer sought to introduce evidence showing that no more than 21.7 percent of its net profits were related to its activities in North Carolina while application of the statutory formula assigned between 66 percent and 85 percent of its net income to that state. The court concluded:

"It is sufficient to say that, in any aspect of the evidence, and upon the assumption made by the state court with respect to the facts shown, the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State." [30]

Based on the reasoning in *Hans Rees'*, a taxpayer attempted to avoid the application of the apportionment formula prescribed by the California Income Tax Act.[31] The evidence showed that the operation of the formula converted a loss of $82,851 into a profit of over $93,500. The court said:

"We read the statute as calling for a method of allocation which is 'fairly calculated' to assign to California that portion of the net income 'reasonably attributable' to the business done there. . . . Hence if the formula which was employed meets those standards, any constitutional question arising under the Fourteenth Amendment is at an end." [32]

The concept of assigning income from a unitary business finds its origin in a case dealing with a capital stock tax.[33] Ohio was permitted to apportion to its taxing jurisdiction a portion of taxpayer's entire capital because there was found to exist a unity of use and management with respect to all of taxpayer's assets.

In addition to the required interrelationship of the activities and investment giving rise to the net income involved, it is necessary that the factors used in the apportionment formula bear a reasonable relationship to the income being apportioned in order to avoid an unconstitutional result. This concept is well expressed in *Virginia Electric & Power Co. v. Currie:*[34]

"In the apportionment of a unitary business the formula used must give adequate weight to the essential elements responsible for the earning of the income." [35]

In the early cases, income derived from investments was considered generally not to be income from a unitary business that might be appropriately assigned to a state by means of a formula. It was felt that the source of such income could be specifically determined with reasonable precision and, in any event, it would be meaningless to suggest that such income had the same source as the trading profit. As we have seen, a state of domicile or residence may tax such income. As we will see later, there also grew up a line of cases which permitted other states to tax such income. Those cases had their origin in cases dealing with property taxes. Perhaps the most revealing of those cases is *Wheeling Steel Corp. v. Fox.*[36] West Virginia imposed an *ad valorem* property tax upon accounts receivable and bank deposits of a Delaware corporation which maintained its general business office in West Virginia. The court upheld the tax on the grounds that the taxpayer had its commercial domicile in West Virginia. West Virginia was considered the seat of corporate government and the place where the management functioned. This case followed several others which had held that a state in which a chose in action or credit was located might impose a property tax because those intangibles had gained a "business situs" in that state.[37] The theory of those cases was that the investment of capital was located in the state and constituted an integral part of the taxpayer's business activities in that state.

The principles of state corporate taxation which have evolved from the decisions referred to above may be summarized as follows:

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[29] Hans Rees' Sons, Inc. v. North Carolina, ex rel. Maxwell, 283 U.S. 123 (1931).
[30] *Id.* at 135.
[31] Butler Bros. v. McColgan, 315 U.S. 501 (1943).
[32] *Id.* at 506.
[33] Adams Express Company v. Ohio, 165 U.S. 194 (1897).
[34] 254 N.C. 17, 118 S.E.2d 155 (1961).
[35] *Id.* at 30; 118 S.E.2d at 164.
[36] 298 U.S. 193 (1936).
[37] New Orleans v. Stempel, 175 U.S. 309 (1899); Bristol v. Washington County, 177 U.S. 133 (1900); State Board of Assessors v. Comptoir National d'Escompte, 191 U.S. 388 (1903); Metropolitan Life Insurance Co. v. New Orleans, 205 U.S. 395 (1907).

(1) The state of domicile or residence may levy taxes directly upon or measured by the entire net income of a taxpayer. There may be an exception with respect to income derived from interstate business having a source outside the state.

(2) A state may levy a nondiscriminatory direct income tax upon the income of out-of-state corporations doing business within its boundaries if the tax is limited to that portion of the income which is derived from instate sources. Unitary business income is deemed to have a source in a state in proportion to the amount thereof that may be reasonably attributable to the state by means of a formula. Income from intangibles may have a source in the state in which the intangibles have a "business situs." Such income also has a source in the state in which the recipient has its commercial domicile.

APPLICATION OF THE DISTINCTION BY THE COURTS BETWEEN BUSINESS INCOME AND NONBUSINESS INCOME TO SPECIFIC ITEMS OF INCOME

It remains to be examined how the principles which evolved out of the cases defining the limits imposed by the Federal Constitution upon the taxing power of the states have been applied with respect to different kinds of income. This analysis will be limited to the treatment of various items of income as nonbusiness income (to be specifically allocated) or business income (to be apportioned by formula).

Most state income tax laws contain language which imposes the tax upon income derived from business activities carried on or property located within the state. Some statutes defined taxable income as income from sources within the state. Such statutory language embodies a recognition of the constitutional barriers imposed upon state taxation of interstate commerce.

Since dividends, interest, royalties, rents, and gains represent the kinds of income normally considered to be nonbusiness income, cases involving the treatment of such income are discussed below.

Dividends

Because of the various concepts with respect to the power of a state to tax intangibles, dividends have been taxed in a number of different ways. The state of legal domicile may properly tax dividends received from corporations doing business elsewhere.[38] On the other hand, the state of commercial domicile may tax such dividends.[39] Also, the state of residence or domicile of the payer of the dividends may claim such dividends for tax purposes.[40]

All of the foregoing cases rest upon well recognized constitutional principles involving the taxation of intangible property at its situs. The situs of the intangible provides the necessary relationship between the taxing state and the income being taxed. In *Southern Pacific Company* v. *McColgan,* [41] the court determined that dividends from subsidiaries were not income from *business done* within the meaning of the Bank and Corporation Franchise Tax Act. The court equated "business done" to the "doing business" concept in franchise tax laws. Since holding stock of subsidiaries is not doing business within that context, dividends from such stock do not represent business income. Accordingly, the aforementioned principles of situs were employed to determine that the dividends were taxable in California because the taxpayer had its commercial domicile there.

There have been attempts to assign dividends by means of an apportionment formula applied to such dividends as well as the trading profit. In most instances those attempts have failed.[42] There is, however, language in the cases indicating that under certain circumstances dividends might be subject to formulary apportionment. If dividends arise out of business activities conducted within a state, or the activities of the corporations paying the dividends are so interrelated with the activities of the corporation receiving the dividends as to make it impossible to identify the various sources of the total earnings of the receiving corporation, then in such circumstances dividends may be apportioned to the state by means of the formula applied to the business income of the receiving corporation. In *F. W. Woolworth Company v. Director of Division of Taxation.*[43] the court gave recognition to the apportionment of dividends from subsidiaries engaged in a unitary business

[38] Miller v. McColgan, 17 Cal.2d 432, 110 P.2d 419 (1941).

[39] Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48, 156 P.2d 81 (1945); California Packing Corp. v. State Tax Commission, 97 Utah 367, 93 P.2d 463 (1939).

[40] Humble Oil & Refining Co. v. Calvert (Tex. Civ. App.), 414 S.W.2d 172 (1967).

[41] See N. 39 *supra.*

[42] Gulf Oil Corp. v. Clayton 267 N.C. 15, 147 S.E.2d 522 (1966); Atlantic Coast Line R.R. Co. v. Kentucky-02 Ky. 36, 193 S.W.2d 749 (1946); Square D Co. v. Kentucky Board of Tax Appeals, 415 S.W.2d 594 (1967).

[43] 45 N.J. 466, 213 A.2d 1 (1965).

with their parent corporation. On the other hand, the statutory formula was found inappropriate when applied to both the business income and dividend income of the parent corporation. The case was remanded to the Director to effectuate a proper result by some means other than the application of the statutory formula to the dividends in question.

Interest

Interest from temporary investments has been held not to be apportionable to a state as part of the unitary business income of the taxpayer.[44] Also, interest derived by a corporation from investment of a special reserve fund required by law is taxable in its entirety by the state of commercial domicile.[45] In neither of these cases did the court pay any attention to the purpose of the investment from which the interest was derived.

On the other hand, a contrary result was reached in two Minnesota cases.[46] One case involved interest from short-term governmental obligations and commercial paper and the other income from investment of a reserve for future expansion of the business. The decisions were based on findings that the business activities of taxpayer produced the income used to purchase the intangibles; income from the intangibles was commingled with business earnings; the investments were carried on the balance sheet as current assets; the same financial officers that controlled the business affairs of taxpayer had responsibility for the investments; and increases, gains and principal were used entirely to pay various expenses and obligations of the business. In the latter case, however, evidence as to the use of the increases, gains, etc., from the investments was incomplete and the court indicated a willingness to rule differently if it were shown that the investments were not used or usable in the day-to-day business of the taxpayer. The court recognized the possibility that at some point funds accumulated, held and invested in anticipation of expansion of a business at a future, but indefinite date, have but a minimal relationship to the successful day-to-day operation of a business.

Interest derived from conditional sales contracts and loans to employees is unitary business income.[47]

Royalties

Generally, royalty income has been assigned on a situs basis.[48] An exception to this principle was made by the California State Board of Equalization in three cases wherein it found that the acquisition, management, and disposition of the patent or copyright constituted integral parts of the corporation's business operations.[49]

The most important thing to remember about these three administrative decisions is that they explicitly recognized the general rule that patents, trademarks, trade names, stocks and bonds, and other intangibles have a situs for taxation purposes at the domicile of their owner. Also of importance is the expression by the Board of its inability to accurately segregate expenses relating to the royalty income involved. In at least one of the cases, the Board found specific evidence of an interdependence between the royalty income and the business of the taxpayer.

Rents

Rental income has been treated differently in different states. The power of the state of domicile or residence to tax rental income was discussed earlier.[50] One line of cases holds that the state in which the property is located may not tax rents received by a taxpayer not a resident or domiciliary of that state [51] while another line of cases holds just the opposite.[52]

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[44] Appeal of American Airlines, Inc., 1 C.C.H. Cal. Tax Cases § 200-195 (1952).

[45] American President Lines v. Franchise Tax Board, 3 C.A 3d 587, 83 Cal. Rptr. 702 (1970).

[46] Great Lakes Pipe Line Co. v. Comm'r of Taxation, 272 Minn. 403, 138 N.W.2d 612 (1965); Montgomery Ward & Co. v. Comm'r of Taxation, 276 Minn. 479, 151 N.W.2d 294 (1967).

[47] Appeal of Marcus Lesoine, Inc., P-H Cal. Taxes, ¶ 13,003.

[48] Rainier Brewing Co. v. McColgan, 94 Cal. App. 2d 118, 210 P.2d 233 (1949); Commonwealth, ex rel. Luckett v. Radio Corp. of America, 299 Ky. 44, 184 S.W.2d 250 (1944).

[49] Appeal of Houghton Mifflin Co., P-H Cal. Taxes, 13 360 (St. Bd. Eq. 1946). Appeal of International Business Machines Corp., 1 C.C.H. Cal. Tax Cases ¶ 200-286 (St. Bd. Eq. 1954); Appeal of National Cylinder Gas Co., 2 C.C.H. Cal. Tax Cases ¶ 200-656 (St. Bd. Eq. 1957).

[50] New York, ex rel. Cohn v. Graves, N. 12 *supra*.

[51] Kentucky Tax Commission, et al. v. American Refrigerator Transit Co., 294 S.W.2d 554 (1956).

[52] American Refrigerator Transit Co. v. State Tax Commission, 238 Ore. 340, 395 P.2d 127 (1964).

Gains

Gains from sales of intangibles and from isolated and occasional sales of tangible property are normally taxed at the situs of such property. Thus, gain from the sale of an office building located in another state by a non-domiciliary taxpayer engaged in a hotel business within a state cannot be included in income to be apportioned.[53] To do so would create a distortion of the type found objectionable in *Hans Rees' Sons, Inc., supra.* On the other hand, the sale of stock in an unrelated corporation obtained in a merger was considered by the court to have contributed substantially to the scheme of corporate functioning and the business potency of the taxpayer. Therefore, the gain from the sale was included in apportionable income.[54]

Before concluding this part of the discussion, a separate but related topic needs to be mentioned briefly. Some income tax laws are imposed upon the privilege of doing business and thus are considered franchise taxes. Net income is the measure of the fee exacted for the privilege of doing business. Corporations engaged exclusively in interstate business are not subject to such tax laws.[55] On the other hand, courts have not applied as strict a test of reasonableness to those laws as they have in the case of direct taxes.[56] There is less reason to examine carefully the source of income involved because the test of reasonableness is considerably more speculative with respect to such a nebulous matter as the value of a franchise. Indeed, the value of a franchise may be affected by property values which are not related to activities in the taxing state.[57]

To sum up this part of discussion, it may be said that most items of income which arise primarily out of the ownership of property can be specifically allocated for income tax purposes to a state in which the property has a situs. If such income is so interrelated to the income arising from the sale of goods or the furnishing of services that it cannot be easily separated or if expenses related to the income in question cannot be determined apart from the general costs of doing business, then such income may be apportioned to a state by a formula which contains factors related to the income. Regardless of the method of assigning income followed by a state, there must be a reasonable relationship between the income taxed and the taxpayer's activities and property within the state.

THE DISTINCTION BETWEEN BUSINESS INCOME AND NONBUSINESS INCOME IN THE UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT

The Uniform Act was primarily the work of Dr. William J. Pierce of the University of Michigan Law School who had been assigned the task of preparing a draft by a committee of the Commissioners on Uniform State Laws. The first tentative draft was submitted to the Commissioners in 1956.[58] The draft provided for specific allocation of rents and royalties from real or tangible personal property, capital gains, interest, dividends, and patent or copyright royalties without regard to whether or not they constituted business income or nonbusiness income.

The allocation sections of the draft contained a number of unusual provisions. Interest and dividends were allocated to the state of origin which was defined as, *inter alia*, the payer's principal income state. If the taxpayer was not organized under the laws of or doing business in the state in which the interest or dividends originated, then such income would be allocated to taxpayer's principal income state. Capital gains from sales of movable tangible personal property were allocated to the state in which the property was located at the time the purchaser took title or the taxpayer's principal income state if the taxpayer was not organized under the laws of or taxable in the state in which the property was located at the time the purchaser took title. Principal income state was defined as the state to which the greatest percentage of income was or would be apportioned under the apportionment formula set out in the Act.

The draft was considered by the Commissioners sitting as a committee of the whole. Relatively little attention was paid to the provisions with respect to specific allocation. A question was raised, however, with respect to rentals from leases of movable tangible property which alluded to the problem of specifically assigning

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[53] People, ex rel. Sheraton Buildings, Inc. v. State Tax Commission, 15 App. Div. 2d 142, 222 N.Y.S.2d 192, (1961).

[54] Pennsylvania v. Emhart Corp. 443 Pa. 397, 278 A.2d 916 (1971).

[55] Spector Motor Service v. O'Connor, 340 U.S. 602 (1951).

[56] See Gulf Oil Corp. v. Morrison, 120 Vt. 324, 141 A.2d 671 (1958); Cleveland-Cliffs Iron Co. v. Michigan Corporation & Securities Commission, 351 Mich. 652, 188 N.W.2d 564 (1958).

[57] Wisconsin & Michigan Steamship Co. v. Corporation & Securities Commission, 371 Mich. 61, 123 N.W.2d 258 (1963).

[58] 1956 Handbook of the Conference of Commissioners on Uniform State Laws, 270.

such income when it represented a principal business activity of a taxpayer. The question implied that apportionment would provide a much simpler solution.

During the discussion of the draft by the Commissioners, a comment was made that is of significance in understanding the intended relationship between the factors of the apportionment formula and the income to be apportioned. A commissioner asked why the property factor was restricted to tangible property. Dr. Pierce answered that it was the feeling of the drafters that as the income from intangibles had been specifically assigned under other sections of the Act, the addition of intangible personal property in the property factor of the apportionment formula would result in a duplication.

The chairman of the drafting committee was Mr. George V. Powell of Seattle, Washington. On May 25, 1956, he wrote an officer of the Comptrollers Institute of America inviting comments and suggestions with respect to the tentative draft. Mr. Paul A. Reck, Chairman of the National Committee on State and Local Taxation of the Comptrollers Institute, submitted lengthy comments and suggestions in a letter dated August 9, 1956. Mr. Reck indicated that it was the consensus of the National Committee that the principal income state concept violated established constitutional principles with respect to the assignment of income from tangible and intangible property. The resort to a principal income state, he said, departed from the concept of taxation at the domicile or "business situs" with respect to intangibles or at the physical situs with respect to tangible property. In addition, he suggested that the sections of the Act pertaining to specific allocation of "nonbusiness" income might be made more appropriately the subject of another act to be kept separate from that proposed for the apportionment of business income. "Thus," he states, "a clear distinction between allocation of income and apportionment of income perhaps could be best accomplished." He concluded this portion of his comments by the statement that in general the Committee was "disinclined to take exception to the manner in which allocations are being made in the majority of those states where non-business income is now being allocated (See Exhibit 1 of Controllership Foundation Report of April 1954)."

In addition to the solicitation of advice from the business community, assistance was sought from tax administrators through the offices of the National Association of Tax Administrators. Mr. Charles F. Conlon, Executive Secretary, arranged a meeting of a number of tax administrators for May 4, 1957, in Chicago. His memorandum of that meeting indicates that the administrators were also concerned about the concept of principal income state. They suggested that commercial domicile be substituted for principal income state. Also, the draft provided that the Act would apply to a taxpayer having income from business activity carried on both within and without the state. The administrators felt that the law should apply if there was any taxable activity, including the ownership of property, in another state.

It was the opinion of most of the administrators that the draft overemphasized direct allocation. A more satisfactory approach was thought to be one under which the business income-nonbusiness income distinction would be the starting point. In order to adopt that approach two new definitions were needed in Section 1 and the appropriate qualifying language in the sections providing for specific allocation. The tax administrators also agreed that the situs of property sold was more satisfactory than the title test as a basis for direct allocation of capital gains from sales of movable tangible property. Finally, the administrators favored the use of the commercial domicile concept as the basis for direct allocation of interest and dividends.

The most important suggestion arising from the May 4, 1957 meeting is that for applying a business income-nonbusiness income test to the types of income to be specifically allocated. The suggestion was that of John S. Warren of California. In his memorandum to the California State Franchise Tax Board, he states that the suggestions which he offered were well received at the May 4, 1957 meeting. He states that it was agreed that the approach to intangible income should be to divide all income into two classes, business income and nonbusiness income, and to apportion the former and allocate the latter by situs, which situs should probably be the commercial domicile of the recipient. The memorandum enclosed a copy of the proposed definitions of commercial domicile, business income and nonbusiness income which Mr. Warren submitted to the group. Business income was defined to include income from tangible and intangible property if the acquisition, management and disposition of the property constituted integral parts of a taxpayer's regular trade or business operations.

The origin of the definitions of business income and nonbusiness income is explained in a letter dated February 10, 1965, from Mr. Warren to the California State Franchise Tax Board. Mr. Warren explains that the first draft of the Uniform Act prescribed rules of situs for the allocation of royalties. To the extent royalties were derived from intangible property they would be allocated to the place where the intangible is utilized by the payer. Mr. Warren continues:

"We felt that this treatment of royalties was in conflict with the decisions of the State Board of Equalization in the appeals of Houghton Mifflin Co., IBM Corp. and National Cylinder Gas Co. which had upheld formula apportionment of such income when the acquisition, management and disposition of the patents or copyrights constituted integral parts of the taxpayer's regular trade or business. Accordingly, I proposed at the Chicago conference that all income be divided into two classes, business income and nonbusiness income, with the former to be apportioned by formula and the latter to be allocated to situs. In my definition of 'business income,' I used the language of the aforesaid Board opinions."

The final draft of the Uniform Act contained the definitions of business income and nonbusiness income proposed by Mr. Warren and provided for the specific allocation of income only to the extent that such income constituted nonbusiness income. There was no discussion on this change by the Commissioners in their review of the revised draft at their annual meeting in 1957.

Further light on the intent of the drafters of the Uniform Act is evident in the written articles or talks of those persons most intimately connected with the drafting effort. At a meeting of the Tax Executives Institute in French Lick, Indiana, on September 30, 1959, Mr. Conlon described the provisions of the Uniform Act and in discussing the allocation provisions stated:

"Allocation of income from intangibles to the commercial domicile involves no more than a recognition of the principle that intangibles are attributed to the domicile of the owner."[59]

In an article in Taxes Magazine in 1957, Dr. Pierce made the following statements with respect to the allocation provisions of the Act:

"Sections 4 through 8 of the Act provide for the allocation of four types of non-business income to specific states, rather than apportionment on the basis of a formula. The reason for this treatment, which is representative of the existing pattern of legislation, is that it is felt that these items of income can appropriately be attributed to a specific state."[60]

In an article in the U.C.L.A. Law Review entitled "California's Uniform Division of Income for Tax Purposes Act,"[61] authored by Messrs. Keesling and Warren, the following statement appears:

"It is important to note that the labels customarily given to types of income—interest, rents, royalties, capital gains—cannot be relied upon to tell us whether the income is business or non-business income. The relevant inquiry is whether the income arises in the main course of the taxpayer's trade or business. Thus, interest income from the investment of temporarily idle funds would be non-business income, whereas interest from trade accounts receivable would be business income. Similarly, if the taxpayer holds a patent on an item which it manufactures and sells and it also licenses other manufacturers to use the patent for a royalty, the royalty income would be business income. These distinctions have been drawn in California administrative decisions under the prior law and will undoubtedly continue to be valid under the Uniform Act."

The use of the terms "business income" and "non-business income" has led to some misunderstanding. Such terminology was in common use at the time of the drafting of the Uniform Act. Income from business activities carried on within a state was the kind of income subject to apportionment. Business activities were interpreted to mean the sort of activities that made a corporation liable for a franchise tax imposed on the privilege of doing business.[62] This did not include income from the holding of intangibles. Income from investments was often referred to as nonbusiness income. At other times such income was referred to as income not received in connection with the transaction of business. Although one may quibble with the propriety of referring to income realized by a business organization as nonbusiness income, it is utterly ridiculous to assume that its meaning is limited to gifts or other receipts having no connection with a profit motive. The assignment of income has nothing to do with semantics.

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[59] Conlon, "The Apportionment of Multi-State Business Income: The NCCUSL **Uniform Division of** ncome Act," 12 The Tax Executives, 226 (April, 1960).

[60] 35 Taxes 749 (1957).

[61] 15 U.C.L.A. L. Rev., 156, 164 (1967).

[62] Cases cited N. 39 *supra*.

In conclusion, the definition of business income in the Uniform Act is the product of California decisional law. It represents the adoption of a limiting exception to the general rule that income from intangible and tangible property will be specifically allocated. It was thought to conform with generally accepted concepts of allocation and apportionment in California and elsewhere.

MODERN DAY INTERPRETATION OF THE DISTINCTION BETWEEN BUSINESS INCOME AND NONBUSINESS INCOME

The Uniform Act did not meet with immediate acceptance by the states. Almost a decade passed with very little activity in regard to its adoption. In 1965, comprehensive legislation regulating state taxation of interstate commerce was introduced in Congress. It was the product of nearly five years of study summed up in a voluminous report of the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary. The states reacted by setting out to put their own houses in order. A Multistate Tax Compact was drafted for adoption by the states. Article IV of the Compact incorporated the Uniform Act. A taxpayer could avail himself of the allocation and apportionment provisions of the Uniform Act if he preferred these to the tax law of any state adopting the Compact. Article VII provided:

"Whenever any two or more party States, or subdivisions of party States, have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, sales or use tax, the Commission may adopt uniform regulations for any phase of the administration of such law, . . ."

By 1967, the Compact had been enacted by a sufficient number of states to bring it into being and today there are twenty-one members. Within the last few years, a number of states have adopted the Uniform Act or a slightly modified version of it as their basic income tax law.

Illinois was the first state to formulate comprehensive regulations interpreting the Uniform Act. These regulations were published in tentative form in 1969 and have subsequently been adopted. In April of the following year a committee of the National Association of Tax Administrators published proposed regulations under the Uniform Act for consideration by states which had adopted the Act. Shortly, thereafter, Indiana drafted regulations under its adjusted gross income tax law which is similar to the Uniform Act. In September 1971, at Miami Beach, the Multistate Tax Commission formally adopted uniform regulations under Article IV of the Multistate Tax Compact.

These various efforts have given rise to some novel interpretations of the Uniform Act. All suffered to some degree through lack of knowledge as to the intent of the drafters of the Act and/or by a desire to extend the application of the apportionment concept beyond that originally intended. The most serious departures from the intent and meaning of the Act occur with respect to income from intangibles. It is in this area that this article will critique these interpretive efforts.

The Illinois regulations separately treat income from intangible personal property regardless of the particular items of income involved. Interest on installment sales made in the regular course of business, interest on customer accounts receivable, and items of income derived from the temporary investment of capital used in a trade or business in short-term obligations, savings accounts or certificates of deposit, are considered business income.

In the absence of clear and convincing evidence to the contrary, the following presumptions are made: (1) if a corporation owns stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote of another corporation, the acquisition, management and disposition of stock or securities issued by the second corporation, and of other intangible personal property giving rise to an item of income from the second corporation will be presumed to constitute integral parts of the first corporation's regular trade or business operations and income with respect thereto will be presumed to be business income; (2) if a corporation owns stock or securities in another corporation and if there is a significant flow of goods or services between the two corporations, the acquisition, management and disposition of such stock or securities, and of other intangible personal property giving rise to an item of income from the second corporation will be presumed to constitute integral parts of the first corporation's regular trade or business operations and the income with respect thereto will be presumed to be business income; (3) if the combined book value of stock (other than stock possessing at least 50 percent of the total combined voting power of all voting classes of stock of another corporation), securities, and other intangible

personal property yielding rents or royalties, owned by the corporation is an amount equal to or exceeding 10 percent of such corporation's current assets, the acquisition, management and disposition of such property will be presumed to constitute integral parts of the corporation's regular trade or business operations and income with respect thereto will be presumed to be business income. Corporations may elect to treat all income as business income.

These regulations make no attempt to assign income to its source. No consideration is given to the relationship between the factors of the apportionment formula and the income being assigned by the formula. The situs basis for assigning income from intangibles is virtually done away with and no substitute is provided to ensure that the constitutional test of reasonable attribution is met.

The proposed regulations of the National Association of Tax Administrators state that interest income is business income if the intangibles with respect to which the interest was received arises out of or was created by a business activity and in those situations where the purpose for acquiring the intangible is directly related to the business activity of the taxpayer. Temporary investments of working capital, reserve funds and advances generate business income. On the other hand, the investment of the proceeds of the sale of stock in a subsidiary pending a decision on their ultimate use generates nonbusiness income.

Dividend income is considered to be business income when dealing in securities is a principal business activity of the taxpayer. Most other dividends are nonbusiness income. Dividends from subsidiaries and from stock in commonly owned supplier corporations are nonbusiness income. There is no mention of interest on advances to subsidiaries.

There is a certain discontinuity between the treatment of interest income and dividends in these regulations. Also, there is a departure from the situs basis for assigning interest income and the regulations appear to adopt a purpose test in its place. Perhaps this is a better rule, but it does not conform to the intent of the Uniform Act. California, Oregon and Kentucky have adopted these regulations.

The regulations proposed by the Multistate Tax Commission contain a single general statement pertaining to the application of the definitions of business income and nonbusiness income. This provision states that all activities generating income on other than an isolated, unusual or sporadic basis, which income is used in the operations of the taxpayer, will constitute elements of the taxpayer's trade or business and give rise to business income. The provision further states that because of the regularity with which most corporate taxpayers engage in investment activities, because the source of capital for such investments arises in the ordinary course of taxpayer's business, because the income from such investments is utilized in the ordinary course of the taxpayer's business and because such investment assets are used for general credit purposes, income arising from the ownership or sale or other disposition of such investments is presumptively business income. The definition of "trade or business" refers to the use of similar terminology in the Internal Revenue Code as determinative of its meaning.

These regulations are vaguely written and of little help to a taxpayer. All examples of specific cases have been omitted. They become involved in a problem of semantics with respect to the meaning of business income. In this regard, there is no reason to refer to provisions of the Internal Revenue Code that have no bearing on the question of allocation and apportionment of income. These regulations have the same deficiencies as the Illinois regulations discussed above. So far, only Alaska has adopted these regulations.

The Indiana regulations with respect to interest and dividends differ from those proposed by the National Association of Tax Administrators in the following particulars. Interest and dividends received from the investment of special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc., are nonbusiness income. Also, interest from short-term investments of working capital is nonbusiness income. In this regard, the Indiana regulations place interest and dividends on the same footing and, therefore, would appear to rest upon a more logical foundation than do the other regulations. Neither the proposed regulations of the National Association of Tax Administrators or the Indiana regulations contain examples involving gain from the sale of intangibles.

State regulations applying the definitions of business income and nonbusiness income contained in the Uniform Act should endeavor to comply with the intent of the Act. To do otherwise would be to legislate and this is not a function of the administrative branch of government. When the wording of a statute is unclear, it is proper to explore the legislative history of the statute in order to determine its meaning. The legislative history of the Uniform Act outlined above, discloses

the derivation of the definitions in question. Although the California administrative decisions that gave rise to the definition of business income dealt only with royalties, they do no more than set forth concepts generally recognized in California law with respect to other types of income from intangibles. For example, interest income from conditional sales contracts has been held to be business income. A careful examination of the California decisions with respect to taxation of income from intangibles would disclose a number of significant departures in the various sets of regulations (except possibly the Indiana regulations) set out above This appears even to be the case with respect to the regulation on interest from short-term investments adopted by California.

One of the major stumbling blocks in understanding the definition of business income is ascertaining what is meant by "the taxpayer's regular trade or business." Since the definition is a product of California law, it seems reasonable to use a California definition of business in order to ascertain its proper meaning. For purposes of apportionment under California law a business has been defined as a group of activities each of which contributes to the production or earning of a given identifiable item of income, no portion of which can be segregated and specifically identified as being attributable to any one of the activities or any combination of activities less than the total number included in the group.[63] If this is the test, then a separate investment activity would not be a part of a taxpayer's manufacturing or mercantile business and interest from such investment activity would not be business income within the meaning of the Uniform Act. The purpose of the investment and the source of the investment (as distinguished from the source of the income) are irrelevant. Interest from investment activity has its source in that activity and not in activities with respect to manufacturing, merchandising, etc. If money is invested wisely, the income and gain will be greater than if it is invested poorly. The income realized has no relation to the taxpayer's manufacturing or mercantile operations.

The combining of income from separate sets of activities gives rise to a serious problem in constructing a common formula. It would be a mere fortuitous situation if the factors used in the common formula did not distort the amount of income assigned to the state with respect to one or the other sets of activities. This alone seems reason enough to adopt the approach of the drafters of the Uniform Act.

CONCLUSION

The distinction between business income and nonbusiness income arose out of the constitutional law principles limiting the taxing power of the states. Interstate business was not immune from state taxation, but a state could reach only such income as was related to activities taking place or property located within the state unless, possibly, the state of domicile had some greater reach. The connection between the power to tax and the income taxed was found in the facilities, benefits, and protection afforded by the state to the income-producing activities taking place within the state. Income from the production and sale of goods or services is the result of a series of interrelated activities or processes. When interrelated activities involve two or more states, the portion of the ultimate profit taxable in a state is considered to be that portion arrived at by the application of a formula based on factors which represent the principal income producing elements involved. Thus, the connection between the income and the state is established.

It is a different matter with respect to income arising from the ownership of property. The situs of the property or the unique relationship of domicile provide the necessary connection. Recently, the purpose of the investment and the source of the funds invested have been considered in establishing a connection with the state. This approach has resulted in finding the following items of income to be business income and apportionable: interest from temporary investments of idle funds available for use in regular business operations, interest from investments of reserves required by law, dividends from subsidiaries engaged in a unitary business with the taxpayer and dividends from corporations having business dealings with the taxpayer, such as a supplier of raw materials. Whether this approach will be carried so far as to include interest from the investment of funds held for some future, unspecified use remains to be seen.

When the amount of investment income is substantial, a question arises as to the appropriate factors to be used in the apportionment formula. If the intangibles and the gross receipts related to the intangibles are to be recognized in the formula,

[63] Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings L.J. 42 (1960).

as it seems they should, the traditional concepts of situs appear to be the only feasible method of locating the intangibles and gross receipts in and outside of the state in the numerators and denominators of the ratios.

Some would argue that all income of a corporation should be apportioned by formula regardless of the nature and source of the income. They argue that any formula will suffice as long as all states use the same formula. Perhaps our changing concepts of federalism would permit such a result. At least one authority does not think so. H.R. 11798, the first comprehensive federal bill to regulate state taxation of interstate commerce, provided for apportionment of all income. On this aspect of the bill, Mr. Keesling testified that it was difficult to see on what ground it could reasonably be urged that Congress can, by any means whatsoever, "increase or enlarge a State's taxing jurisdiction."[64]

It is safe to predict that the issue of how income should be allocated or apportioned for tax purposes will remain a controversial one for many years. It is a complex area that has no simple solution.

INDUSTRY STATEMENT ON PROPOSED INTERSTATE TAX LEGISLATION

ORGANIZATIONS REPRESENTED BY THIS STATEMENT

National Associations
- Committee on State Taxation of the Council of State Chambers of Commerce
- National Association of Manufacturers
- National Association of Wholesaler-Distributors
- National Small Business Association
- The Tax Council

National Trade Associations
- American Footwear Industries Association
- American Machine Tool Distributors Association
- American Research Merchandising Institute
- Associated Equipment Distributors
- Association of Footwear Distributors
- Association of Institutional Distributors
- Association of Steel Distributors
- Automotive Service Industry Association
- Direct Mail Advertising Association
- Distilled Spirits Council of the U.S.
- Federal Wholesale Druggists' Association
- Industrial Fasteners Institute
- Laundry and Cleaners Allied Trades Association
- Lawn & Garden Distributors Association
- Manufacturing Chemists Association
- Material Handling Equipment Distributors Association
- Millers National Federation
- National Association of Aluminum Distributors
- National Association of Container Distributors
- National Association of Glove Manufacturers, Inc.
- National Association of Hosiery Manufacturers
- National Association of Photographic Manufacturers
- National Association of Sporting Goods Wholesalers
- National Association of Textile & Apparel Wholesalers
- National Association of Upholstery Fabrics Distributors
- National Builders' Hardware Association
- National Building Material Distributors Association
- National Council of Salesmen's Organizations
- National Electronic Distributors Association
- National Fastener Distributors Association
- National Industrial Distributors Association
- National Locksmiths' Suppliers Association
- National Ornamental Metal Manufacturers Association
- National Paint Distributors, Inc.
- National Paper Trade Association, Inc.
- National Sash and Door Jobbers Association
- National School Supply & Equipment Association

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[64] Hearings Before the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary, 89th Cong., 2d Sess., Vol. 2, at 1793 (1966).

National Screw Machine Products Association
National Welding Supply Association
National Wholesale Druggists' Association
National Wholesale Furniture Association
National Wholesale Hardware Association
National Wholesale Jewelers' Association
North American Wholesale Lumber Association, Inc.
Northamerican Heating & Airconditioning Wholesalers
Paper Stationery & Tablet Manufacturers Association
Petroleum Equipment Institute
Pharmaceutical Wholesalers Association
Point-of-Purchase Advertising Institute
Power Transmission Distributors Association
Scientific Apparatus Makers Association
Shoe Service Institute of America
Single Service Institute
Society of American Florists
Steel Plate Fabricators Association
Steel Shipping Container Institute
The American Association of Nurserymen
The American Paper Institute
Truck Equipment & Body Distributors Association
Wholesale Florists & Florist Suppliers of America
Wood Turners and Shapers Association
Writing Instrument Manufacturers

State Associations

Alabama Chamber of Commerce
Associated Industries of Alabama
Associated Industries of Missouri
California Beer Wholesalers Association, Inc.
Connecticut Business & Industry Association
Delaware State Chamber of Commerce
East Texas Chamber of Commerce
Empire State Chamber of Commerce
Florida State Chamber of Commerce
Georgia Chamber of Commerce
Greater South Dakota Association
Idaho State Chamber of Commerce
Illinois Manufacturers' Association
Indiana State Chamber of Commerce
Kansas Association of Commerce & Industry
Kentucky Chamber of Commerce
Maryland State Chamber of Commerce
Michigan Manufacturers Association
Michigan State Chamber of Commerce
Minnesota Association of Commerce & Industry
Montana Chamber of Commerce
New Jersey Manufacturers Association
New Jersey State Chamber of Commerce
Ohio Chamber of Commerce
Pennsylvania Chamber of Commerce
Pennsylvania Manufacturers' Association
South Texas Chamber of Commerce
Utah Manufacturers Association
Virginia Manufacturers Association
Virginia Soft Drink Association, Inc.
Virginia Wholesalers and Distributors Association, Inc.
West Texas Chamber of Commerce
West Virginia Chamber of Commerce
Wisconsin State Chamber of Commerce

Regional and Local Associations

Associated Industries, Inc. (Gastonia, N.C.)
Associated Industries & Manufacturers (Sheboygan, Wis.)
Associated Industries of Oshkosh (Wisconsin)
California Association of Employers (San Francisco)

Central Illinois Industrial Association (Peoria)
Central Piedmont Industries (Charlotte, N.C.)
Central Virginia Industries, Inc. (Lynchburg)
Greater Boston Chamber of Commerce
Industrial Association of the Mohawk Valley (New York)
Manufacturers Association of Berks County (Pennsylvania)
Manufacturers Association of Jackson (Michigan)
Manufacturing Association of Southern Connecticut, Inc. (Bridgeport)
Northeast Wisconsin Industrial Association (Manitowoc)
Piedmont Associated Industries (Greensboro, N.C.)
San Francisco Employers Council (California)
Small Business Association of New England
Southern Industrial Distributors Association
Southern Wholesalers Association
The Naugatuck Valley Industrial Council, Inc. (Waterbury, Conn.)
West Branch Manufacturers Association (Montoursville, Pa.)

SUMMARY

1. The Report of the Special Subcommittee on State Taxation of Interstate Commerce (the Willis Committee) documented the need for Congressional action to correct: (a) "widespread noncompliance," (b) "overtaxation and undertaxation," and (c) "diversities and complexities in legal rules, the prevalence of returns in which the cost of compliance exceeds the tax . . ." These defects found by the Willis Committee have not been refuted, but there has been no relief from their burden on interstate commerce and, in some respects, the situation has worsened in recent years.

2. S. 1245 provides remedies for the defects found by the Willis Committee by: (a) establishing a "business location" jurisdictional test for state and local imposition of net income, capital, and gross receipts taxes; (b) codifying the present case law on the liability of the seller to collect sales and use taxes, but providing some relief and protection for *small* business through a registration procedure; and (c) clearing up the present great uncertainty as to how corporate income from interstate sales is to be allocated and apportioned among the states.

3. Title II of S. 1245 establishes a "ceiling" which a state could not exceed in determining the amount of income or capital of an interstate business it can tax without placing an excessive burden on interstate commerce. As long as it does not exceed the ceiling, a state would still be free to tax such businesses as it sees fit.

4. Congressional action on state taxation of dividends and foreign source income is necessary because an undue, and very likely an unconstitutional, burden is being placed on interstate and foreign commerce. Moreover, state taxation of foreign source income improperly injects the state into foreign policy. S. 1245 would remedy this situation by making state taxation of dividends and foreign source income generally compatible with the Internal Revenue Code and by eliminating discriminatory taxation of foreign source income.

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  - Consolidation—Combined Reporting.
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STATEMENT

Any serious discussion of State Taxation of Interstate Commerce ought to begin with the 1964 Report of the Special Subcommittee of the House Judiciary Committee that became popularly known as the Willis Committee in recognition of the ability and dedication of its chairman. The Subcommittee and its excellent professional staff worked for four years during which time it held extensive hearings and compiled the only comprehensive and authoritatively documented survey of State taxes as they affect interstate commerce in the United States.

This was a landmark study in that it represented the first time in the history of our country that the Congress had undertaken to shoulder the responsibility to assure a proper relationship between interstate commerce and the tax systems of the states. The study, exclusive of appendices, contains well over one thousand pages and certainly is not susceptible to brief summarization. However, the basic thrust of the Report is indicated in the transmittal letter to the Hon. Emanuel Celler, Chairman, Committee on the Judiciary on May 25, 1964:

"I think it will suffice for me to say that the information contained in this report inevitably leads to the conclusion that the prevailing system of state and local income taxation creates, for companies engaged in interstate commerce, serious problems which it would be appropriate for Congress to attempt to resolve."

The Report found that the major problems are not confined to income taxes, but relate to all the taxes studied. It also found that the present system of state taxation as it affects interstate commerce works badly for both business and the states. Quoting from the Report, the major defects that pervade the present system are:

"First, it was found that the system is characterized by widespread noncompliance. This includes both a failure to file returns, especially where jurisdiction is asserted on the basis of something less than a place of business in the State, and a failure among companies which do file to comply accurately with the requirements of the prescribed system. For the States, the gap between what is prescribed and what is practiced means a loss of revenue. For business, the result is inequity among similarly situated taxpayers, some of whom comply and most of whom do not. However, were noncompliance to be replaced by full compliance with all of the requirements of the prescribed system, it is likely that the inequities of haphazard taxation would be transformed into the burden of excessive compliance costs.

"A second defect of the current system is its tendency to give rise to over-taxation and undertaxation. Overtaxation is implicit in inconsistencies in the rules prescribed by the various States. These inconsistencies also give rise to undertaxation, which is augmented by noncompliance. The Subcommittee's studies confirm the fact that both of these departures from a coherent system do in fact occur.

"A third defect of the present system is the existence of provisions which are advantageous to locally based companies relative to competitors based elsewhere. While litigation might ultimately invalidate some of these provisions, the generally low level of State tax rates and the expense and uncertainty of the litigation process discourages taxpayers from seeking relief by that means.

"A fourth defect of the present system is the attitude which it has generated among taxpayers, especially small and moderate-sized companies. The diversities and complexities in legal rules, the prevalence of returns in which the cost of compliance exceeds the tax, the demand that a distant seller account for a local buyer's tax under circumstances in which taxability depends on what the buyer is to do with the goods—these and other aspects of the present system have produced widespread resistance to the assumption of taxpayer responsibility."

The existence of these defects was not challenged when the Report was issued and has not been refuted in the interim; but there has been no relief from their impact. What has happened is exactly what the Willis Committee predicted:

"There is every reason to believe that, without congressional action, the worst features of the present system will continue to multiply. For the company selling in interstate commerce the likelihood that it will be caught up in the troubles of the system becomes greater with increased exposure through the passage of time and the widening of its spread of activities."

On pages 11 through 14 of the Report the Subcommittee established that the courts cannot remedy the defects in the system. This inability is explained as follows:

"The reason for this inadequacy is completely unrelated to the ability or diligence of a particular court or of any particular judge. The inadequacy is entirely institutional."

The problem arises from the fact that a court deals in absolutes, and in this area an absolute decision in either direction is not likely to be satisfactory.

The inadequacy of the judicial process to deal with the problems of multi-state taxation has long been recognized by members of the Supreme Court with widely

different philosphies: Justices Jackson,[1] Rutledge,[2] Black,[3] Frankfurter,[4] Douglas,[5] and Clark.[6] Justice Frankfurter[7] put it this way in his dissenting opinion in the *Northwestern States Portland Cement Co.* v. *Minnesota:*

"At best this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life.

*   *   *   *   *   *   *

"The problem calls for solution by devising a congressional policy. . . . The solution to these problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources."

It is obvious why the Subcommittee recommended Federal legislation in 1965. Its bill, H.R. 11789, provoked cries of anguish from all sides.

A spotlight had been focused on the parochial viewpoints and haphazard enforcement practices of the states and for the first time the matter was being moved out of the sphere of an academic exercise toward remedial action. The tax collectors were joined by certain taxpayers who felt that the proposed legislation injected the Federal Government into state taxation to an unnecessary degree. The Subcommittee was most receptive of constructive criticism and modified its legislative recommendation to remove most of the direct federal involvement. Nevertheless, many thought the states should be given a chance to reform the system so that federal legislation would be unnecessary and the states have had such an opportunity for the last eight years. The record is one of all the frustration, futility, and aggravation of the problems that the Willis Subcommittee foresaw.

This is not intended to be a criticism of the states. The inability of the states to cope cooperatively with the problems of commerce between themselves was apparent 200 years ago and resulted in the Commerce Clause in the Constitution, which places the responsibility for regulation of interstate commerce on Congress. There have been some state efforts toward reform—but, in all honesty, their vigor has been in direct proportion to the threat of federal action.

At first, the concept of a Multistate Tax Compact seemed to offer a promising vehicle. However, it soon became clear, even to some of its leaders, that effective action was impossible without federal legislation. More than half the states are not members of the Compact. The most significant action the Multistate Tax Commission has taken, from the point of view of taxpayers, is the adoption of regulations implementing the Uniform Division of Income for Tax Purposes Act. This renders 99% ineffective the provisions of the Act relative to allocation of income from investments, thereby destroying the considerable degree of uniformity that had previously existed as to the taxation of this type of income. In adopting these regulations, the Multistate Tax Commission rejected regulations recommended by its own Rules and Regulations Committee, regulations adopted by the National Association of Tax Administrators, and comprehensive and well-documented testimony by the business community that the intent of the drafters of the Uniform Act and the plain words of the pertinent provisions precluded the adoption of such regulations. After almost eight years of frustration and ineffectiveness, even the most die-hard "states-righter" must concede that the Willis Subcommittee displayed remarkable foresight when it predicted:

"Without congressional action, the worst features in the present system will continue to multiply."

There has been practically no disposition on the part of the states to relieve the plight of the small businessman that was so frankly and fully exposed in 1964. Taxpayer attitudes have not improved; taxpayer morale has been ignored; the free flow of commerce has been hampered by needless interference, particularly in the case of businesses which are too small to afford the burden of excessive tax compliance costs. The inequities in this unhappy situation have been magnified by the dramatic rise in state and local tax collections from $44 billion in 1962 to an estimated $111 billion.

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[1] *Northwest Airlines, Inc.* v. *Minnesota*, 322 U.S. 392, 305–07 (1944) (concurring opinion).
[2] *International Harvester Co.* v. *Department of Treasury*, 322 U.S. 340, 360 (1944) (concurring opinion).
[3] *McCarroll* v. *Dixie Greyhound Lines*, 309 U.S. 176, 188–89 (1940) (dissenting opinion).
[4] *McCarroll* v. *Dixie Greyhound Lines*, supra note 21, at 188–89 (dissenting opinion).
[5] *McCarroll* v. *Dixie Greyhound Lines*, 309 U.S. 176, 188–89 (1940) (dissenting opinion).
[6] *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 457–58 (1959).
[7] *Ibid.* at 476–77.

in 1972,[8] and the equally dramatic increase in compliance costs due to the proliferation of local taxation of interstate business.

There are two approaches to solution of this problem—the theoretical approach and the practical approach. It is hoped that the emphasis will be on the practical, but—above all else—we hope that, in the technical discussions that will take place during this hearing, the basic long-range objectives will not be lost sight of and that Congress can speedily reach, in the words of the Willis Committee, "a general solution which substitutes order and realism for chaos and impracticality."

We believe that S. 1245, introduced by Senators Mathias and Ribicoff, provides a practical approach toward the solution of the many problems existing in this area.

I—Jurisdiction to Taxes

The Willis Committee found that efforts to impose state taxes and tax obligations on persons with no business location in the state create a situation where filing returns is rare and the state is incapable of systematic enforcement on an equitable basis. This situation is extremely undesirable for both taxpayers and tax administrators. Title I of S. 1245 provides the following remedy.

A. NET INCOME, CAPITAL STOCK, AND GROSS RECEIPTS TAXES

A "business location" in the state is the jursidictional standard for net income, capital stock, and gross receipts taxes. A taxpayer has a business location in a state if he:

(1) owns or leases real property within the state; or

(2) has one or more employees located in the state; or

(3) regularly maintains a stock of tangible personal property in the state for sale in the ordinary course of his business; or

(4) regularly leases tangible personal property to others for use in the state.

An employee is not considered to be in a state if his only activities in the state are either solicitation covered by P.L. 86–272, or installation and repair activities which are incidental to an interstate sale of tangible personal property.

B. SALES AND USE TAXES

S. 1245 also provides for two jurisdictional standards for sales and use taxes—one for nonbusiness customers, another for business customers. The standard for nonbusiness customers codifies the *Scripto* and *National Bellas Hess, Inc.* decisions, while overruling the *Miller Bros.* decision.[9] A person making interstate sales to nonbusiness customers may be required to collect and remit a sales or use tax if:

(1) he has a business location in the state; or

(2) regularly makes household deliveries in the state other than by common carrier or U.S. Postal Service; or

(3) regularly engages in the solicitation or orders in the state for sale of tangible personal property by means of salesmen, solicitors, or representatives.

As for business customers, a seller without a business location within the state cannot be required to collect a sales or use tax when such seller obtains the buyer's registration number in writing. Every person with a business location within a state and purchasing goods in interstate commerce must obtain a registration number from that state.

One of the major problems in the interstate taxation matter has been the need to arrive at some reasonable federal jurisdictional standards with respect to the collection of state and local sales and use taxes on interstate sales. This concern dates back to the United States Supreme Court decision in the *Scripto* case, which required an out-of-state business to collect and remit use tax on sales within a state even though the business maintained no facilities in the state and handled all of its sales through independent contractors.

The establishment of a minimum jurisdictional rule for the collection of state sales and use taxes has been of particular concern to small and medium-sized businesses. These businesses have been particularly anxious to eliminate the uncertainty about the liability for collecting these taxes—liability which in many cases is a small fraction of the compliance cost. The need for a reasonable jurisdictional standard was well documented during the hearings held about 10 years

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[8] *Source:* Department of Commerce, Bureau of the Census. 1972 estimate by the Tax Foundation.

[9] *Scripto, Inc.* v. *Carson*, 362 U.S. 107 (1960), *National Bellas Hess, Inc.* v. *Department of Revenue of the State of Illinois*, 386 U.S. 753 (1967), and *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340 (1954).

ago. Because of the proliferation of local sales and use taxes there is a substantial interest in the business community as a whole in establishing some reasonable minimum jurisdictional rules.

Prior to 1972, most of the business-supported bills restricted the power of the states to require an out-of-state seller to collect sales and use tax to instances in which the seller had a "business location" in the state or regularly made household deliveries, whereas the bills supported by state tax administrators, such as the Cranston-Talcott Bills, would codify the major U.S. Supreme Court decisions. In an effort to solve this impasse, the National Association of Manufacturers, the Committee on State Taxation (COST) of the Council of State Chambers of Commerce, and the National Association of Wholesaler-Distributors got together during 1972 and agreed to accept the states' approach with respect to sales and use jurisdictional standards provided it was coupled with some registration procedure. The registration procedure was advanced not as the only possible solution to the problem, but rather as one way to avoid the impasse. In fact, it is understood that some state tax administrators are working on an alternative solution to the problem.

As incorporated in Sec. 304 the registration procedure would provide that a seller without a business location in the state is not required to collect or pay a sales or use tax if the seller obtains the buyer's registration number in writing. The central thought of this approach is that the state would look to its home-based businesses for the tax rather than to an out-of-state vendor which has no business location in the state. In fact, in most cases the tax already is technically imposed on the in-state buyer. There are many who believe that the adoption of such an approach could result in the states obtaining revenue from some in-state buyers that they currently are not getting.

Some state tax administrators have argued that the registration procedure would result in the states having to register many business buyers not currently registered. But if this is the case, such a procedure could have the desirable effect of identifying on the tax rolls of the state buyers who would then be required to self-assess tax.

There has been some misunderstanding about the registration procedure which should be cleared up. It should be understood that this procedure would only apply to sellers that do not have a business location in the state. Also, the proposal does not mean that the states would have to look to most purchasers for the tax because in most cases the vendor who is selling to the purchaser does have a business location in the state and thus would be required to collect the tax. Let us say again that it is simply one attempt to help the small businessman compete in interstate commerce. We certainly would be receptive to consideration of an alternative means as long as it provided some effective relief.

Most of the other sales and use tax provisions included in S. 1245 are much less controversial and generally consistent with similar provisions included in other legislative proposals. Specifically, subsection 301(a) provides that a state or political subdivision may impose a sales or use tax only if the destination of the sales in that state or in a contiguous state or political subdivision of a contiguous state for which there is a reciprocal collection agreement. Subsection 301(b) provides for a use tax credit for tax previously paid to another state or locality on the same property and subsection 301(c) provides for a refund of use tax paid to another state on the same property. Subsection 301(d) imposes a limit on the credit for prior sales or use taxes paid which are measured by periodic payments made under a lease. Vehicles and motor fuels are exempted from the provisions of section 301 by subsection 301(e).

Section 302 precludes a state or political subdivision from levying a sales or use tax on household goods and motor vehicles brought into a state by a person establishing residence there if the goods were acquired and used by the person for 90 days or more before bringing the property into that state.

Section 303 would exclude from the tax base transportation charges incidental to an interstate sale provided such charges are separately stated in writing. The purpose of this section is to ease the compliance burden by establishing a uniform treatment for all states.

The purpose of Section 305 is to relieve a seller from liability for sales or use tax if the seller obtains a valid exemption certificate from the purchaser. Such certificate would have to include the name and address of the purchaser, his registration number if any, and the signature of the purchaser. The purpose of this section is to eliminate the many disputes which arise when a seller has obtained what he considers to be a valid exemption certificate but a state will not accept it because the state contends the seller did not use "good faith" in accepting the certificate.

The purpose of Section 306 is to deal with the current morass of local sales and use taxes. This section limits the requirements for collection or classification of interstate sales for political subdivisions to those instances in which the seller has a business location in or regularly makes deliveries other than by common carrier or U.S. Postal Service to the political subdivision. However, if the local tax is imposed in all geographic areas of a state upon like transactions at the same combined state and local rate, administered by the state, and applied uniformly so that a seller would not be required to classify interstate sales by geographic areas in the state, the tax shall be treated as a state tax and the jurisdictional standards for state tax purposes will apply. In order to give the states and localities adequate time to adjust to the limitations for collecting local sales and use taxes, subsection 531(b) provides that the effective date of these provisions will be for periods beginning on or after July 1, 1978.

II—Allocation and Apportionment for Purposes of Determining Maximum Percentage of Income or Capital Attributable to a Taxing Jurisdiction

A. GENERAL COMMENTS

S. 1245 and H.R. 977 contain provisions which limit the percentage of income or capital of a multistate business enterprise that may be attributed to a taxing jurisdiction. S. 2092 contains similar provisions with respect to income only. What is the function of federal legislation limiting the amount of income or capital which a state or other taxing jurisdiction may subject to tax? A matter of jurisdiction as well as burden on interstate commerce is involved. It has been stated that:

"The due process clause of the Fourteenth Amendment both prevents a state from enforcing a tax in its courts against a person outside their jurisdiction and prohibits the taxation of persons or things whose relationship to the state is thought insufficient to sustain the particular exaction." [10]

It has been mistakenly assumed that the only issue involved with respect to those provisions in federal bills which prescribe allocation and apportionment methods is one of uniformity. It goes without saying that a limitation of the nature contained in the bills under discussion will protect interstate business against overtaxation and will have some effect on making state income and capital stock tax laws uniform. Nevertheless, the provisions are in the form of a limitation on the power to tax and do not prevent other methods of allocation and apportionment as long as the limit is not exceeded.

Although uniformity is important as a protection against overtaxation, it is even more important that multistate taxpayers be fairly treated and, at the very least, that they have all of the protections afforded by the due process requirement of the Fourteenth Amendment. Indeed, any provisions concerning allocation and apportionment must adhere to concepts of due process for it is without the power of the Congress to encroach on the protections afforded by the Fourteenth Amendment. It is equally important that the allocation and apportionment provisions do not go beyond the power of the Congress to restrict the power of the states to tax under the guise of regulating interstate commerce. If the states are taxing local incidents, even though engaged in by a multistate business enterprise, it is doubtful that the Congress can restrict such taxation. If a federal bill attempts to restrict a state in the amount of income it may subject to tax in favor of another state and the restriction on the first state fails on constitutional grounds, multistate business will be taxed on a part of its income in more than one state. This possibility is discussed in more detail in that part of the statement dealing with the treatment of dividend income.

Limiting the amount of income or capital which a taxing jurisdiction may subject to tax will protect the multistate taxpayer against overtaxation and duplicative taxation, will clarify the limits of due process with respect to taxation of income derived from sources outside the taxing jurisdiction or of extraterritorial values, will lessen the possibility of discriminatory treatment of out-of-state taxpayers, will provide a measure of certainly (particularly with respect to maximum tax liability) and will materially reduce the burden of litigation to resolve doubtful applications of state tax laws which otherwise would exceed the boundaries of due process or result in overtaxation.

Certain guidelines should be followed in drafting allocation and apportionment provisions. Such provisions should lend themselves to ease of enforcement and compliance so that the least amount of interpretive effort is required. They should be neutral in their effect on different types of business enterprises and should not

[10] "Developments in the Law-Federal Limitations on State Taxation of Interstate Business" 75 *Harvard Law Review* 961-2, (1962).

discriminate between corporate taxpayers. They should distribute fairly the tax burden of the state (or other taxing jurisdiction) among the corporate taxpayers having a presence, conducting activities or owning property within the borders of the state (or other taxing jurisdictions). Manipulation and avoidance schemes by taxpayers should be made as difficult as possible and, hopefully, impossible. Whatever method is adopted should be the least disruptive of existing state laws and practices.

B. THE NEED FOR LIMITS ON AMOUNTS OF INCOME OR CAPITAL ATTRIBUTABLE TO A TAXING JURISDICTION

Federal legislation must include provisions limiting the maximum amount of income or capital attributable to the taxing jurisdiction. The present systems of allocation and apportionment in state taxation result in uncertainty, overtaxation and duplicative taxation, excessive compliance burdens, and an inefficient allocation of economic resources by reason of inefficient and unsound business practices that are required in order to avoid excessive taxes.

1. Uncertainty

A great deal of uncertainty exists today because the states cannot agree on a common interpretation of the Uniform Division of Income for Tax Purposes Act. The Uniform Act was drafted by the Commissioners on Uniform State Laws in 1957 upon consultation with representatives from the states and the business community. It was intended to reflect what had come to be generally accepted practices among the states with respect to allocation and apportionment of income for tax purposes.[11] Accordingly, sections 4 through 8 provide for specific allocation of rents, capital gains, interest, dividends and royalties to the extent that they constitute "non-business income." "Non-business income" is defined as all income other than "business income" and the definition of "business income" is an extraction from California decisional law.[12] It is quite clear from the material which bears on the intent of the Commissioners and those who participated in the drafting of the Act that the enumerated types of income would generally be assigned under the provisions of sections 4 through 8 but that in the less usual situations where such types of income could not be readily segregated from the "business income" of the taxpayer and more logically should be included with the "business income," they would be apportioned by formula.[13]

The Uniform Act, or its equivalent, is in effect in a majority of states including 20 of the 21 member states of the Multistate Tax Compact.[14] The Compact emerged in 1967 as a product of the Council of State Governments and the National Association of Tax Administrators. It was intended to bring uniformity and certainty to systems of allocation and apportionment in state income tax laws. The same motive prompted the adoption of the Uniform Act by the states. The impetus for the movement among the states toward uniformity and certainty was the Report of the Special Subcommittee on State Taxation of Interstate Commerce of the House Judiciary Committee (the Willis Committee) in 1964.[15]

The Report described the various attempts to achieve uniformity and noted their failure:

"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. Efforts over many years have failed to achieve any marked degree of acceptance of uniformity of tax base or division-of-income rules. The result has been that highly regarded State tax administrators have themselves concluded that if uniformity is to be achieved, it can be done only by Federal action." [16]

It is an unfortunate fact that the enactment of the Uniform Act and the adoption of the Multistate Tax Compact by a significant number of states have not brought about uniformity and certainty with respect to the allocation and apportionment of income. Of particular importance to multistate business is the distinction between income to be specifically allocated ("non-business income") and income to be apportioned by formula ("business income"). There has been no

[11] Pierce: "The Uniform Division of Income for State Tax Purposes," 35 *Taxes Magazine*, No. 10, 749 (1957).
[12] Peters: "The Distinction Between Business Income and Non-Business Income," 1973 *So. Calif. Tax Inst.* 251.
[13] *Ibid.*, p. 272 et seq.
[14] Article IV of the Compact Act adopts the Uniform Act as the Compact's rules concerning apportionment and allocation. Florida, while a member of the Compact, adopted a new corporate income tax law which repealed Article IV of the Compact.
[15] House Report No. 1480, 88th Cong., 2nd Sess. (1964).
[16] *Ibid.* p. 133.

consistency among the states or state associations or commissions in the application of the distinction between "non-business income" and "business income" as the following instances will show.

Although the Multistate Tax Compact came into being in 1967 and a Multistate Tax Commission was created and given authority to adopt uniform regulations, the Commission had not proposed uniform regulations as of April 1970 when the State of Illinois published proposed regulations under its Income Tax Act. The Illinois Act included the allocation and apportionment provisions of the Uniform Act. Those proposed regulations construed the definition of "business income" to include virtually all income. Only in rare instances would income of the types to be specifically allocated under the Uniform Act not be apportioned by formula. The regulations did not take into account the legislative history of the Uniform Act.[17] Indeed, the authors of the regulations were unaware of that legislative history.

At about the time the State of Illinois was drafting regulations, the National Association of Tax Administrators (NATA) was engaged in the same task. At its annual meeting in Detroit in June of 1970, it released proposed regulations under the Uniform Act for consideration by the states. These proposed regulations differed significantly from the Illinois regulations but heavily favored apportionment of income in distinction to specific allocation under sections 4 through 8 of the Uniform Act. These regulations were eventually adopted by California, Oregon and Kentucky. Meanwhile, Illinois adopted its proposed regulations without substantial change.

In December 1971, the State of Indiana adopted regulations which followed rather closely the intent of the drafters of the Uniform Act. These regulations differ significantly from the Illinois regulations and those proposed by NATA with respect to the distinction between "non-business income" and "business income."

The Multistate Tax Commission established a Rules and Regulations Committee which worked closely with the NATA Regulations Committee. The Committee submitted regulations identical to those proposed by NATA to representatives of the member states for adoption. Hearings were held and the Hearing Officer recommended drastically different regulations with respect to the definition of "non-business income" and "business income." Again, the legislative history of the Uniform Act was ignored and reliance was placed on concepts in the Internal Revenue Code having to do with deductions and having nothing to do with allocation and apportionment of net income. At its meeting in September of 1971 (four years after the Compact had been in effect), the member states adopted uniform regulations which followed the recommendations of the Hearing Officer. The turmoil which this created is evident from the report of the Multistate Tax Commission describing the impact of the action taken by the member states.

"The vote appeared to constitute a stunning victory for the philosophy that all of a corporation's taxable income is 'business income' and should, therefore, be apportioned. The new regulations shift to the taxpayer corporation the burden of establishing why, under the Uniform Division of Income for Tax Purposes Act (UDITPA), any of its income should be considered to be 'non-business income' and, therefore, allocable to the state of the corporation's commercial domicile. The Multistate Tax Compact includes UDITPA in its entirety.

"In contrast to the regulations which were approved by the Commission, the proposal of the Rules and Regulations Committee accepted the position that, under UDITPA, certain of a corporation's income is 'business income' and certain of it is 'non-business income;' that the former is apportionable and the latter is allocable. In taking this position, the Committee believed that it was reflecting the interpretation of UDITPA which can generally be expected from the courts. The Hearing Officer disagreed with them on this score and the Commission supported him. Of course, the possibility exists that some courts will object that the regulations do not interpret the statute correctly." [18]

In a letter dated September 24, 1971 to the members of the Ad Hoc Committee drafting federal legislation, Eugene Corrigan, Executive Director of the Multistate Tax Commission, noted the adoption of the "full apportionment" concept in the Commission's regulations. He stated:

"While none of you apparently like to see full apportionment of all corporate taxable income, many of you on the business as well as the state side are concerned

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[17] Sarver and Hynes: "Proposal For a Uniform Regulation on Business Income Under UDITPA," 22 *The Hastings Law Journal* 31 (1970).

[18] *Multistate Tax Newsletter*, No. 30, September 1971.

about the problems which may arise legally in making the *change*." (emphasis added)

The States of Alaska, North Dakota and, perhaps, Idaho adopted the Multistate Tax Commission regulations. At this point in time, multistate business was faced with four different applications of the definition of "non-business income" and "business income" in the Uniform Act, but that is not the end of the story.

In February 1973, the Multistate Tax Commission revised its regulations. Although the revised regulations are closer to the NATA regulations than those originally adopted, there are still significant differences. California has adopted the revised Multistate Tax Commission regulations with one notable exception involving dividend income. North Dakota and several other states have initiated steps to adopt the revised Multistate Tax Commission regulations. It is impossible to tell how many of the states will adopt the revised Multistate Tax Commission regulations or when they may do so.

Thus, in the period of time since the Willis Committee completed its comprehensive study there has been increased confusion, diversity and uncertainty. Concepts of allocation and apportionment are extremely important to the multistate business enterprise and the failure of the states to adhere to traditional concepts founded on constitutional principles and grounded on the determination of source of income has placed a heavy burden on interstate commerce. It is impossible, in many instances, to advise a multistate business on the proper way to allocate or apportion income for state tax purposes with any degree of assurance that the state will accept the method used in the tax return. The inclusion in a federal bill of allocation and apportionment provisions which operate as a limit on the amount of income which can be attributed to a taxing jurisdiction will reduce the uncertainty presently existing to manageable proportions.

2. Overtaxation and duplicative taxation

Overtaxation (or undertaxation) is implicit in the different methods of allocation and apportionment adopted by the states. The multistate business finds itself caught between different basic approaches to allocation and apportionment. For example, a number of states have established their right to tax all dividend income received by corporate taxpayers having a domicile within the state.[19] Under the MTC regulations, this same dividend income would be subject to formula apportionment and to tax in all states in which the recipient corporation is doing business.

There are not only differences between the states with respect to what is "non-business income" and "business income" under the Uniform Act but also in the application of the Act to related corporations. In *Chase Brass & Copper Company, Inc.* v. *Franchise Tax Board*, 10 Cal. App. 3d, 496 (1st Dist.), *cert. denied*, 400 U.S. 961 (1970), the California Supreme Court upheld the imposition of a combined report for the purpose of ascertaining the income tax liability of Chase Brass (a subsidiary of Kennecott Copper Corporation) which included the business income and apportionment factors of Kennecott and certain of its subsidiaries, while the Utah Supreme Court upheld a refusal to permit a similar report in Utah by Kennecott and permitted the State Tax Commission to use a separate accounting approach that treated one division of Kennecott as the taxpayer for Utah income tax purposes. *Kennecott Copper Corporation* v. *State Tax Commission*, 27 Utah 2d 119, *cert denied*, 93 S. Ct. 323 (1972). The Supreme Court of the United States refused to intercede in spite of a representation in the Jurisdictional Statement of Kennecott to the effect that it was being taxed on more than 100% of its net income. Its refusal, no doubt, was due to the fact that the Court considered each method reasonable under the circumstances of the situation in each state, although the methods were not compatible with each other. As stated by Justice Frankfurter in his dissent in *Northwestern States Portland Cement Company* v. *Minnesota*, 358 U.S. 450, 476 (1959), "The problem calls for solution by devising a Congressional policy."

The Supreme Court also refused to review *Commonwealth* v. *Emhart Corporation*, 443 Pa. 397, 278 A. 2d 916 (1971). *cert. denied*, 92 S. Ct. 451 (1971) although the jurisdictional Statement alleged that the gain on the sale of securities which Pennsylvania included in the apportionable base of the Connecticut-domiciled taxpayer had been taxed in full by Connecticut on the theory that it did not represent business income.

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[19] Opinion of the Attorney General, 1 CCH North Carolina Tax Cases, 201-470; *Southern Pacific Co.* v. *McColgan*, 68 Cal. App. 2d 48, 156 P. 2d 81 (1945). *Cf. Atlantic Coast Line R.R. Co.* v. *Kentucky*, 302 Ky. 36, 193 S.W. 2d 749 (1946); *California Packing Corp.* v. *State Tax Commission*, 97 Utah 367, 93 P. 2d 463 (1939).

In addition to the diversity that exists with respect to the interpretation and application of the Uniform Act, there is still considerable diversity in state income tax laws. As we have noted, a number of states adopted the Uniform Act following the congressional study of state taxation of interstate commerce. More recently, there has been a trend away from the adoption of the Uniform Act in state income tax laws. Florida enacted a corporate net income tax law which adopts the full apportionment concept and contains a sales factor, which is weighted more heavily than the other factors of the formula. Ohio's recent corporate income tax law recognizes the federal dividend received deduction but apportions some dividend income. Wisconsin has just revised the sales factor of its corporation income tax law to provide for a method of assigning sales (other than of tangible personal property) contrary to the method prescribed by the Uniform Act and giving more weight to the sales factor than the other factors of the formula. Income tax laws have been approved by legislatures in New Hampshire and Washington which do not contain the distinction between "non-business income" and "business income" found in the Uniform Act. The Washington Act will not become effective unless the voters approve a constitutional amendment to authorize an income tax at the November 1973 elections.

There has been no attempt at uniformity in the apportionment of capital values for capital stock tax purposes similar to that with respect to income for state income tax purposes. As might be expected, there is considerable diversity in the formulas prescribed by state capital stock tax laws. As a result, there is the same potential for overtaxation and undertaxation inherent in this situation as there is with respect to state income taxation. The fact that many state capital stock tax laws contain a relatively low maximum tax or tax rate and that a number of states do not have such taxes probably accounts for the lack of attention heretofore paid the apportionment provisions is such laws. Also, the privileged nature of capital stock taxes has given them a different history in the development of the law. A Federal bill which contains a prescribed method of apportioning capital values beyond which a taxing jurisdiction may not go will relieve interstate commerce of the specter of overtaxation and will result in greater uniformity. It may be noted here that the multicorporate business enterprise is also faced with duplicative taxation if investments in and advancements to subsidiary or affiliated corporations are included in the capital stock tax base.

3. Unsound business practices

The attempt by some states to tax an apportioned part of dividends received by an out-of-state corporate taxpayer from a subsidiary corporation will have a profound effect on the way in which a multicorporate business enterprise is structured. Such a business will find it extremely beneficial to conduct its business in those states by means of separate subsidiaries which will have no dividend income to be taxed. It will give rise to the creation of pure holding companies in states that do not tax dividends for the limited purpose of receiving dividends from subsidiaries and investments. Multicorporate businesses may have to resort to filing consolidated returns as the only viable way to avoid an exorbitant tax burden thereby "impelling an unwarranted increase in the filing of consolidated returns" with all of the difficulties and inequities that such returns create.[20] On the other hand, if a multicorporate business cannot arrange its business affairs in order to reduce the duplicative effect of dividend taxation, it will find itself subject to a heavy and discriminatory tax burden. The present state of affairs lends itself to inefficient allocation of resources.

It is perfectly natural for a state to adopt a tax system that minimizes the impact on its citizens and, in effect, exports its tax burden. The incidence of taxation of dividend income or foreign source income of a multistate or multinational business will be distributed far beyond the borders of the state imposing the tax and will affect residents very little. The resulting shift in the state's tax burden may be desirable from she state's point of view but it is not in the national interest as evidenced by the manner in which those items of income are treated under the Internal Revenue Code. In order to minimize the deleterious effect of state taxation of intercorporate dividends, whether from domestic or foreign sources, this income should not be taxed at all but if taxed should be allocated to the state of the recipient's domicile.

[20] Review and Status Report on Interstate Taxation Bills Pending in *Congress*. Paper prepared for National Association of Tax Administrators Annual Meeting, June 14, 1973, in Atlantic City by Owen La Clarke, Deputy Commissioner of Massachusetts Department of Corporations and Taxation.

4. Compliance costs

State income and capital stock taxes are providing an increasingly large share of tax revenues, with an increasing number of states imposing such taxes. The magnitude of these taxes indicates the high cost to taxpayers and the burden on interstate commerce caused by diverse interpretations of tax laws, inconsistency in administration, and overzealous enforcement of inequitable tax laws. An example is the enforcement of "throwback" provisions contained in the sales factor of some tax laws which present serious compliance and enforcement problems. The amounts involved in litigation before the courts today and in the assessments outstanding against multistate businesses bear mute testimony to the seriousness of this situation.

It is not possible to determine precisely the costs associated with the problems described above or to measure the economic impact those costs might have upon interstate commerce. Indeed, we may not be able to do so until it is too late and a proliferation and aggravation of the problems discussed above together with increasingly sharp foreign competition create a crisis for United States businesses. Few municipalities or other units of local government impose income taxes or capital stock taxes today. There is no reason why they might not do so in the future and all of the problems described above will be aggravated many times if that should come to pass. In the final analysis, the key question is whether the Congress is willing to permit the present condition in which interstate commerce must operate—a situation which is both chaotic and unpredictable—to continue; or whether the Congress will take this opportunity to create an orderly system of state taxation of interstate commerce.

C. HOW SHOULD LIMITS ON THE AMOUNT OF INCOME OR CAPITAL ATTRIBUTABLE TO A TAXING JURISDICTION BE DETERMINED?

The attributes which well-drafted allocation and apportionment provisions should have are set forth in the General Comments at the beginning of this section. Allocation and apportionment provisions afford the multistate taxpayer the protection of due process and comport with generally accepted concepts of fairness and equity. Due process is satisfied if there is a discernible connection, between the income or capital attributed to a taxing jurisdiction and the presence, activities or property of the taxpayer within the boundaries of the taxing jurisdiction. If the method of attributing income or capital does not fulfill this requirement, there is taxation of extraterritorial values or events. While the measure of a tax is subject to less scrutiny when a franchise fee is involved, the policy consequences pertinent to franchise taxes are irrelevant to the proper limitations under a federal bill governing all state income and capital stock taxes. If extraterritorial values or unrelated income are attributed to a taxing jurisdiction, the taxpayer is being subjected to taxation without representation with all of the consequent harm resulting from such a situation.

It has been generally accepted that the income and capital values of a corporation may be attributed to a taxing jurisdiction by means of a formula. This is admittedly a rough measure of the income or capital values having a source or location in the taxing jurisdiction. In the absence of federal legislation, many different apportionment schemes have been permitted by the Courts. Nevertheless, the outer limits of permissible attribution have been set by the Courts. A profit which is the end result of a series of interrelated activities, such as purchase of raw materials, manufacturing and sale to wholesalers, is appropriately attributed to a taxing jurisdiction by means of a formula whose factors reflect the income-producing elements of the profit realized. Income from investment activities presents a more difficult problem of attribution. Courts have taken different approaches to the attribution of rents, royalties, interest and dividends. This subject will be explored further in the discussion of the treatment of dividend income.

As a general proposition, attribution by means of formulary apportionment should comply with two fundamental principles: (1) there should be a relationship between the income or capital being apportioned and the factors of the apportionment formula; and (2) the factors of the apportionment formula should represent the activities or property of the taxpayer in the taxing jurisdiction. If the concept of source of income is adopted, due process is afforded the taxpayer and the criteria of appropriate attribution by formula will be met. To the extent that source of income is not recognized, there will be a departure from the principles outlined above and, if severe enough, a violation of due process.

The allocation and apportionment provisions of Title II of S. 1245 satisfy the criteria for appropriate limits on the amount of income or capital attributable to a

taxing jurisdiction. The formula prescribed is one in common usage today in state income tax laws. Its application to capital stock taxes may be somewhat more controversial. A serious problem is avoided in this regard if there is little likelihood that there will be any significant amount of intangibles in the capital stock tax base. For this reason, S. 1245 excludes investments in and advancements to subsidiary and affiliated corporations—the major item of intangibles in many corporate taxpayers' balance sheets.

S. 1245 describes an optional three-factor formula to be applied to a corporation's apportionable income, or to its entire capital (reduced by investments in and advancements to subsidiaries and affiliated corporations) as determined under state law for the valuation date at or after the close of the taxable year. In the case of a tax measured by income, the limit on the amount of income attributable to a taxing jurisdiction includes the amount of income apportioned to it by the formula and, in addition, income allocable to it. Apportionable income does not include foreign source income and dividend income (dividend income will be treated as apportionable income if the taxpayer's principal business activity is dealing in securities). Dividend income, other than that which constitutes foreign source income, received from corporations in which the taxpayer owns less than 50% of the voting stock is considered allocable income and will be allocated to the state of commercial domicile of the taxpayer receiving such income.

The property factor is limited to the average value of the corporation's real and tangible personal property owned and used, or rented and used, during the taxable year and located in the United States. Owned property is valued at its original cost. Rented property is valued at eight times the net rents payable during the taxable year. Property leased to others is excluded. Inventory is included. The location of movable property is determined in accordance with rules set out in section 514 of the Act. These rules are identical to those suggested by the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary in House Report No. 952, 89 Cong., 1st Session.

The payroll factor includes wages as defined for purposes of the Federal Unemployment Tax Act paid to employees located in the United States. The location of an employee for purposes of computing the amount of wages paid in a state is determined under the provisions of section 515 of the Act. Those provisions were adopted from the Model Unemployment Compensation Act which has been enacted in all the states so that a taxpayer will have readily available data to compute its payroll factor in any state.

The sales factor includes receipts from all sales and from the rental of tangible personal property. Sales of tangible personal property are assigned on a destination basis. Sales, other than sales of tangible personal property are assigned by reference to the income-producing activity. Rental receipts are assigned to the state in which the property is located. Only sales within the United States are included.

If the denominator of any factor is zero, that factor is disregarded in computing the apportionment fraction. If the denominators of all factors are zero, then all income is assigned to the state where the corporation has its business location.

Section 207(b) provides for adjustment of the apportionment factors to include property, payroll and sales attributable to sales of tangible personal property having an ultimate destination outside the United States if income from such sales is included in the apportionable base.

The most controversial aspects of the allocation and apportionment provisions of S. 1245 are those concerning the allocation of certain dividend income and the definition of the sales factor. This discussion will be limited to those two aspects of the bill with a few comments on the problem of rigidity that is inherent in the prescription of a formula to be applied to many different kinds of business.

In S. 1245, that dividend income which is subject to state income taxation (dividends other than certain dividends constituting income from sources outside the United State and dividends from domestic corporations in which the taxpayer owns less than 50 percent of the voting stock) are specifically assigned to the state of commercial domicile.

There are several reasons why this method of assigning dividends appears to be appropriate. First, such income can be readily accounted for separately. Second, the activities which produce such dividend income normally take place at the taxpayer's headquarters, i.e., in the state of taxpayer's commercial domicile. Third, such dividend income typically has little or no economic connection with the states in which the business assets and activities of the taxpayer are located. More specifically, such income is not related to the three factors of the prescribed apportionment formula because such income is not the product of the tangible

property used in the production or sale of the taxpayer's goods or services; very little, if any, of the taxpayer's payroll is associated with it; and there is seldom any relation to the state of destination of the goods or services generated by the taxpayer's direct business operations. Dividend income traditionally has been specifically allocated on a situs basis by state income tax laws, and it has been recognized by the courts that the state of commercial domicile has a strong claim to the taxation of dividend income.[21]

Although the Congress has full and complete power to regulate interstate commerce and this power has been broadly interpreted in other areas, such as labor relations,[22] different considerations are present when the taxing power of the states is involved. If taxation of dividend income received by one corporation from another is not of itself an impediment to interstate commerce, it is difficult to understand upon what basis of national interest a state in which a corporate taxpayer maintains its commercial domicile may be forbidden to tax all of the dividend income received by that corporation. Indeed, the state of commercial domicile in which the investments giving rise to the dividend income are managed and controlled is best able to support its taxation of such income on a valid economic foundation and in accord with the basic justifications for governmental taxing power. Congress should not attempt to restrict this taxing power of the state of commercial domicile except for strong and convincing reasons. It is submitted that no such reasons exist.

Assignment of all such income to the state of commercial domicile by the proposed federal statute will avoid Constitutional problems raised by the attempts of other states to tax portions of the same income or by the denial of the right of the state of commercial domicile to tax all of such income. Since attribution to the state of commercial domicile has been the general practice among the states until very recently, such treatment of dividend income by S. 1245 would not seriously affect state income tax revenues.[23]

The definition of the sales factor in S. 1245 includes the total sales of the taxpayer within the United States during the taxable year. Sales include receipts from the rental of tangible personal property. There is no question but what a sales factor should include receipts from all sales made in the ordinary course of business. Also, it is logical to include rental receipts. There does not appear, however, to be any basis for distinguishing between receipts from the rental of tangible personal property and from the rental of real property.

A more difficult problem is presented with respect to receipts from the investment of intangible property. In one sense, interest is the rent one receives for the use of his money and should be treated no differently than receipts from the rental of tangible personal and real property. Receipts from sales of intangibles should be included if intangibles are regularly sold by the taxpayer. Royalties and dividends, to the extent included in the apportionable base, should be included in the receipts factor. The problem is locating receipts from intangibles within and without the taxing jurisdiction. If the policy is to apportion such income, then the specific assignment of such income for purposes of developing the receipts factor counters the effect of including such income in the apportionable base.

The problem is essentially what to include in the apportionable base, rather than how to assign income in the receipts factor. If it is decided to apportion interest, royalties and dividends, then it must be determined that such types of income are appropriately assigned to a taxing jurisdiction on the basis of a taxpayer's tangible business assets, payroll and receipts from sales of its products or services. For the many reasons set out above, it is believed that dividend income cannot be appropriately assigned by means of a formula. The business community has reservations about the appropriateness of assigning interest, capital gains and royalties by formula but is willing to accept formulary apportionment of such types of income because they are more difficult to segregate and they will not likely represent a relatively significant amount of income to the taxpayer.

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[21] Cases cited in note 8. Also, 1941 Opinion of Attorney General of Louisiana, P-II State & Local Taxes (Louisiana 13,062); *Gulf Oil Corp.* v. *Clayton*, 267 N.C. 15,147 S.E. 2d 522 (1966); *Square D Company* v. *Ky. Bd. of Tax Appeals*, 415 S.W. 2d 594 (1967).

[22] *United States* v. *Darby*, 312 U.S. 100 (1941).

[23] The exclusion of intercorporate dividends with respect to subsidiaries will have a revenue effect in the few states that now tax such dividends, such as California, but that state has traditionally followed the practice of allocating dividend income to the state of taxpayer's commercial domicile. As to the general practice with respect to allocating dividend income, see Cohen, "Apportionment and Allocation Formulae and Factors Used by States in Levying Taxes Based on or Measured by Net Income, etc.: A Research Report Prepared for Controllership Foundation, Inc." (1954), and *Humble Oil & Refining Co.* v. *Calvert* (Tex. Civ. App.), 414 S.W. 2d 172 (1967).

The sales factor in S. 1245 includes sales of real property as well as intangible property. These sales, however, are assigned to a state based upon the place where the income-producing activity is performed. Sales of real property logically should be located in the state in which the real property is located. The location of the income-producing activity may cause some difficulty with respect to sales of intangible property and it may be desirable to define more precisely the location of such sales.

The sales factor in S. 1245 does not include a "throwback" provision. Sales of tangible personal property are on a straight destination basis. A "throwback" provision requires sales to be reported to the state from which the property was shipped if either (1) the taxpayer is not taxable in the state of the purchaser, or (2) the purchaser is the United States Government.

In attempting to determine for each state how much of the taxpayer's income is attributable to that state, the philosophy should be to measure the activities being performed in that state which help generate the income—and *not* the activities of the taxpayer in some other state. For example, it does not seem appropriate that less income should be assigned to State A for 1973 compared to the amount assigned for 1972 if the taxpayer's activities in State A were exactly the same in both years but, because of additional activities in State B, the taxpayer became subject to the jurisdiction of State B during 1973. This is exactly what would happen if State A had the so-called "throwback" provision and a taxpayer who previously was not subject to the jurisdiction of State B to which he shipped did become subject to that state's jurisdiction.

The utilization of a "throwback" provision would also encourage taxpayers to adopt uneconomic routing procedures in order to minimize their taxes. For example, with the existing state tax rates, a taxpayer who has substantial foreign shipments might well find it economical to transfer all shipments to a place of business in a low-tax state and then make all of these shipments to his foreign customers from that state. Also, the use of a "throwback" or "recapture" provision increases the administrative complexities because of the dual test with most sales on a destination basis but others on an origin basis. These practical problems were recognized by the Special Subcommittee on State Taxation of Interstate Commerce. On page 244 of Volume I of their report they stated that:

"It should also be observed that the existing throwback rules add to the complexity of the system even if their applicability is clear. When a throwback rule applies, it will normally require the taxpayer to develop data in addition to that needed to comply with the primary division-of-income rules of the taxing State. When a destination State requires that certain sales be thrown back to the State of origin, for example, the taxpayer is required to determine the point of origin of each transaction subject to the throwback. The development of such information may materially increase the burden of compliance."

With respect to foreign sales, there is considerably less justification for a sales recapture provision because the tax laws in foreign countries are entirely different from those in the United States and P.L. 86–272 has no meaning in these foreign countries. There is nothing to prevent a foreign country from levying a tax strictly based on the fact that the shipment was made into that foreign country. In other words, the foreign country has the right to levy a tax if it so chooses, regardless of order activity, place of business, etc. Further, we believe it is in the national interest to encourage the exportation of products and the exclusion of foreign destination sales from the "throwback" rule does offer such encouragement. It should be noted that the property and payroll factors will still work to apportion a substantial part of the income from such export sales to the various states. Apparently those who worked on the Ad Hoc Bill (S. 2092) recognized many of these considerations and, therefore, that bill provides that there would be no "throwback" provision for foreign shipments, other than sales to the United States Government. In the analysis supporting the Ad Hoc Bill, the following comments were made concerning the "throwback" rule as it might apply to foreign shipments:

" . . . Export sales, however, other than export sales to the U.S. Government, are assigned to the foreign destination. . . . The "throwback" provisions properly apply where the nationally imposed jurisdictional standards prevent the destination state from imposing tax, but such justification is lacking where sales have a destination in foreign countries, since such countries are subject neither to the jurisdictional standards nor the uniform apportionment formula imposed on the states."

It is safe to predict that the administrative problems both for the states and taxpayers will be increased substantially and numerous disputes will arise if a "throw-back" rule is adopted with respect to foreign shipments.

As to sales to the U.S. Government, there appears little justification for assigning such sales to the state from which they were shipped. This is true, particularly, when viewed from the standpoint of the many administrative complexities that result from a sales test which would require the accounting for some sales on a destination basis and others on an origin basis. It might be argued that sales to the United States Government differ from commercial sales in that more of them are transacted in Washington, D.C. or at the taxpayer's principal place of business. However, if such were the argument, then an order-activity type test would seem more appropriate than a point-of-shipment basis. On balance, however, the exception in treatment for sales to the United States Government does not seem to justify the administrative problems.

It should also be noted that a number of states, in adopting their laws, have not included the sales "recapture" provision, but rather have enacted a straight destination sales test.

There is rigidity in the prescribing of a formula in definite and specific terms and it may be that difficulty will arise in applying the prescribed formula to every type of business covered by the bill. This is a matter which needs further study. Such a study should not in any way delay prompt Congressional action.

D. STATE TAXATION OF DIVIDENDS AND FOREIGN SOURCE INCOME

The multicorporate business enterprise is also faced with duplicative taxation when states subject intercorporate dividends and foreign source income to taxation. Although few states that have any number of multicorporate and multinational businesses headquartered within their boundaries have subjected intercorporate dividends (particularly from subsidiaries) and foreign source income to taxation, the trend toward apportionment of dividend and foreign source income is likely to change this situation. It should be noted here that the result of such taxation by the states is the obstruction of the free flow of funds between affiliated corporations, unwieldly capital structures for subsidiaries, and the subjection of a single economic gain within an affiliated group to multiple taxation. The transfer of funds up a chain of affiliated corporations usually does not result in a change in beneficial ownership and should not be considered taxable events. There is also the matter of discrimination. State income tax laws should be neutral as far as the form which a business enterprise takes is concerned and should not penalize multicorporate enterprises unless there are sound reasons for discouraging multiple corporations. It is not practicable for some businesses to operate as a single corporate entity and the Congress should protect them against discriminatory taxation that requires them to bear a disproportionate share of a state's tax burden.[24]

Recognizing constitutional limitations, it is often the expressed intent of state income tax laws to tax only that income derived from sources within that state.[25] However, some of these same states are reaching well beyond that scope and taxing foreign source income by either taxing the foreign source dividends received by a taxpayer or, alternatively, by requiring that the income of foreign companies be included in the state's apportionable tax base, whether or not such income has been received by the taxpayer in the form of dividends.

In the view of many taxpayers, state taxation of dividends and foreign source income are the two most important elements in the current controversy in state taxation. It is also the view of many taxpayers that the sections of S. 1245 dealing with these items of income are needed to make state tax requirements compatible with present Internal Revenue provisions dealing with these types of income at the federal level.

In regard to the taxation of income, states generally take a different approach to the determination of the source of the income than does the Federal Government:

(1) States generally do not have provisions in their income tax laws comparable to those contained in Subchapter N of the Internal Revenue Code, which are generally known as the sourcing sections of the Code.

(2) Another important difference between state and federal tax rules is the fact that only one state (Alaska) provides a mechanism similar to the foreign tax credit provisions contained in Sections 901 through 906 of the Internal Revenue

[24] The Report of Hearings before the Committee on Finance, U.S. Senate, on H.R. 8300, 83rd Congress, Second Session, pages 1975–6, with respect to removal of 2 percent tax on consolidated returns of regulated public utilities.

[25] Section 63-3002 Idaho Income Tax Act, "Declaration of intent. It is the intent of the legislature by the adoption of this act . . . to impose a tax on . . . the income of non-residents which is the result of activity within or derived from sources within this state."

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Code. In fact, many states do not even provide a deduction for foreign taxes paid.

(3) A few states aggregate further the burden upon taxpayers in regard to foreign source income by invoking the so-called unitary business concept of taxation. Under this concept, income of domestic companies related to a taxpayer with a business location in the state by application of a 50% ownership test will be included in that taxpayer's income base to be apportioned to the state. The same is true of foreign companies whether or not their income has actually been distributed in the form of dividends.

(4) Additionally, some state laws do not provide for the elimination of "gross-up" from the federal starting point in arriving at state income tax base. Since the amount "grossed-up" is equivalent to foreign taxes paid before the payment of dividends and is included in the Internal Revenue Code merely as a mechanism for arriving at the proper amount of income to which the foreign tax credit will apply, the inclusion of "gross-up" in state tax bases can result in the taxation of fictitious income.

It is the foregoing differences between the federal and state tax rules which create the need for compatibility, which can be achieved by the enactment of an Interstate Taxation Act by the Congress. We feel that it is within the power of Congress to act in this area because of the authority vested in it by Article I, Section 8, Clause C of the U.S. Constitution. Moreover, state taxation of foreign source income improperly injects the states into foreign policy, which is the sole jurisdiction of the Federal Government.

Section 207(a)(1) of S. 1245 prohibits the inclusion in "apportionable income" of income from sources without the United States, including dividend income. The prohibition against the apportionment of foreign source income, coupled with the prohibition against allocating such income in Section 208, results in a total exclusion from the tax base of income earned outside the United States. It is important to note that, by virtue of Section 522, the income to be excluded is that to which the foreign tax credit provisions of the Internal Revenue Code presently apply. Most states have not attempted to tax this income but, because of the actions of a relatively few states, the S. 1245 prohibitions regarding foreign source income are necessary.

Section 207(a)(2) excludes all dividends, regardless of source, from apportionable income unless the taxpayer's principal business activity is dealing in securities. Indirect taxation of dividends, such as through the California "interest offset provision," is also forbidden. The purpose of this exclusion is the elimination of double taxation by one or more states, and to make clear as to a single state that having taxed the earnings of a corporation, it cannot again tax those earnings as dividends to an affiliate. Thus, dividends from foreign sources and dividends from corporations in which the taxpayer owns 50 percent or more of the voting stock are not allocable to any state. However, by virtue of Section 208, "portfolio dividends," i.e., those from less than 50 percent-owned corporations, are allocable to the state of commercial domicile and that state will determine whether or not it desires to tax them.

The combined result of Sections 207 and 208 is to exclude from the tax base all dividends from affiliated corporations. This, too, is compatible with the taxation of inter-company dividends under the Internal Revenue Code. Under the Internal Revenue Code dividends passed among a consolidated group of U.S. corporations affiliated by stock ownership of at least eighty percent are eliminated from the tax base. To the extent that there is less than an eighty percent ownership of one U.S. corporation by another, eighty-five percent of the dividend income is eliminated by virtue of Internal Revenue Code Section 243 (dividend received credit). In the case of dividends from foreign affiliates, the tax on such dividend income is largely, if not wholly, eliminated by the foreign tax credit.

At this point, it may be beneficial to present, by way of an hypothetical example, a comparison of the different approaches to taxation of dividends and foreign source income now prevalent among the various states. In our hypothetical case we have assumed a United States operating company domiciled in New York and also doing business in the states of Michigan, California and Maine. We have assumed that the corporation receives dividends from three wholly-owned foreign subsidiaries whose earnings are completely outside the United States. For the purpose of simplicity in comparing tax burdens in the four states, we have assumed identical operating factors (sales, payroll and property) in these states. Also, we have computed the state taxes at a standard rate of 10 percent, as well as showing the taxes at the actual rates.

The four states selected for our examples represent four different approaches to taxation of foreign source income by the states. The methods used and the resulting

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tax liabilities based on the assumed operating facts and a 10 percent tax in each state follow:

Michigan requires the inclusion of foreign subsidiary dividends in the income base to be apportioned. These foreign dividends are included in the denominator of the sales (receipts) factor in the computation of the apportionment percentage. In the attached example, $923,200 of income is apportioned to Michigan and, with a 10 percent tax rate, the tax liability would be $92,320.

California follows a technique known as the unitary concept, which requires the consolidation of all affiliated companies 50 percent, or more, owned by a common parent. As indicated by the attached example, many taxpayers are presently bearing an unreasonable burden in that state with respect to taxation of foreign source income. Based on the assumed operating facts, $1,485,000 of income is apportioned to California and the tax liability at a 10 percent rate would be $148,500.

Maine follows the practice of allocating dividends, including foreign dividends, to the state of commercial domicile. In the case of the U.S. parent company, which in our example is domiciled in New York, only the parent's domestic operating income would be apportioned to Maine. The apportioned amount under the assumed facts would be $250,000 and the tax at 10 percent would be $25,000. But if the parent company in the example were domiciled in Maine instead of New York, all of the foreign dividends would be included in the income base, together with the $250,000 apportioned operating income of the parent. The result would be a tax of $325,000, based on apportioned and allocated income of $3,250,000 and a 10 percent tax rate.

New York does not tax dividends received from subsidiaries more than 50 per cent owned. Other dividends are taxed in proportion to the payor's business done in New York State. Therefore, although the parent company in our example is domiciled in New York, only its domestic income is taken into the base for apportionment. This produces apportioned income of $250,000 and tax liability of $25,000 at a 10 percent rate.

PARENT COMPANY OPERATING ONLY IN THE UNITED STATES

		Operating in States—Domicile			
	Total	New York	Michigan	California	Maine
Sales by destination	$10,000,000	$2,500,000	$2,500,000	$2,500,000	$2,500,000
Payroll	4,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Property:					
1st cost	8,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Depreciation reserve	4,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Net value	4,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Net income before Federal income tax:					
Operating income	1,000,000				
Foreign source dividends	3,000,000				
Total	4,000,000				

FOREIGN INCORPORATED SUBSIDIARIES—100 PERCENT OWNED-FOREIGN OPERATING

	Subsidiaries—		
	A	B	C
Sales—Foreign destination	$10,000,000	$10,000,000	$10,000,000
Payroll—Foreign	1,000,000	100,000	1,000,000
Property—Foreign:			
1st cost	2,000,000	200,000	1,000,000
Depreciation reserve	1,000,000	100,000	500,000
Net value	1,000,000	100,000	500,000
Net income before foreign income tax	4,000,000	2,000,000	4,000,000
Foreign income tax	2,000,000	1,000,000	
Net after tax income	2,000,000	1,000,000	4,000,000
Dividends paid to parent	1,000,000	1,000,000	1,000,000

FOREIGN INCORPORATED SUBSIDIARIES—100 PERCENT OWNED-FOREIGN OPERATING—Continued

Apportionment fraction	Numerator	Denominator	Percent
MICHIGAN			
Sales—Parent	$2,500,000	$10,000,000	
Dividends:			
Subsidiary A		1,000,000	
Subsidiary B		1,000,000	
Subsidiary C		1,000,000	
Total	2,500,000	13,000,000	19.23
Payroll—Parent	1,000,000	4,000,000	25.00
Property—Parent (gross)	2,000,000	8,000,000	25.00
Total			69.23
Average			23.08
Income base:			
Operating income—Before federal income tax		1,000,000	
Dividends:			
Subsidiary A		1,000,000	
Subsidiary B		1,000,000	
Subsidiary C		1,000,000	
Total		4,000,000	
Apportioned to Michigan at 23.08 percent			$923,200
Tax at 10 percent (hypothetical rate for comparison)			92,320
Tax at actual Michigan tax rate of 7.8 percent			72,010
CALIFORNIA			
Sales—Parent	2,500,000	10,000,000	
Subsidiary A		10,000,000	
Subsidiary B		10,000,000	
Subsidiary C		10,000,000	
Total	2,500,000	40,000,000	6.25
Payroll—Parent	1,000,000	4,000,000	
Subsidiary A		1,000,000	
Subsidiary B		100,000	
Subsidiary C		1,000,000	
Total	1,000,000	6,100,000	16.39
Property—Gross (Parent)	2,000,000	8,000,000	
Subsidiary A		2,000,000	
Subsidiary B		200,000	
Subsidiary C		1,000,000	
Total	2,000,000	11,200,000	17.86
Total			40.50
Average			13.50
Income base:			
Operating income—Before Federal income tax		1,000,000	
Subsidiary A—Income before foreign income tax		4,000,000	
Subsidiary B—Income before foreign income tax		2,000,000	
Subsidiary C—Income before foreign income tax		4,000,000	
Total		11,000,000	
Apportioned to California at 13.50 percent			$1,485,000
Tax at 10 percent (hypothetical rate for comparison)			148,500
Tax at actual California tax rate of 9 percent			133,650
MAINE			
Sales—Parent	2,500,000	10,000,000	25.00
Payroll—Parent	1,000,000	4,000,000	25.00
Property—Parent	2,000,000	8,000,000	25.00
Total			75.00
Average			25.00
Income base:			
Operating—Before Federal income tax			$1,000,000
Apportioned to Maine at 25 percent			250,000
Tax at 10 percent (hypothetical rate for comparison)			25,000
Tax at actual Maine rate of 4 percent			10,000

FOREIGN INCORPORATED SUBSIDIARIES—100 PERCENT OWNED-FOREIGN OPERATING—Continued

Apportionment fraction	Numerator	Denominator	Percent
DOMICILED IN MAINE[1]			
Income base:			
Operating before Federal income tax			1,000,000
Income subject to apportionment			250,000
Dividends to be allocated to Maine:			
Subsidiary A		$1,000,000	
Subsidiary B		1,000,000	
Subsidiary C		1,000,000	
Total		3,000,000	
Apportioned and allocated to Maine			3,250,000
Tax at 10 percent (hypothetical rate for comparison)			325,000
Tax at actual Maine tax rate of 4 percent			130,000
NEW YORK			
Sales—Parent	$2,500,000	10,000,000	25.00
Payroll—Parent	1,000,000	4,000,000	25.00
Property—Parent (net)	1,000,000	4,000,000	25.00
Total			75.00
Average			25.00
Income base:			
Operating income—Before Federal income tax			$1,000,000
Apportioned to New York at 25 percent			250,000
Tax at 10 percent (hypothetical rate for comparison)			25,000
Tax at actual New York State tax rate of 9 percent			22,500

[1] Apportionment fraction same as above.

The effect of these different approaches to taxation of our hypothetical U.S. corporation by the four states may be summarized as follows, using the standard 10 percent tax rate. New York excludes the foreign dividends from the income base as does Maine, with the result that the tax liability in both states would be $25,000. But if the parent were domiciled in Maine instead of New York, the Maine tax would be increased by $300,000 as a result of allocation of $3,000,000 dividends to that state. Because of bringing foreign dividends into the base for apportionment, Michigan's tax is increased by $67,320 above the $25,000 liability which would result with the dividends excluded. By including income of the foreign subsidiaries in applying the unitary concept to the U.S. parent company, California increases the tax liability by $123,500 above the $25,000 liability with foreign income excluded.

Of the above examples, the Michigan approach follows the regulations developed by the Multistate Tax Commission. As member states in the MTC adopt these regulations, they too can be expected to use the Michigan approach. While only Oregon has so far adopted the California unitary business concept, pressures are mounting in several other states to adopt it.

The examples illustrate how our foreign commerce and investment are burdened by state taxation of foreign source income, with the trend being for more and more states to tax such income.

It is the position of those who support S. 1245 that the enactment of sections 207, 208, 209 and 522 of that measure will accomplish the result of eliminating discriminatory taxation of foreign source income and achieving compatibility of state income taxes with federal income taxes under provisions of the Internal Revenue Code.

E. CONSOLIDATION-COMBINED REPORTING

The first step in any discussion of "consolidation" requires that it be reconciled with the phrase "combined reporting." Both terms refer to the joining of the income and factors of more than one related company for the determination of state income. While various distinctions have been made between the terms[26] (e.g., when only the income and factors of taxpayers within a single jurisdiction

[26] As examples: Georgia will permit consolidation only where the companies involved are Georgia taxpayers reporting 100 percent of their income to Georgia and filing consolidated federal income tax returns. California, under similar circumstances, where all taxpayers involved report 100 percent of their income to California, does not permit combined returns. Another example is that California may require a combination of all unitary companies whether organized in the United States or in foreign countries even when only one affiliate may be a taxpayer in California. New York will permit or require combination where there are unitary features between related companies but will confine the combination to companies which are New York taxpayers.

are joined, some states call it "combined reporting" and others "consolidation"), for purposes of this presentation the term "consolidation" is used to describe the concept regardless of scope.

The majority of states have statutes that authorize some degree of consolidation but, as a practical matter, less than a dozen states either require or permit consolidation of any type.

There are four general practices with respect to consolidation. They are:

(1) Prohibited.
(2) Permitted or required.
(3) Required but not permitted.
(4) Permitted but not required.

To the extent, if any, that federal legislation recognizes consolidation, identical options should be available both to taxpayers and states—consolidation must not be a one-way street.

The Willis Committee considered consolidation and made the following recommendations:

THE TREATMENT OF MULTICORPORATE ENTERPRISES

Often corporations which are controlled directly or indirectly by the same interests are so mutually dependent on each other for their success that the books of an individual corporation cannot accurately reflect that corporation's contribution to the profitability of the entire multicorporate enterprise. In short, separate accounting among affiliated corporations is often as inappropriate and as troublesome as is separate accounting among the branches of a single corporate entity. As a result some States have formulated "unitary business" rules designed to treat the income of affiliated corporations in the same manner as though earned by a single business.

The present "unitary business" rules provide vague and sometimes unevenly administered standards for determining when the income of a multicorporate enterprise should be treated as a whole. In order to clarify this troublesome area and to provide standards which are both easy to apply and equitable in their effect the Committee recommends that State tax administrators be allowed to require consolidation in any case where two or more corporations are affiliated by common ties of more than 50 percent of stock ownership and at least one of the affiliates has realty or an employee in the State. Conversely, all such affiliated corporations should have the right to consolidate their income for the purposes of any State's tax. Thus, not only would administrators be able to obviate the inaccuracies that flow from separate accounting among members of a multicorporate group, but the multicorporate enterprise would be able to insist that its total liabilities to all States be no greater than if all of its operations were conducted by a single corporate entity.

CORPORATIONS WHICH OPERATE OUTSIDE OF THE UNITED STATES

In keeping with the basic structure of our Federal system, the Committee is of the view that international tax policy should be formulated by the Federal Government and not by individual States. Therefore, with respect to income earned by corporations which operate either wholly or partially outside of the United States, the Committee recommends that State apportionment rules be required to conform to the international policies that have been formulated for Federal income tax purposes.

Thus, if the immunity of any income from taxation by the United States results from its being considered to be from sources outside the United States, such income could not be attributed to any State of the United States. Likewise, no State would be allowed to require that such income be included in the consolidated income of a multicorporate enterprise for apportionment purposes. These prohibitions apply to corporations incorporated outside of the United States and are designed to eliminate inconsistencies which currently exist between Federal policy and the practice of a few States.

At the same time, if a corporation is considered to have income from sources outside the United States and that income is taxable by the United States, such income could be included in a State's tax base prior to apportionment and the State would not be required to include property or payroll located outside the United States in its apportionment formula. These rules would apply to corporations incorporated in the United States and are designed to make available for apportionment among the States all of the tax base available to the United States.

Before proceeding to consider the available consolidation alternatives, it must be emphasized that the treatment accorded dividends and foreign source income has a controlling effect as to any proposal. If such items are considered taxable to the states then consolidation must be available so that proper factor representation will more accurately affect the assignment of income to the taxing jurisdictions. However, we are strongly opposed to the taxation of dividends and foreign source income.

Assuming, as we believe correct, that such intercorporate dividends and foreign source income are exempt from taxation, then the following alternatives would be available:

The first alternative would be consolidation based solely on ownership. This is the basis in S. 2092. Its asset is simplicity of determination of companies included. Among the strong objections to this procedure are these:

(1) Consolidation would be mandated in every state in which any affiliate of a multicorporate organization is taxable.

(2) In the case of an affiliated group of corporations engaged in diverse businesses, consolidation would join unlike taxpayers with indefensibly distorted results.

(3) Since not a single state has a consolidation procedure based solely on ownership, this type of consolidation would be seriously disruptive of existing tax systems.

(4) This procedure would raise a serious question of constitutional due process since only the single thread of ownership could be offered to support the right to consolidate.

The second alternative would be consolidation based upon the unitary relationship of the consolidated corporations; i.e., only those corporations having an operational interdependence would be included. This unitary concept has the same degree of theoretical justification that applies to the taxation of a corporation with unitary divisions—it differs principally in the legal concept of "piercing the corporate veil." As a practical matter, however, the unitary procedure suffers the following defects:

(1) The determination of the affiliates to be included in the consolidation requires highly informed and sophisticated subjective judgments. This results in:

(a) Complex budget forecasting problems for states and taxpayers.

(b) Potential variances in the consolidated group among the states with attendant disputes resulting in litigation.

(c) Problems resulting from the high degree of sophistication required in making audit determinations involving such a consolidated group. Few, if any, states are currently staffed to perform such audits on a sustainable basis.

(2) Since only two states currently enforce the unitray consolidation procedure, its spread to other jurisdictions would produce essentially the same disruptive result previously mentioned under the bare-ownership theory.

The third alternative would be the "non-arms-length" concept presented in S. 1245. This confines the consolidation to those related corporations which are found to be engaged in non-arms-length transactions. Among the defects are:

(1) The states lack the expertise to audit.

(2) The states could claim that any sale between related parties is prima facie non-arms-length.

(3) The corporations could create non-arms-length transactions with affiliates desired in a consolidation.

(4) Complex budget projections for states and taxpayers.

A fourth alternative would confine consolidation to affiliates which are taxpayers in the state. This is the current practice of many states and affords corporations a potential to consolidate loss affiliates. To some, its principal defect is the lack of theoretical consistency with the use of the apportionment formula. An acceptable variant would be the consolidation of unitary affiliates which are taxpayers in the state.

The fifth alternative is a prohibition of consolidation. As previously mentioned, the alternatives are presented on the assumption that dividends and foreign source income will be exempt from state taxation, thereby limiting any consolidation to domestic corporations. Under these circumstances consolidation is not the panacea that some suggest. Consolidation does not necessarily produce income. Currently only five states (Washington, Texas, South Dakota, Wyoming and Nevada) do not have an income tax. It can be reasonably anticipated that the first three will fall from these ranks in the near future. What would domestic consolidation do then? It would not alter the income to be divided among the states—it would merely alter the reporting by adding to some states only what is taken from others.

Thirty-eight states had taxes measured by income at the time of the Willis study. Eight have enacted such taxes since then. The potential tax havens in Illinois, Ohio, Michigan, Florida, etc. have vanished. The variation in tax rates would not be adequate incentive for a corporation to shift its income, if such were possible.

This prohibition will cause the least disruption in current tax systems, since under current statute and practice the majority of states do not regularly require consolidation. The ease of compliance, audit and budget projections would be greatest for both state and corporation.

III—Jurisdiction of Federal Courts

A federal law regulating the taxation by the states of interstate commerce should provide for a single federal court with exclusive jurisdiction to review disputes arising from its application or from P.L. 86-272.

The principle of federal review was included in the original Willis Bill, H.R. 11798, in 1965 (Sec. 522(f) and (g)), and in the Willis Report (Vol. 4, pp. 1162-63). The reasons include these:

(1) *Uniform judicial interpretation.* Review by a single Federal court is far preferable to the creation of individual and inevitably conflicting bodies of precedential law in state courts. The most compelling recent example, already cited, is the treatment of Kennecott Copper Corporation and a subsidiary by the courts of California and Utah. In *Chase Brass & Copper Co., Inc.* v *Franchise Tax Board*, California fund Kennecott and is subsidiary, Chase Brass, to be unitary businesses and imposed its tax on a "combined" basis even though Kennecott did no business there. This produced far more revenue for California than if Chase Brass had been separately taxed. Soon thereafter, in *Kennecott Copper Corporation* v. *State Tax Commission*, the Utah Supreme Court upheld the Utah Tax Commission its determination that, even though the same two companies were indeed unitary, they must file tax returns on a separate reporting basis. Utah's revenues also were greatly increased. The United States Supreme Court refused to review either case. This was inequitable treatment which mandatory review by a single federal court would have avoided.

(2) *Avoidance of Undue Litigation Burdens.* Taxpayers would avoid litigation of similar issues in numerous states, and thus save the expense of unnecessary and unjustifiable court actions.

(3) *Development of an Expert Court.* A single court hearing many cases and guided principally by its own decisions would produce results of higher quality than the judgments of numerous state courts charged only occasionally with deciding complex issues of interstate taxation.

(4) *Consistent Handling of Interstate Commerce Taxation.* The principal reason for federal legislation to mandate the method of taxing interstate transactions is to assure uniform treatment. Such legislation must be supplemented by uniform mandatory regulations. A third logical requirement is that the decision of judicially disputed issues be lodged in a single impartial tribunal.

This statement is concerned with the adoption of the principle of Federal review by a single court rather than with the details of its implementation. It is suggested, however, that either the Court of Claims or the Tax Court could perform this function. Either court could minimize the expense of litigation by hearings on circuit, and either could develop a consistent body of law based on expert knowledge.

We believe that a properly drafted bill could establish the jurisdiction of a federal court without violating the Eleventh Amendment. Although the Amendment and judicial interpretations provide that a suit shall not be commenced or prosecuted against a state in federal court by a citizen of any state (*Hans* v. *Louisiana*, 134 U.S. 1 (1890)), it is established that this immunity can be waived. The question whether a state may claim immunity from suit in federal court initiated by persons asserting federally created causes of action was considered in *Parden* v. *Terminal Railway of the Alabama Docks Department*, 377 U.S. 184 (1964) and *Employees of the Department of Public Health & Welfare* v. *Department of Public Health & Welfare*, (decided on April 18, 1973). These cases are concerned with the circumstances in which a state will be deemed to have waived its immunity from and consented to suit in federal court by an individual. Although some of the Supreme Court justices have philosophical differences over what constitutes consent by a state to suit in federal court, all would agree that consent, effectively given, properly vests jurisdiction in a federal court. The decisive question appears to be whether the Congress intends that a state must waive its immunity as a condition to functioning under the provisions of a federal law. We

believe that the rationale of the *Parden* and *Public Health* cases would uphold jurisdiction in a federal court to consider interstate taxation disputes if the following, or a similar, provision were included in the statute:

"Any state, or subdivision of any state, that imposes any tax or the duty to collect a tax regulated by this Act, whether or not such tax or duty to collect shall have been imposed before the effective date of this Act, shall have waived its immunity from and consented to suit by any person in any duly designated Federal court concerning any issue relating to a dispute arising under this Act or under Public Law 86-272."

A hearing in the federal court should be de novo. While exhaustion of state administrative remedies is a proper requirement, the parties to the de novo proceeding should not be bound by the factual determinations of the administrative tribunals of the states. Therefore, the federal law should provide that additional evidence could be introduced before the designated federal court, to be considered by it together with, or to the exclusion of, findings of fact by state administrative tribunals.

Senator MONDALE. Our next witness is the Honorable Alan Cranston, the Senator from the State of California. Appearing with him is Mr. Bruce W. Walker, chief, compliance division, California State Franchise Tax Board, who is also speaking on behalf of the California State Board of Equalization.

We will take just a minute right here.

We are very pleased to have Senator Cranston with us this morning.

STATEMENT OF HON. ALAN CRANSTON, A U.S. SENATOR FROM THE STATE OF CALIFORNIA

Senator CRANSTON. I thank you very, very much, Mr. Chairman. I welcome this opportunity to present very briefly to the committee my views on the best approach for Congress to take in the matter of interstate sales and use taxation.

The first issue before the committee, it seems to me, is the basic question of federalism. Is not this matter more properly the concern only of State and local governments?

I, for one, seriously question whether Congress should be legislating in this area at all.

If, however, the committee insists that Congress set jurisdictional rules for the levying of these taxes by States and localities, I think the most equitable approach to the problem is the one presented in S. 282.

The sales tax is an extremely important source of revenue for many States. The State of California currently imposes sale and use taxes at the rate of 4¾ percent. In addition, the State collects locally imposed sales and use taxes for its 58 counties and 407 cities under a uniform law at the rate of 1¼ percent. This is a combined uniform rate of 6 percent. It is expected that fiscal year 1973-74 revenues from this combined tax will be about $3.8 billion, making it California's most important source of State general fund revenue.

The various bills before this committee propose different jurisdictional standards to sales and use taxation. One proposal would subject a seller to uniform sales and use taxes only in the State or States where the seller has an actual business location.

This approach, which allows escape from taxation of solicitation-only sales across State lines, would cause severe revenue losses to many States. It would also create tax havens for those multistate businesses which could avoid having a business location in a market State. In California, for example, estimates of revenue loss if this

source of tax were to be removed from the State, are set at $15 million to $20 million annually.

An even more serious effect of this type of tax dodge is that it gives a considerable competitive advantage to solicitation-only businessmen, at the expense of resident businessmen—particularly small businessmen.

The bill which I have introduced, S. 282, in my opinion, represents the best solution to today's interstate sales and use tax problems, and it retains the time-tested sales and use tax jurisdiction based on sales solicitation within the State. Under my bill, a seller would be subjected to the jurisdiction of any State and of any local subdivision having uniform State-administered local tax where the seller regularly solicits orders for the sale of tangible property by salesmen, solicitors, or representatives in the State.

The presence of sales personnel within a State provides the most logical jurisdictional standard. Salespeople make sales, with or without fixed business locations, in direct competition to local merchants.

Senator MONDALE. Does your bill also extend to mail-order solicitation, or is it just to sales?

Senator CRANSTON. No, it does not. It does not cover mail-order sales.

For all the reasons cited, my bill is supported by the California Chamber of Commerce, the California Manufacturer's and Retailer's Associations, and the State Board of Equalization and the Franchise Tax Board of the State of California. In addition, Governor Reagan and his administration actively support the bill.

Senator MONDALE. Yesterday I received a letter from the Governor to that effect, and I would ask that that letter appear following this statement.

Senator CRANSTON. This morning, the committee will hear from Mr. Bruce Walker of the California Franchise Tax Board. Mr. Walker will speak on behalf of both the tax board and the State board of equalization. I might add that I served in both of these bodies, the California Franchise Tax Board and the State Board of Equalization, when I was the State comptroller of California. I know Mr. Walker well from those days and recommend him very highly to you.

I will leave it to his greater expertise in this area to explain the importance to my State—and, I believe, to the majority of States—of the approach to sales and use taxation which is employed in S. 282.

Thank you, Mr. Chairman, for this chance to address the committee on this matter of great importance to the State of California.

Senator MONDALE. Thank you very much, Senator Cranston, for that most useful statement. It is particularly noteworthy since it is based upon your rich experience in precisely this field as comptroller of the State of California. We are very pleased to have your statement. We will now hear from Mr. Walker.

Senator CRANSTON. Thank you very much.

[The letter from Governor Reagan to Senator Mondale follows:]

STATE OF CALIFORNIA,
GOVERNOR'S OFFICE,
Sacramento, September 14, 1973.

Hon. WALTER F. MONDALE,
Chairman, Senate Finance Subcommittee on State Taxation of Interstate Commerce, U.S. Senate, Washington, D.C.

DEAR SENATOR MONDALE: I concur with your view that any federal legislation in the area of state taxation of interstate commerce should have the support of a

consensus on the part of the states and acceptance by the business community.

One of the great strengths of our federal-state system is the freedom of the states to act to meet their own particular problems in the ways that seem best to them. Interference by the federal government with the states' power to tax would be a major blow to such freedom.

While there have been some representations that there is a general agreement, a close look will reveal that there are very important areas of controversy between the states and the business community. S. 1245, for example, sets up an unacceptable rule as to organizations doing business in multicorporate form. The adoption of this bill would result in revenue losses to California of up to $100 million a year. Such losses would inevitably have to be shifted to other taxpayers.

California is making every possible effort to cooperate with other states in the development of uniform rules and procedures. I believe any objective review of the past ten years will show that substantial progress has been made. This should be allowed to continue.

There is no question but that the states need constant pressure if they are to continue their progress toward greater equity and uniformity. The most constructive action that could be taken by the Congress would be to provide an oversight function with check points at reasonable intervals, such as every five years.

Federal intervention in the interstate taxation field is both undesirable and dangerous and should only be considered as a last resort.

Sincerely,

RONALD REAGAN,
Governor.

STATEMENT OF BRUCE W. WALKER, CHIEF, COMPLIANCE, DIVISION, CALIFORNIA STATE FRANCHISE TAX BOARD, ALSO REPRESENTING THE CALIFORNIA STATE BOARD OF EQUALIZATION, ACCOMPANIED BY JAMES HAMILTON, ASSISTANT CHIEF COUNSEL, CALIFORNIA STATE FRANCHISE TAX BOARD

Mr. WALKER. Senator Cranston, thank you very much.

Mr. Chairman, with me is Mr. James Hamilton who is the assistant chief counsel of the California State Franchise Tax Board.

There have been several questions you asked, Senator, of people who appeared. I would like to respond to them. One of them was why hadn't California become a member of the multistate tax compact earlier. Well, we have always been an associate member, but we did have a problem with the voting arrangements of the commission. They had a one-State, one-vote system, and we felt that population should have some weight in the voting. That was changed, and this is one of the reasons that we thought we could go in.

There was another statement made by Mr. Stanley as to the multistate tax compact only having 21 members. Well, one of the reasons is that the COST group has vigorously opposed the entry of States into the compact. In fact, that is where our primary opposition has come before our legislature, from the COST group. I think that they are in a poor position to complain that there are so few members when they are one of the reasons that there are so few members. We have the support of most of the California-based businesses for our joining the compact. We think the compact is a very good thing. It will promote uniformity, and our businessmen see that, they feel that that is the way to go. But, the COST group, for some reason known only to themselves, are opposing our entry into the compact. They opposed the entry of Pennsylvania, and I assume other States.

Now, you asked earlier, Senator, as to whether it would be appropriate to split off the sales and use tax matter from the income tax. I feel that it probably would. I think the questions of jurisdiction are

substantially different, and I think it might be well to kind of break these apart and kind of encapsule these separate problems. There are areas of divergence of opinion here, I know, but I think it would be helpful.

As to the sales and use tax matters, I believe Senator Cranston has expressed our basic view very well. Yesterday there were a number of questions by Senator Long as to the Louisiana plan, and I think that it certainly would have the support of California and most of the other States. California is in the position that we do have a uniform sales tax throughout the State with one small exception that has to do with the Bay Area Rapid Transit. So, we would certainly get right into that type of plan if there were no constitutional problems involved.

Senator MONDALE. We heard from someone, Mr. Courtney, I believe, who is the vice chairman of the National Association of Wholesaler-Distributors who said he does not think there is any dispute on the question of tax liability or the tax rates. The problem for the members of his group has been the multiplicity of taxing jurisdictions and the variations in their laws, their enforcement policies, and so on. If they could be relieved of those burdens, without committing himself to any specific language, he thought there was a basis for compromise. I think that is what he was saying. I understood him correctly. You have also indicated, without having had a chance to examine the constitutional and legal issues that might be involved, that the Louisiana proposal makes sense. There might be grounds for agreement here.

Mr. WALKER. Yes, I think so. Now some other States are not in as good a position as California because we do have a uniform sales tax throughout the State. There is no county or city which has a different rate, and the base is substantially the same, with one small exception, so we would fit right into that type of plan.

I would like to make some observations about the income tax generally. It seems to me, despite some statements to the contrary, that the major interstate income tax problems of small- and medium-sized businesses have been taken care of by the jurisdictional standards of Public Law 86–272. Now, it has also taken care of, unfortunately, some rather large businesses in that they have escaped tax under it.

Senator MONDALE. That particular legislation was passed following the *Northwestern Portland Cement* case, was it not?

Mr. WALKER. Following what?

Senator MONDALE. I think that was in response to the Supreme Court decision in a Minnesota case.

Mr. WALKER. Yes, that is correct.

Senator MONDALE. That held, as I recall, that Minnesota could tax the income of Northwestern Portland Cement earned through sales in Minnesota, even though they did not have an office there, was that correct?

Mr. WALKER. Basically that is correct.

Senator MONDALE. Congress then passed this bill which you refer to that provides what?

Mr. WALKER. Well, it provides a minimal jurisdictional standard. If an organization has no office in the State, merely solicits in the State and the orders are filled from outside of the State, if that is all that happens, then there is no tax.

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Senator MONDALE. So any corporation, large or small, that complies with those standards cannot be taxed by that State?

Mr. WALKER. That is correct, and that is what I was referring to, that many large organizations have escaped tax for that reason. Some of the sales in the State of California have gone well over the $10 million mark for the year, and they still escape tax.

Senator MONDALE. Has that law, in your opinion, encouraged a shift in sales techniques?

Mr. WALKER. Very slightly, Senator. I would not say that it has been a major problem—there has been some restructuring of businesses to take advantage of it, but I would not say that it was widespread. A very large organization simply cannot function in that way, so I think the present push, as Mr. Cahoon has indicated, is one that affects the multistate and multinational corporate giants rather than the small businesses. And as we see it, rather than an effort to solve a problem in some reasonable fashion, it seems that many of the efforts are to cripple the States in their tax dealing with these corporate giants.

Now, in the area of controversy between the States and multinational corporations, many feel the multinationals already have an edge in power and influence, and we feel it would be a serious mistake for Congress to come down on the side of these multinational corporations in their controversy with the States. We think it would be bad not only in the tax field, but in the legislative arena generally.

Senator MONDALE. You say multinational. Do you mean multistate?

Mr. WALKER. No, I mean multinational corporations, corporations that are functioning in maybe a dozen countries of the world or more.

Senator MONDALE. Well, that is not your problem. Your problem is the multistate corporations, whether they are overseas or not.

Mr. WALKER. Well, no, sir. It is the multinationals that we are having a major controversy with, the oil companies that do business all over the world, and this term multinational is one that has come into favor just recently and we find most large corporations are now multinationals.

Senator MONDALE. Yes, we hear it a lot.

Mr. WALKER. But these are the ones who are the principal backers, I would say, of such bills as S. 1245.

Now, this bill has been represented by some elements of industry as being a reasonable compromise in which the States agree. It is not compromise. Every single issue in the proposal has been resolved in a way to restrict the States. A reasonable compromise is one in which each party has some issues resolved in its favor. The States get nothing from S. 1245 except fetters.

Now, there are several more issues, of course, in S. 1245, but in our view, the major ones are in the combination area and the provisions relating to foreign source income. Actually this is just one problem, but we give it two names.

Senator MONDALE. Can you give me an example of how that would work in a given case in California?

Mr. WALKER. How the provisions of section 2092 or S. 1245 would work?

Senator MONDALE. Yes.

Mr. WALKER. Well it would not work. That is the problem.

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Senator MONDALE. Give me an example of what you are doing now and how that would work.

Mr. WALKER. All right. What we are doing now, we look at the totality of the business. Let us take an oil company They have production in the Middle East and Venezuela, in California, in Texas, all over, and perhaps in Alaska. No matter how they are structured, whether there is one corporation or several, we would simply apply a formula to the total operation, take the California payroll, sales and property, in relation to the total payroll, sales and property, and take that portion of the net income represented by the California fraction. Now, it makes no difference under our concept whether they do business through one corporation, or 50, or 90, or no matter how many. We simply lump them all together and get an answer.

Now, if S. 1245 were passed, we would be faced with this: Suppose a corporation decided to have 50 corporations to handle its functions. Maybe it had nothing to do with taxation, that it was simply a matter of administrative convenience that they wanted to have 50 corporations. Then under S. 1245 we would simply be restricted as to tax by the corporations which were in California, and we would certainly get a far different result by applying the formula only to those. If we said we wanted to combine, we would have to prove that there was some type of nonarm's length transaction involved, that they sold crude oil from one corporation to another corporation at a price different than the prevailing price, or something of that type. This is extremely difficult to do, as the Internal Revenue Service experience, with section 482 of the Internal Revenue Code has shown, and actually this arm's length test is irrelevant, because you can by taking a large corporation, splitting it up for administrative reasons into, say, a dozen different corporations, have wide swings of the income between the various States involved without ever intending to do so. It is just a matter of the way things happen to work out.

So, we think this idea that form should be stressed over substance, as S. 1245 would have it, is very bad.

Senator MONDALE. Now, has your theory been challenged in the court? I assume it has.

Mr. WALKER. Yes, it has, and a number of times. And we have also——

Senator MONDALE. What has the result of those suits been?

Mr. WALKER. We have won all of the cases.

Senator MONDALE. And how high have those cases gone?

Mr. WALKER. Well, I think the California appellate court is as far as they have gone. Perhaps Mr. Hamilton can respond.

Senator MONDALE. This is the State court system?

Mr. HAMILTON. That is correct.

Senator MONDALE. Have you been in the Federal courts?

Mr. HAMILTON. There was one case, Chase Brass, which was presented to the California appellate court, but they concluded that on the facts that the foreign operations there were not—it was not a part of the unitary business, and so on appeal that particular issue was not there. But, we have been sustained in the State courts and in the cases that have been litigated before our administrative board.

Senator MONDALE. How do you explain the fact that there is not more legal activity on this if this is such an issue? Why can it not be resolved by the courts?

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Mr. HAMILTON. I would think in time it will be.

Senator MONDALE. Remember, I asked this question earlier, and someone said we have tried to get it up to the Supreme Court, and we cannot get it there.

Mr. WALKER. Well, I think that you do have a problem in that perhaps certiorari has been tried at times. But, the Supreme Court perhaps would not take jurisdiction because they felt that there was not a substantial Federal question involved. And I suppose, I think the business community is fairly certain they would lose, and that is the reason that they have not put these cases to the test.

Senator MONDALE. I see some heads shaking back there.

Mr. WALKER. Well, we are willing to litigate, so that they have had an opportunity. We have pursued the unitary concept for a great many years.

Senator MONDALE. It seems to me that perhaps one of the most important functions of the U.S. Supreme Court is reconciling differences between the States and to monitor that difficult concept of interstate commerce. That is one of its most important functions. When it does not operate, the Congress, which possesses the authority to exercise the Federal power which is supreme, retains responsibility. It surprises me, given the intensity of feeling on this issue, that it has not gotten to the Supreme Court so it could have been resolved.

Mr. WALKER. We are in litigation at the trial level with Firestone right now. They say they are going to take the case as high as they can, but this is a long way from a decision. There has been a great deal of money involved in many of these cases, and I assume that if the companies involved thought they could win, they would have gone up with them because they were not small matters. They involved millions of dollars and would be well worth litigating.

Mr. HAMILTON. I might add here that the Board's position is set forth in a published guide where we have said that if a combined report is necessary, this approach must be used regardless of the geographical location of the taxpayer.

Mr. WALKER. Yes. Our position has been quite clear, so if anyone wants to attack it, you know, they have had the opportunity to do so.

The foreign source matter I think has been misrepresented by some as an attempt by the States to tax such income. It really is not that at all. All we are doing is looking at the totality of the operation and trying to see what California's fair portion is. Now, as far as we can see, it makes no difference whether a subsidiary is operating in England or Wyoming or Minnesota. It is just the same thing. We either take it in, or leave it out, depending on whether it's unitary or not.

There have also been some allegations that somehow California had a foreign policy in this area, which we do not, and also it has been alleged that in some way our practice adversely affect the balance of payments. That is not the case at all. All we are really doing is trying to see that all of the corporations, of the organization are put on the same plane vis-a-vis California. We say that just because an operation is in a foreign country, it should not have a special privilege of being left out of the formula. To do so would encourage foreign operations as opposed to domestic operations. And I do not think Congress really intends that in these days of some joblessness in the United States and charges that some U.S. corporations are really exporting jobs. We believe Congress should be particularly careful not to place foreign

operations at a competitive advantage over domestic, and that is what would be done if the provision of S. 1245 were adopted.

Senator MONDALE. I think we are going to have to stop here because of our time limt. If you would submit any statements that you may have for the record, I would appreciate it. We are running out of time. Thank you very, very much.

[State of California's presentation follows:]

STATE OF CALIFORNIA'S PRESENTATION

The following documents are submitted:

1. Letter from Governor Ronald Reagan to Senator Walter F. Mondale.*
2. Comments of the Franchise Tax Board Before the Subcommittee.
3. Staff Observations of California Franchise Tax Board on Interstate Taxation Problems.
4. Staff Observations Regarding Income Tax Provisions of Legislative Proposals.
5. Summary of Principal Points of the California State Board of Equalization Relating to Sales and Use Taxes and Comments of the California State Board of Equalization Relating to Sales and Use Taxes.

COMMENTS OF THE CALIFORNIA STATE FRANCHISE TAX BOARD

It is now quite clear that the major interstate income tax problems of small and medium size business have been taken care of by the jurisdictional standards of Public Law 86-272.

The present push in this field is that of the multistate and primarily multinational corporate giants. Rather than an effort to solve a problem in some reasonable fashion, it seems to be an effort to cripple the states in their tax dealings with these multinational corporate giants.

In the area of controversy between the states and the multinational corporations, many feel the multinationals already have an edge as to power and influence. In this contest we believe the intervention on the part of the Federal Government on the side of the multinationals would be disastrous not only in the tax field but in the legislative arena generally.

S. 1245 has been represented by industry as being a reasonable compromise with which many states agree. It is most emphatically not a compromise. Every single issue in this proposal has been resolved in a way to restrict the states. A reasonable compromise is one in which each party has some issues resolved in his favor. The states get nothing from S. 1245 except fetters.

There are several important issues in S. 1245, but in our view the major one is that barring combination and the provisions related to foreign source income. These are one issue.

The "arms length" provisions of Section 209 of S. 1245 are offered as a Solution. They do not even relate directly to the fundamental problem which is a question of form versus substance. Should a different tax result be obtained when an organization decides to do business in multicorporate form rather than using only one corporate structure?

The answer is clearly "no". It should be observed that most corporations do not use the multicorporate form in order to minimize state taxation. Rather, there are other reasons related to such matters as administrative convenience. In these cases the "arms length" rule is meaningless and the tax in any particular state is smaller or larger than it would be otherwise simply because of a corporate decision in no way related to taxes.

The foreign source matter has been misrepresented to some extent as an attempt by the states to tax such income. It is not such an attempt at all, but merely extends the logic of combination to include the foreign operations as a part of the base. Failure to do this puts foreign operations at an *advantage* over domestic operations which seems a most unusual thing to do.

There have been implications that the inclusion of foreign source income in the apportionable base in some way *adversely* affects the balance of payments. Just the opposite is the case. If foreign based operations are excluded from the base, such operations can more effectively compete against United States' operations.

*This letter is reproduced in this volume at p. 285.

In these days of considerable joblessness in the United States, and charges that United States' corporations are "exporting jobs", we believe Congress should be particularly careful not to place foreign operations at a competitive advantage over domestic operations.

In respect to federal legislation, we believe that where there is general consensus there is presently reasonable uniformity and no legislation is necessary.

In the important areas where there is no consensus we believe the process of of accommodation presently going on should continue, under some type of Congressional oversight to insure that progress is being made.

California State Franchise Tax Board

Interstate Taxation Problems

STAFF OBSERVATIONS

Whatever need there has been for federal legislation in the field of state taxation of multistate businesses has, in our view, been adequately met by the provisions of PL 86-272. This by no means is a perfect law as it has given unwarranted protection to some very large businesses. However, it has protected from taxation small businesses having only minimal contacts with some states.

It is difficult to understand the reason for the hue and cry over lack of uniformity in tax laws among the several states when differences in laws to meet local situations represent one of the great strengths of our federal-state form of government.

Reasonable uniformity in laws generally is a worthwhile goal, but not one in which the federal government should adopt a coercive role. There are differences between the laws of the several states in all major areas: contracts, torts, criminal law, consumer affairs, trusts, domestic relations and traffic, just to mention a few. These differences do cause problems, particularly to individuals; but there seems to be no pressure upon Congress to force the uniformity of such laws. Even in the field of welfare, which is so important to so many millions, we do not have uniformity despite some strong support for such an approach.

The major problems of small businesses have been largely resolved by PL 86-272, so the present thrust is obviously directed at the alleged problems of larger business organizations. This is clearly reflected in the various laws that have been proposed. The question arises as to why the largest business organizations in the country (and the world for that matter) can't cope with a reasonable amount of variety in respect to state tax laws.

The position of these larger organizations seems to be "we are big and therefore should have special consideration". To illustrate: Corporation A operates only in State X and grosses $10 million a year. It complies with all the laws of State X. Corporation B operates in States X, Y, & Z doing $10 million gross in each state. Is it any more burdensome for B to comply with the laws of X, Y and Z than it is for A to comply with the laws of X?

We do not deny that reasonable uniformity among the states is a worthwhile goal and it is being pursued vigorously through the adoption of the Uniform Division of Income for Tax Purposes Act (UDITPA) and the efforts of the Multistate Tax Commission. In general, state laws do not depart radically from the Internal Revenue Code and the burden of such departures is certainly not severe in these days of computerized accounting systems adaptable to the handling of a large number of variables.

In the extremely varied personal income tax field some organizations have written programs to handle the matter of return preparation for all states. The problems of lack of uniformity have been grossly exaggerated by the proponents of federal intervention.

One case frequently cited as a horrible example of lack of uniformity is that of Kennecott Copper Corporation. In that case, California and Utah took different views of the same law and each was upheld by their appellate state authority, the U.S. Supreme Court, dismissing the appeal from the Utah decision.

This was unfortunate but certainly not unparalleled in other areas. Observe the fact that the Internal Revenue Code is sometimes interpreted differently in the various courts of appeal, and the Supreme Court at times refuses for years to resolve the matter. If the Internal Revenue Code is not uniformly interpreted when very large sums are involved, the isolated problem represented by Kennecott decisions does not warrant radical legislation.

The proponents of federal legislation understandably stress double taxation problems. The more serious and more common problem is just the reverse. There is substantial escape from taxation due to inconsistent reporting methods resorted to by taxpayers.

A reasonable amount of freedom for policy making by the states in this area is essential and the problems such freedom present are actually quite minor.

It seems to us that progress is being made toward a goal which may be stated as follows:

1. If a multistate business operates solely within the United States, the formula applied in apportioning its income shall be such that 100% of its income is apportioned to states having jurisdiction to tax such income (whether they choose to do so or not).
2. If a multinational business operates in the United States, the portion of the income apportioned to the states is reflected by a formula which gives proper weight to the factors both within and without the United States.
3. Formula apportionment is the rule and shall be applied when a unitary business exists, whether as a single corporation or in multicorporate form.

The question of combination is the central issue here and, while the approach used is well known, something of the theory may be worth stating.

Formula apportionment is now generally accepted as the only sensible approach to the apportionment of income among states where one corporation engaged in one business is involved. This recognizes the limitations of separate accounting and adopts a general economic theory that income arises from the use of property and manpower with sales representing the contribution of the market.

When organizations decide to carry on a business using say from two to fifty corporations instead of one, this should have no effect on the apportionment of income. And, using the combination approach, it does not. Let's take an integrated steel company for example which has iron and coal mines, transportation facilities, mills, and an extensive array of selling facilities. Should it make any difference in the apportionment of income whether one corporation is involved or two or perhaps fifty?

Combination is essential to avoid a reliance on form over substance.

The discussions of foreign source income by the private sector assume that by including such income as subject to apportionment by formula, this somehow taxes it. This is an absurdity. What is being done is that the state taxes the income properly apportionable to activities within such state as measured by the in-state factors compared to total factors.

If the formula approach is valid at all, it certainly doesn't stop at the waters' edge. Why should it make a difference if an oil producing subsidiary is in Montana, or Canada, or Venezuela so far as the formula approach is concerned when, in each case, it is a part of an integrated oil company?

Federal legislation

All legislation under consideration at this time has major faults when measured against any reasonable objectives. Some comments on S. 1245 will illustrate this.

Sec. 202 et seq.

"The formula is such that large amounts of income may escape taxation despite the fact it is all clearly from United States activities.

Sec. 209

"The rule provided is a reversion to an outmoded and outdated separate accounting concept which assumes that the accounting for each separate corporate entity truly reflects the economic contribution to the affiliated group of corporations. This leaves the burden of proof to the contrary on the several states.

"This provision discards the experience of many decades and adopts a rule that is basically unworkable. If the states attempt to examine any reasonable sample of intercorporate transactions, the burden will be tremendous and the results of examining the same transactions by several states will not be uniform at all.

"The proposal is one which exalts form over substance. This would leave the tax administrator practically at the mercy of the corporate taxpayer who would have the facility of avoiding tax by casting its activities in various forms at its own discretion. The problem of dealing with 'Proteus' is essentially the one being proposed here for the states."

Sec. 401

"State court jurisdiction is superseded by a federal court.

"A need for this provision has not been established. If a balancing of state-taxpayer interests is required with respect to tax litigation, should jurisdiction in state tax matters be pre-empted by a federal court so that a small number of taxpayers will not be inconvenienced? Furthermore, conflicting state decisions if they occur can be resolved by the U.S. Supreme Court."

Sec. 529

"This section acts as a bar to the assessment of any tax which does not come within the provisions of the proposed law. It is retroactive to all years.

"No convincing reason has been established as to why a taxpayer should be rewarded for not complying with a state's taxing laws. Furthermore, such provisions in some cases would apply unevenly and, in other cases, could preclude assessments where an audit has been deferred for any number of reasons."

These are not the only objectionable areas but are illustrations.

Conclusion

We do not believe that the compliance burden on the small number of large taxpayers resulting from some differences in tax laws is so burdensome that the federal-state relationship should be greatly altered for their convenience.

In recent years the states have made significant progress in alleviating compliance problems of all taxpayers, consistent with the goals mentioned above.

The legislation proposed to date has not given any consideration to the fact that state tax laws have been developed, revised, and refined throughout a state's existence to harmonize its revenue requirements with conditions so as to best serve the needs of a state and its taxpayers. It would seem that with the progress states are now making in developing and adopting uniform rules and procedures, the major technical compliance problems will be alleviated. In our view, this can occur without disrupting state tax bases, or affecting federal-state relationships.

California State Franchise Tax Board

Staff Observations Regarding Income Tax Provisions of Legislative Proposals

SUMMARY

1. The State of California collected $866 million in income and franchise taxes in 1972–73, two-thirds of which was derived from taxpayers whose income was determined by an apportionment formula. Accordingly, any change in the California tax base or apportionment formula should be carefully evaluated to prevent inequities or a large loss of revenue.
2. Public Law 86–272 has provided guidance for small businesses. It has also permitted some businesses with large sales to operate on a substantial scale and with the advantage of a tax exempt status, in competition with local businesses. It is suggested that Public Law 86–272 not be applicable after sales exceed a predetermined level.
3. There should be no restrictions on the states' tax base.
4. States should be permitted to continue using the most equitable method for determining the income of a commonly owned group of corporations which are conducting a unitary business. The tax results should not be changed simply because the corporate form in which a unitary business is conducted is altered.
5. No state taxes foreign source income. States, however, should be able to take into account, in determining income from their sources, all of the income and factors of a unitary business regardless of its geographical location.
6. Since income from continental shelf areas is exempt from states' taxes, states should not be required to include the property, payroll, and sales with respect to such property in the denominator of the apportionment formula.
7. Apportionment formulas should not cause a major shift in tax burdens, and should be designed to attribute all apportionable income to a state which has jurisdiction to impose a tax.
8. Any change which is required with respect to the taxation of dividend income should be carefully considered. If federal legislation should deal with such income, the amount subject to tax should be apportioned so that all taxpayers will be taxed in an equitable manner.
9. If a class of tax exempt income is created, such income should be adjusted with respect to interest and expenses properly attributable thereto.

10. If a higher jurisdictional standard is required than currently exists, taxpayers should not be relieved of liability because they failed to comply with states' tax laws.
11. The necessity for federal court review of state tax disputes has not been established. Furthermore, the procedure suggested seems to be cumbersome, and may greatly increase costs of litigation.
12. If major substantive changes in state tax laws are imposed, states should be allowed a reasonable period of time to implement necessary changes.

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INTRODUCTION

The State of California and the Franchise Tax Board have opposed all federal interstate tax proposals. The reasons for the opposition are:

1. Any legislative proposal introduced to date would substantially change the corporate income tax laws of this state and thus is of great concern because of the amount of revenue involved, the number of taxpayers affected, and the greater danger that tax burdens will be redistributed in such an inequitable manner, as to seriously damage California's business climate.

The total income and franchise (measured by income) taxes collected from corporations in 1972–73, was $866 million. This tax was collected from approximately 150,000 corporations. The net income reported exceeded $8.4 billion. An analysis made of 1967 income year returns established that approximately two-thirds (65.3%) of the total income is reported by corporations using an apportionment formula. Accordingly, any legislative provision which alters the corporate tax base, or the apportionment formula can have a substantive and continuing revenue effect. Proposals introduced to date have been opposed because they granted preferential treatment to interstate taxpayers, jeopardized the federal-state relationship, and prohibited states from maintaining their fiscal independence and retaining their full sovereignty.

2. The various federal legislative proposals introduced contain unrealistic apportionment standards which benefit only large interstate taxpayers, having most of their physical property located outside of this state.

3. The income tax apportionment provisions of all legislative proposals to date would ultimately result in an increase in the tax burden of local businesses.

4. Some of the proposals contain technical and artificial jurisdictional standards which would exempt interstate sellers, thereby granting them an unfair tax advantage over local businesses.

5. Provisions which would prevent California from determining income of a unitary business on the basis of a combined report permit interstate business to avoid tax by altering the corporate form through which its business is conducted, prohibits California from determining the income of such businesses by the realities of their total business operations. Such a provision would cause artificial corporate structures to be created for the purpose of minimizing tax exposure and could result in an annual revenue loss of up to $100 million. The objections are more fully set forth below.

JURISDICTION

The California franchise tax first imposed in 1929 applies to corporations engaged in any intrastate transaction for the purpose of financial or pecuniary gain or profit (Section 23101, California Revenue and Taxation Code). The corporation income tax imposed in 1937 applies to every corporation deriving income from sources within this state (Section 23501, California Revenue and Taxation Code). The validity of both taxes has been upheld by the United States Supreme

Court (*Matson Navigation Co.* v. *State Board of Equalization*, 3 Cal. 2d 1, affirmed 297 U.S. 441; and *West Publishing Co.* v. *McColgan*, 27 Cal. 2d 705, affirmed 328 U.S. 823).

Interstate businesses deriving income from California sources but not having intrastate activity are subject to the California source income tax. A foreign corporation is considered to have income from sources within California if it ships goods into California from points outside this state, pursuant to orders taken by employees in the state—or sends goods to California dealers or brokers on consignment or maintains a stock of goods from which deliveries are made pursuant to orders taken by independent dealers or brokers (Title 18, California Administrative Code, Chapter 3, Subchapter 3.5, Section 23040 (b)).

The above provision was applied without limitation until Public Law 86-272, effective September 14, 1959, superseded the provisions of the California regulations with respect to corporations selling tangible personal property and which do not have an office or place of business in this state.

While Public Law 86-272 does provide jurisdictional guidelines for interstate business engaged in selling tangible personal property, it also serves to shield from state taxation some businesses with extensive sales activity in this state.

A review of records in 1961 disclosed that 176 corporations were removed from the California tax rolls as a direct result of the enactment of Public Law 86-272. Of the corporations which were granted income tax immunity, the annual sales of 14 of the corporations were over $1 million, and the California sales in one case exceeded $7 million. Since the corporations were granted a tax exemption their current sales are unknown. However, it would not be unreasonable to assume that in some cases annual California sales of the Public Law 86-272 tax exempt corporations now exceed $10 million.

While Public Law 86-272 has provided certainty for small and medium size businesses, it also has served to permit certain types of businesses to pursue markets on a massive scale to the detriment of local businesses. It would therefore seem that the primary consideration which led to the enactment of Public Law 86-272 could be served, and competitive equality maintained if a reasonable cutoff point is provided for the application of Public Law 86-272.

Perhaps the simplest change would be to provide that Public Law 86-272 is not applicable after sales exceed a predetermined level in a state, e.g., $300,000. Such a provision would provide certainty for small businesses, and yet permit states to require tax returns and payments from those interstate sellers which are in substantial competition with local businesses.

For a comprehensive discussion of the jurisdictional problems, see: *Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income* by Berndt Lohr-Schmidt, *Hastings Law Journal*, Volume 22, March 1971, pp. 1035-1116.

The income tax jurisdictional standards in the bills introduced to date vary greatly. S. 1245 imposes a "business location test," while S. 2092 contains no income tax jurisdictional provisions.

Under the jurisdictional standards of S. 1245, a corporation is not subject to a state income tax unless it owns or leases real property within the state, has one or more employees within the state, or regularly maintains a stock of tangible personal property for sale in the ordinary course of its business, or regularly leases to others tangible personal property for use in the state.

It is not clear whether or not a corporation must own or lease real property *and* have employees located in the state before it is subject to tax.

Also, if a corporation is present in a state because it maintains a stock of goods, property on consignment is not considered as stock maintained by the consignor. And if a person has a business location because of leased property, the business location applies only with respect to such property. (Sec. 513(a).)

In addition, Sec. 515(c)(3) provides that an employee is not considered located in a state if his business activities consist of installing or repairing tangible personal property which is the subject of interstate sale by the employer, if such installing or repairing is incidental to the sale.

The above provisions which relate to jurisdictional standards must be considered together with Sec. 209 of S. 1245, which provides that income may be determined on the basis of consolidated apportionable income and apportionment factors of the parties to the non-arm's-length transactions. This provision, when considered with the jurisdictional standard, would permit a business to arrange its business so that it would expose to tax only that segment of its business of its own choosing. For example, it could create a separate selling corporation for each state and, in such case, its manufacturing income could not be taken into account in determining total income subject to tax where sales activity occurs.

A business which has its manufacturing facilities located in another state could totally avoid tax in states where sales are made by having its salesmen cover more than one state if it does not own or lease property within the state. It also seems that a corporation is not considered to be present in a state so long as its employees operate from their dwelling place (Sec. 514(c)(2)).

In addition, Sec. 515(c)(3) greatly expands the provisions of Public Law 86-272 by authorizing employees of an interstate business to install or repair tangible personal property, if such is incidental to the sale. It is apparent that such a provision could allow a corporation to conduct substantial activities in a state without being subjected to tax as, for example, in the case of the installation of an electrical generator or a large suspension bridge. This provision also fails to specify whether or not repairs can be made over the life of the property. If such is the case, it would not be difficult for most interstate businesses to arrange their affairs so that they are subjected to tax only in the state or states where they elect to establish manufacturing or distribution facilities.

In view of the above, the jurisdictional standards of S. 1245, coupled with its other provisions, would permit most interstate businesses to pursue markets in most states with a tax exempt status. Such provision would result in a large loss of revenue, which would not be attributed back to the states where the corporation is present. Such preferential treatment would also be extremely detrimental to local businesses as they would be forced to compete against tax exempt interstate businesses, while perhaps suffering an increasing tax burden because of the favorable tax status of their competitors.

Accordingly, it is recommended that if jurisdictional standards are imposed they be equitable to both local and interstate businesses. This objective can best be accomplished by establishing a ceiling for the application of Public Law 86-272.

TAX BASE

All recent federal legislative income tax proposals have provided that the apportionment fraction is applied to a corporation's net income as determined under state law. Some proposals would exempt from the state tax base dividend income and what has been designated as "foreign source" income. These items of income which would be exempted will be discussed later.

States should be permitted to establish their own tax base. The legislative proposals allow this. However, under the legislative proposals if *all* income is apportioned, state tax burdens will be substantially redistributed.

At the present time California apportions all business income and allocates nonbusiness income. The most substantial item of nonbusiness income is dividend and interest income. Under California law income from interest and dividends is allocable to this state if the taxpayer's commercial domicile is in this state (Section 25126 of the California Revenue and Taxation Code). Under California regulations most dividend income is nonbusiness income, unless dealing in securities is a principal business activity of a taxpayer.

The California practice was developed because there were serious doubts as to whether or not a state could include in the apportionable income tax base nonbusiness income, such as dividend income, unless the taxpayer had its commercial domicile in the taxing state.

Most authorities recently have concluded that if authorized by Congress there is little, if any, doubt that all income may be apportioned by a uniform formula. However, such a provision does, to some extent, bring the commerce clause into conflict with the due process clause since states would be authorized to tax a foreign corporation on income derived from sources within other states. They would also be precluded from taxing a commercially domiciled corporation on all of its income from sources within the state.

California has not yet completed a study as to the revenue effect of legislation which would apportion all income and, in particular, dividend income, which to date under California law is classified as nonbusiness income, and allocated to one state. If all income, including dividend income, is apportioned the tax of California based business will be reduced and that of foreign (non-California) corporations will be increased. Such a provision would go far toward equalizing the tax burden of similarly situated corporations. If the apportionment of all income is mandated, and at some later date, it is judicially determined that the inclusion of dividend income in the apportionable tax base in the case of foreign corporations violated the due process clause of the Federal Constitution, the revenue loss would be substantial. It is therefore suggested that before any legislation is proposed which apportions all corporate income that the record

note that Congress has concluded that in the interest of uniformity it is its determination that all income, regardless of its historical classification, should be apportioned by a uniform formula.

COMBINED REPORTING AND CONSOLIDATED RETURNS

The central issue with respect to proposed federal interstate tax legislation is the resolution of methods states may use for determining the income of multistate corporate taxpayers which are commonly owned and are conducting their affairs through more than one corporate entity. Under such facts some states, in apportioning income, take into account only the income and factors of each separate corporation. Other states, such as California and Oregon, take into account all of the income of a group of separate but commonly owned and operated corporations of an integrated business for the purpose of determining the amount of income apportioned to the taxing state. This method of determining income of a unitary group of corporations is commonly referred to as the "combined report" approach.

All states determine the income of a single corporation which conducts its activities in more than one state by an apportionment formula, which in almost all cases is the three-factor formula specified by the Uniform Division of Income for Tax Purposes Act. The California and Oregon approach differs from the practice of other states only in that an integrated business, commonly referred to as a unitary business, is for purposes of determining income treated as one business. Under the "combined report" approach, the separate corporate entities of the group are not disregarded. Instead, the "combined report" is simply the computation by formula method of the unitary business income properly reportable by members of the unitary group.

The combined report method insures that an economic unit is not taxed unless income is realized by the entire unit. In addition, its utilization makes it unnecessary to examine intercompany transactions in great detail in order to determine whether or not a fair price standard has been adopted or whether or not intercompany charges, such as for overhead, are so arbitrary that an adjustment is required. The "combined report" approach simply takes into account the income and factors of the entire economic unit and requires that the income be determined by the realities of the total unitary operations and not by the corporate form through which part of a unitary business may be conducted.

Some legislative proposals seem to require identical treatment for a consolidated return and a combined report. A distinction as to the types and purposes of a consolidated return and a combined report should be made in any legislative proposal. When a consolidated return is filed the income of the commonly owned corporations is treated as a unit and taxed as a unit. Under the combined report method, information as to the combined income and factors is needed only to properly determine the amount of income attributable to the business conducted in the state. Once the income attributable to a state is determined it is considered the income of the taxpayer conducting business in the state. Thus, unlike a true consolidated return where the tax is computed on the combined income of a group of corporations for which one or more or all are liable, under the combined report method each member of the affiliated unitary group is a separate taxpayer which is liable only for its own taxes on its own income.

California and Oregon only include in the combined group commonly owned corporations which are engaged in a unitary business. A corporation is a part of a "unitary business" if its operations within the state substantially contribute to, or are dependent upon, operations without the state.

California has used the combined report approach for determining income for over 35 years. There are now approximately 14,000 corporations which use the "combined report" approach for determining the amount of income subject to tax. While some have criticized the "combined report" approach, only three cases have arisen in California challenging the "combined report" approach, and one of the cases has not yet been heard by the trial court. The cases involving the "combined report" approach are *Edison California Stores, Inc.* v. *McColgan*, 30 Cal. 2d 472; *Chase Brass and Copper Co.* v. *Franchise Tax Board*, 10 Cal. App 3d 496, and The Firestone Tire & Rubber Company v. Franchise Tax Board, Los Angeles County Superior Court No. C-31243, filed June 2, 1972.

The difficulty of applying the unitary concept has been overstated by some of its critics. Furthermore, the "unitary concept" is far more definite and easier to apply than the non-arm's length test required by S. 1245.

It has been suggested that the contribution-dependency test may be outmoded. In an article which was published in Vol. 15 UCLA Law Review, November

1967, pp. 155 to 175, Messrs. Frank M. Keesling and John S. Warren stated on page 172:

"The idea that a company might sustain losses from business transactions in certain areas and realize profits from business transactions in other areas is commonly held and is fully in accord with what may be referred to as conventional conceptions of source of income. But such conventional conceptions are both archaic and myopic. A broader conception of unity is needed to keep pace with the increasingly complex commercial, industrial and financial world.[47]

The original House bill, H.R. 11798, 89th Congress, concluded that consolidation could be required in any case of affiliation by common ties or more than 50% of stock ownership. The bill provided that either state tax administrators or taxpayers could insist upon consolidation. By so providing, it would be possible to obviate the inaccuracies that flow from separate accounting among members of a multicorporate group, and the multicorporate enterprise would be able to insist that its total liabilities to all states be no greater than if all its operations were conducted by a single corporate entity.

The ownership test as the sole basis for combined reporting is provided for by Section 301(d) of S. 2092. The basic difference between S. 2092, and H.R. 11798 is that the required stock ownership is increased from "over 50%" to "80%".

S. 1245 precludes the use of a combined report for determining income unless either the taxpayer or a state can establish that a taxpayer has engaged in non-arm's-length transactions which cause a material distortion of income.

The use of a combined report for determining income is not based upon the concept that members of a unitary business have not acted at arm's length. It is used because separate accounting, regardless of its mathematical accuracy, does not properly reflect the income of a unitary business. For example, assume one corporation manufactures an item which is sold by another wholly owned corporation and that combined net income is $1 million. In such case, should it matter if separate accounting records reflected that one corporation earned $3 million, and that the other corporation lost $2 million?

It is also noted that S. 1245 contains the startling proposition that the taxpayer can force consolidation by showing that it has engaged in non-arm's-length transactions. Thus, under such a provision, if a taxpayer wanted to have a loss operation included in a consolidated report, all that is required is for it to tell its controlled subsidiary to enter into a non-arm's-length transaction.

The practical difficulties of applying Section 482 of the Internal Revenue Code, upon which the non-arm's-length provision is based, can best be determined from Internal Revenue Service auditors. The section has been used so sparingly that it is referred to as "the silent policeman." If the Internal Revenue Service finds the section is difficult to apply, the states would find it impossible to apply. Particularly when detailed examination of records throughout the country may be required simply in order to make a preliminary screening. The non-arm's-length proposal, in practical effect, prohibits the determination of income under the "combined report" approach. *Such a provision would permit taxpayers to control the amount of and place where their income is subjected to tax.* Thus, tax consequences would be governed by the corporate form in which a business is conducted. This provision violates the most basic principle of tax law—namely, that taxes must be determined by substance.

The "combined report" approach requires that the income of an economic unit be determined by the realities of the total activities of a commonly owned group of corporations. The only valid objection to such method is that it is not utilized by all states and, at least from a theoretical viewpoint, could cause overtaxation. This objection can be met if a clear guideline is provided. Since any statutory provision incorporating the unitary concept would be subject to interpretation, which may not, in all cases, be uniform, a practical test for combination would be one based on ownership. Under such a test, because of the diverse activities of some businesses, the tax attributed to a particular state may seem inequitable when compared with separate accounting income attributable to that state.

"[47] The 'diversified,' 'conglomerate' or 'polyglot' corporation is becoming common in modern business. John K. Galbraith suggests a reason: 'It combines great size with highly diverse lines of manufacture. Thus it can absorb the adverse consequences of uncertainty that cannot otherwise be eliminated. Uncontrolled aversion of customers to one product, such as aircraft, is unlikely to affect telephones or building materials. The effects of market uncertainty are thus contained in what will often be a relatively small part of the total planning unit.' J. GALBRAITH, THE NEW INDUSTRIAL STATE 27 (1967). He cites the example of General Dynamics Corporation which was able to survive a $425 million loss in the jet transport program of its Convair Division because its other products—missiles, building materials, submarines and telephones—produced annual revenues of around $2 billion. If one division saves the corporation from being wrecked by financial disaster in another division, isn't this adequate evidence of unity even though the two divisions are engaged in different types of business?"

However, such an ownership test, applied by all states, would prevent a business from being exposed to tax on more than 100% of its income. Thus, an ownership rule is suggested not for its merit, but for its simplicity.

"FOREIGN SOURCE" INCOME

There have been many statements made to the effect California taxes foreign source income and thus injects itself into the domain of international law. These statements are incorrect and seem to be based on a fundamental misconception as to the issue involved.

Neither California nor any other state taxes foreign source income. What is done by states using the unitary concept is that all of the income producing activities of a company are considered regardless of where such activities are conducted. The state then taxes *that portion* of the total income properly apportionable to the state based on that state's factors. S. 1245 prohibits the apportionment of "foreign source" income, which, when coupled with the prohibition against taxing dividends from "foreign source" income, results in a total exclusion from the tax base of income earned outside the United States.

If states are prohibited from taking into account the income and factors of a unitary business located in a foreign country, they are compelled to give preferential treatment to corporations doing business abroad simply because the Federal Government does. There is no rational basis nor legal support for such a position. The Congress of the United States sets policy in many areas through its income tax laws. To contend, however, that every matter of policy set by Congress must be duplicated by the several states is preposterous.

One of the leading United States Supreme Court cases involving state corporation income taxes is Bass, Ratcliff & Gretten, Limited v. State Tax Commission, 266 U.S. 271 (1924). Under the facts of the case the corporation had no net income upon which it was subject to federal income tax. It did have overall net income in excess of $2 million, a portion of which was allocated to the State of New York. In upholding the New York tax, the court stated at page 283:

"The fact that the Company may not have had any net income upon which it was subject to payment of income tax to the Federal Government, obviously does not show that it received no net income from the business carried on in New York."

There is no justification for legislation which prevents states from taxing all income derived from within its boundaries, nor which requires the application of different tax laws because of the geographic location of a part of a unitary business. A provision such as contained in S. 1245 would simply exempt much of the income of some large multistate corporations. It would also give the large corporations with foreign subsidiaries a competitive advantage over the smaller corporations which conduct their business within the United States.

A provision such as contained in S. 1245, relating to exemption of income from "foreign sources," would prevent states from determining the income of corporations by taking into account their total operations. Accordingly, it is recommended that the preferential treatment of "foreign source" income as provided for by S. 1245 be rejected.

INCOME FROM CONTINENTAL SHELF AREAS

The only bill introduced which covers this area is S. 1245. Under Sec. 207(a)(1) of the bill apportionable income does not include income from sources without the United States. In addition, Title 43 of Section 1333 of the United States Code excludes from state taxation income from continental shelf areas.

Section 522 of S. 1245 provides that income from sources without the United States means income from sources without the United States determined under the Internal Revenue Code, except that Section 638 shall not apply. Section 638 relates to continental shelf areas.

Since the income is exempt, and as the property, payroll and sales are not included in the numerator of any state's apportionment formula, this provision seems to be designed to have such property included in the denominator of the apportionment formula. Such a provision would attribute income (exclusive of that arising from continental shelf areas) to such areas.

Such a proposal not only exempts income from the continental shelf areas, but apportions otherwise apportionable state income thereto. Such preferential tax treatment for a special class again demonstrates that the provisions of S. 1245 are designed to provide the maximum tax benefit for large multi-national corpo-

rations. It is recommended that this provision, like others which would provide special tax benefit for a special class of taxpayers, be deleted.

APPORTIONMENT FORMULAS

The traditonal and commonly accepted apportionment formula consists of three factors, which are a property factor, a payroll factor, and a sales factor. This formula has been used by most states for many years.

The House of Representative Tax Acts are the only legislative proposals which have not incorporated the usual three factor formula. The House Acts omitted the sales factor, which reflects activity in the market states, and proposed a two factor formula. The factors consist of property and payroll. It was so developed so that the Acts jurisdictional standard and the apportionmnent formula would be congruent.

The most common apportionmnent formula is that provided for by the Uniform Division of Income for Tax Purposes Act (referred to hereafter as the Uniform Act). California is one of the 28 states which has adopted the Uniform Act.

Practically all apportionment formulas provide that the property factor consists of real and tangible personal property. Rented property is also included in the property factor in most cases, and the rental property is valued at eight times the net rental. Property is valued at its original cost, which has been construed under regulations recommended by the National Association of Tax Administrators and the Multistate Tax Commission to mean its original tax basis.

S. 2029 excludes from the property factor the value of any property located in a state in which the corporation is not taxable.

The payroll factor of most apportionment formulas is similar to the payroll factor provided for by the Uniform Division of Income for Tax Purposes Act. In general, under the Uniform Act, payrolls are attributed to the state where compensation is reported for unemployment insurance tax purposes.

The most radical deviation from what has been considered as a noncontroversial factor is contained in Section 203(c) of S. 1245. Section 203(c) provides that the only wages included in the payroll factor are wages as defined in Section 3306(b) of the Internal Revenue Code. Thus, wages under this provision are limited to $4,200 per employee. If a payroll factor is to be employed, and it is a significant income-producing factor, there is no justification for not including in the payroll factor all compensation paid to employees.

Again, this factor, as in the case for all factors, should be designed so that all income is attributed to the states which have jurisdiction to impose an income tax.

The most controversial, and the most difficult factor is the sales factor. This factor was omitted from the House Interstate Tax Bills. Almost all states, including California, have adopted a sales factor. Unless such factor is included in the apportionment formula, in many cases there would be drastic shifts in tax burdens. In general the omission of a sales factor would cause an increase in the tax of locally based businesses, and would result in a decrease in tax for out-of-state based businesses.

In order to minimize the amount of income which could be attributed to a state which does not have jurisdiction to tax, the Uniform Act provides that sales will be assigned on a destination basis unless the taxpayer sells to the U.S. Government or ships to a state in which it is not taxable. In this case the sales are attributed to the state from which the property is shipped.

S. 1245 includes in the sales factor receipts from the sale of tangible personal property, receipts from the rental of tangible personal property, and sales, other than sales of tangible personal property if the income-producing activity is performed in one state or, if the income-producing activity is performed in more than one state, all sales are attributed to the state where the greater proportion of the income-producing activity occurred based on costs of performance. Sales of tangible personal property are attributed to the place where the property is received by the purchaser after all transportation has been completed. Sales to foreign countries are included in the denominator, even though the seller is not taxable therein.

The sales factor in S. 1245 unduly favors the interstate seller in that it may assign sales to many states in which the seller is not subject to tax, thereby giving it a competitive advantage over a local business which is subject to tax on all of its income. Furthermore, unless the factors are designed so as to attribute income only to states which have jurisdiction to impose a tax, the straight destination rule will apply most unevenly. For example, a mail order business may be able to attribute almost one-third of its income to states which do not have

jurisdiction to impose a tax. Also, businesses which sell products which do not require servicing, such as tobacco or liquor, could attribute large amounts of income to states where they are tax exempt under the straight destination rule, and the high jurisdictional threshhold of S. 1245.

Sec. 204(b)(2), which includes in the sales factor receipts from sales other than from sales of tangible personal property, would create many complex administrative problems and lead to inequitable results. The provision was adopted from the Uniform Act. However, the regulations have greatly limited the application of the provision. This was first accomplished by providing that the section does not apply if a taxpayer is engaged in a business where its principal activity consists of sales, other than sales of tangible personal property. The later regulations treat each activity as a separate transaction so that income is attributed to the place where the income is earned. In general, these businesses consist of those selling personal services.

For example, if an engineering consulting firm built a bridge across a river on the border of two states and 49% of the costs of performance are incurred in one state and 51% in the other, the total receipts under S. 1245 are attributed to the 51% state.

Another example may be a firm engaged in a research and development project for the United States Government. During the course of its research it may engage in activities in eight states; however, under S. 1245, all of the sales would be attributed to one state where the greatest income producing activity occurred, based on costs of performance.

It is also clear that the treatment of sales as provided for by S. 1245, in most cases, would permit only one state to impose tax on income derived from sources within a state by management firms, advertising agencies, architects, insurance agencies, and assayers, unless the greater proportion of the income-producing activity occurred in that state, based on costs of performance.

Section 207(b) permits taxpayers to include in the sales factor sales from outside the U.S. if apportionable income includes income derived from such sales. Taxpayers are permitted to include such sales in the sales factor, whether or not they are subject to tax in the foreign country. It has been suggested that the foreign country has exericsed its taxing jurisdiction by permitting shipments of the property. However, if an apportionment formula is to apply equitably, it should attribute income only to areas which have jurisdiction to impose an income tax, determined by the laws and Constitution of the United States. Unless this is done those businesses which sell tangible personal property outside the United States would be granted a tax advantage over those which confine their sales to the several states. Sales attributable to foreing countries should be treated the same as sales attributable to other states, and such sales should be attributed to a foreign country only if that country could impose an income tax by application of judicial concepts as developed under the laws and Constitution of the United States.

It is therefore suggested that in order to attribute income only to those states which have jurisdiction to impose an income tax the denominator for each factor consist of the total of the numerators of the states which have jurisdiction to impose a tax. The apportionmnet formula contains a sales factor so as to reflect activities in the market states. Also, for ease of administration, the sales factor should include only receipts from the sale of tangible personal property, receipts from the rental of such property, and receipts from the sale of real property, if a taxpayer is engaged primarily in the sale of real property.

DIVIDEND INCOME

According to the Internal Revenue Service Statistics Income, *1968, Corporation Income Tax Returns*, approximately $6.8 billion of the $84 billion total net income reported was dividend income. Thus, approximately 8.2% of corporate income is attributable to dividends. The federal ratio of dividend income to net income would also be applicable to state taxes but may vary somewhat from state to state.

Because of the significance of dividend income, most legislative proposals contain special provisions regarding its taxation. Both S. 1245 and S. 2092 exclude from the tax base dividends received from corporations in which the taxpayer owns more than 50% (S. 1245) or 80% (S. 2092) of the voting stock. Both bills assign dividends, which are taxable, to the state of the taxpayer's commercial domicile.

Dividend income, like interest or other items of income realized from intangibles *is* income. The extent and manner in which such income is taxed, like all other items of income which includes a state's tax base, should be left to the state

legislatures. Thus, if a state chooses it should be free to allow an 85% deduction for dividends received from domestic corporations, or exempt them entirely, as do some states, or tax such income in whatever manner is appropriate.

There is a valid reason for excluding from the tax base dividend income received by a corporation from its affiliates if the income of the corporation and its affiliates can be determined on the basis of a combined report. In this case, since for purposes of determining income the affiliated group is treated as a unit, it is proper to disregard a transfer of funds from one entity to another since such transfer does not increase the real income of the affiliated group.

S. 1245 and S. 2092 limit the taxation of dividends to the state of the taxpayer's commercial domicile. This is the manner in which California taxes dividend income, after allowing a deduction for income included in a combined report and for income previously included in the measure of the tax. The method adopted by California undoubtedly was so adopted because of grade doubts as to whether or not dividends received by corporations commercially domiciled outside of California could be required to include dividend income in their apportionable income tax base. The considerations which gave rise to the California law may not be a significant factor with respect to federal legislation. If federal legislation can provide for the apportionment of all of a corporation's income, there seems to be no reason why a special rule need be adopted for dividend income.

If all dividend income is apportioned, all classes of taxpayers would be treated more equitably. Under present law many corporations have their commercial domiciles in states which do not impose an income tax, or which exempt all dividends from the tax base. Other states, such as California, tax dividend income except that paid from income included in a combined report or paid from previously taxed income. Thus, under the present California law California domiciled corporations suffer a heavier tax burden than do their competitors when they are located in a state which does not tax dividend income. Tax equality as a similarly situated corporation could best be maintained if all corporate income, including dividend income, is apportioned by an appropriate apportionment formula.

PROHIBITION OF ADJUSTMENTS WITH RESPECT TO TAX EXEMPT INCOME

S. 1245 provides that income and dividends from sources without the United States, and dividends received from a corporation in which a taxpayer owns 50% or more of the stock of a corporation are exempt from state tax. Sec. 207(a) prohibits a state from making offsetting adjustments with respect to exempt income.

Under this provision a taxpayer would be permitted to borrow money to purchase a foreign subsidiary and pay the interest on the loan from its United States source earnings which would reduce the amount of income subject to apportionment, and receive its foreign source income exempt from state taxes.

We think this is clearly a tax avoidance proposal. If any guidelines are to be provided with respect to taxable-nontaxable income and expenses, it is suggested that they be no more restrictive than are those provided in Section 265 of the Internal Revenue Code which provide for the allocation of interest and expenses with respect to tax-exempt income.

LIABILITY FOR UNASSESSED TAXES

All of the bills which have been introduced provide that no state or political subdivision shall have the power, after the date of enactment, to assess a person for a tax unless his activities meet the bill's jurisdictional standards.

This provision is based upon Section 2(a) of Public Law 86-272. However, Public Law 86-272 was enacted because it was feared that the decisions of the United States Supreme Court in *Northwestern States Portland Cement Co.* v. *Minnesota* and *T. V. Williams, Commissioner* v. *Stockham Valves and Fittings, Inc.* (79 Sup. Ct. 357 (1959)), had exposed businesses to state income taxes on activities which theretofore had been considered immune. Because of the broad scope of the language of the Supreme Court, Congress provided that the assessment of taxes prohibited by the bill shall not be made after enactment of the bill, even though the assessment is for prior years.

State taxing jurisdiction has been static since 1959. Furthermore, P.L. 86-272 has provided a jurisdictional guideline to businesses. If a much higher jurisdictional standard is mandated upon the states, a provision barring the assessment of taxes for prior years would only reward those taxpayers which have failed to comply with a state's tax laws. Those taxpayers which have ignored their responsibility with respect to state tax laws should be required to meet their obligations

just as have most taxpayers which do comply with state tax laws. It is therefore recommended that if higher jurisdictional standards are imposed states be free to assess and collect amounts due from those taxpayers which have failed to comply with their tax laws.

FEDERAL COURT REVIEW OF STATE ASSESSMENTS

S. 1245 is the only one of the state tax bills which relates to federal review. The bill would deny to state courts review of any dispute arising under the Act or under P.L. 86-272. It may first be questioned as to whether Congress could deny to state courts jurisdiction over state tax disputes. Such appeals would be to the Court of Claims for a review de novo, after the final decision of a state administrative body. It further permits taxpayers to bind any state given notice or appearing as a party. Actions of the Court of Claims are subject to review by the Supreme Court of the United States under Title 28, Sec. 1254, United States Code. Under this section review is limited to (1) Writs of Certiorari, (2) where a state statute is held unconstitutional, and (3) certification by the Court of Appeals of any question of law or instruction desired. Since the third ground refers specifically to the Court of Appeals, and as the disputes are limited to those arising under the Act or P.L. 86-272, the appeals would be limited in scope.

Under this provision a taxpayer could choose the state in which it wished to commence its litigation. Only upon appeal would a state which may have the greatest interest in the outcome of the litigation, be notified. It is only at such time that a state would be in a position to begin its audit development of the facts. Furthermore, states would be compelled to follow and participate in all litigation. Almost any decision could be important because of precedent effect. Thus, states would either be compelled to greatly enlarge their audit and legal staffs, or permit decisions which directly affect them and their tax base to be made without their participation. The bill also does not provide where hearings would be conducted. Wherever conducted, it would seem that a number of states would be compelled to incur significant additional expenses.

As justification for such a drastic proposal, it is suggested that such action is necessary because of different results with respect to the Kennecott Copper Corporation in the cases of *Chase Brass and Copper Co.* v. *Franchise Tax Board*, 86 Ca. Rptr. 350, and *Kennecott Copper Corp., et al.* v. *State Tax Commissioner*. (Utah Supreme Court, unreported, case No. 12498, filed 1/24/72). That case involved state statutes, and does not establish that the state courts would be less consistent that other courts if they were construing a uniform federal statute. Furthermore, some conflict in complex areas of law is normal and expected. For example, most of the appeals accepted by the United States Supreme Court from the Court of Appeals arising under the Internal Revenue Code are granted to resolve conflicts among the circuits. If states' courts were operating under a common federal statute, the same remedies would be available for resolving conflicts among the state court decisions. The cases which arose under P.L. 86-272 did not demonstrate that the states' courts failed to act reasonably. Certainly there should be no presumption that the states' judicial systems will fail simply because they are resolving disputes under a federally imposed statute. Accordingly, it is recommended that the resolution of state tax disputes be under the jurisdiction of state judicial systems.

EFFECTIVE DATES

The income tax provisions of the bills which have been introduced are effective for taxable years ending after the date of the enactment (H.R. 977 and S. 2092) or beginning on or after one year from the date of enactment (S. 1245). None of these complex bills allow adequate time for implementation.

If state tax laws are to undergo far reaching and radical change, states must be allowed a reasonable amount of time to prepare for such unprecedented upheavals in their tax laws. In order to make transition as orderly as possible, considerable lead time would be required for example to:

1. Familiarize personnel with the changes;
2. Prepare appropriate forms and instructions for the guidance of taxpayers; and
3. Review existing laws and make required adjustments.

In addition, if major changes are proposed, the operative date of any proposed change should be deferred so that its provisions can be reviewed in detail so as to determine whether or not revisions will be required before they are effective.

Accordingly, it is recommended that if comprehensive legislation is enacted the substantive provisions, at a minimum, not become operative with respect to taxable years ending three taxable years after the date of enactment.

Summary of Principal Points of the California State Board of Equalization Relating to Sales and Use Taxes

1. The Congress should not enact federal legislation inhibiting the imposition of *state* sales and use taxes.

(a) The jurisdictional standards established by a series of United States Supreme Court decisions are well understood and not difficult for businesses and tax administrators to follow.

(b) Many multistate businesses do not consider a need for federal intervention in *state* sales and use taxation.

(c) The burdens of multistate businesses selling across state lines under the established nexus guidelines are not greater than the burdens of the interstate businesses with which they compete.

2. If federal legislation is enacted with respect to sales and use taxes, the following points should be considered:

(a) Congress should not require application of the principles of Public Law 86–272 to sales and use taxes. To do so would create gross discrimination against merchants within the state who are in competition with out-of-state businesses. Large revenue losses to the states would result.

(b) Congress should not impose the registration number concepts of S. 1245 (Mathias-Ribicoff) upon the states. To do so inhibits the states in obtaining compliance from multistate business because the audit efforts of the states would be forced away from the basic source—seller collection.

(c) Congress should use the principles of S. 282 (Cranston-Tunney) as a model for any federal legislation in the sales and use tax field. This bill is acceptable to the business community and many of the states. It would provide relief to small businesses in dealing with a multitude of non-uniform local sales and use taxes and those local sales and use taxes that are not state-administered.

(d) As a further measure of relief for small businesses, Congress might consider establishing reasonable minimum reporting periods where a business is without a business location in a state and has small tax liabilities.

3. Congress should give consent to the present Multistate Tax Compact but without making its membership coercive and without changing its role from that of an advisory body to one that becomes a third level of government. Congress should provide for a periodic review of the progress of the Multistate Tax Compact and the Multistate Tax Commission.

COMMENTS OF THE CALIFORNIA STATE BOARD OF EQUALIZATION

In the interests of conserving the time of the Subcommittee, we requested that our testimony relating to sales and use taxation be combined with the presentation made by the Franchise Tax Board by Mr. Bruce W. Walker. Since we had the opportunity to present our basic views in writing to your Subcommittee staff at the round table discussions held on August 10, 1973, we will not again repeat in detail the points made at that time by our Chief Counsel. A copy of these written comments, dated August 10, 1973, is attached hereto, incorporated herein, and marked Exhibit A. We respectfully request that they be made a part of your Subcommittee record. In addition, we have several points that we desire to present to the Subcommittee.

1. Need for Federal sales and use tax legislation

California's basic position is that the Congress should not enact Federal legislation inhibiting the *state* sales and use taxes. Interstate sellers with presence (nexus) in a state are in competition with local merchants. Be they large or small they should be treated the same as local merchants.

We note that the COST position on the need for Federal legislation in the sales and use tax area was expressed in July 1973 by Mr. William R. Brown, the COST Associate Research Director, thusly:

"Most COST corporate members do *not* consider the state sales tax as the area where they personally feel the need for Federal interstate tax legislation—rather their desire for Federal legislation results from problems that have developed in recent years in the corporate income tax field."

2. Problems of "small businesses"

If the Congress finds that Federal legislation relating to sales and use taxation is essential, and especially with respect to local taxes, it should use the provisions of S. 282 (Cranston-Tunney) as a model. This bill codifies the jurisdictional standards for state sales and use taxes as they have been set by a series of decisions of the United States Supreme Court. Furthermore "small businesses" are relieved

of accounting for non-uniform local sales and use taxes where their nexus with local jurisdictions is solicitation only. The case of *Texas, Inc. (Texad Specialty Company)* mentioned at the round table discussions with your staff on August 10, 1973, and now pending on appeal to the United States Supreme Court (No. 72-1670) while framed in terms of nexus serves to point up the potential problems of multistate business in having to deal separately with a multitude of local jurisdictions. We make no comment on the merits of the basic legal issue now pending before the court. Nevertheless, from the facts set forth in the jurisdictional statement of the appellant we would point out the burdens of any business similar to Texad's would be greatly relieved by having to contend only with the several states and those uniform local taxes which are state-administered and treated as state taxes under S. 282 (Cranston-Tunney).

Some proponents of small business want the principles of Public Law 86-272 applied to sales and use taxes. That is, they want to allow solicitation-only into a market state without the responsibility to collect the use taxes of the market state. This, in our opinion, would be the worst possible "solution."

We are aware of nationwide firms selling books, magazines, record albums, ready-to-wear dresses, kitchen utensils, cosmetics, plastic items, and a host of other consumer products which collectively have very significant multimillion dollar retail sales volumes based upon sales solicited in the state but without the maintenance of a business office in our state. We are also aware that there are many firms that have the ability to change their methods to solicitation-only if they could obtain a tax advantage. These firms could obtain total tax immunity and compete on an unfair basis with our local sellers if Public Law 86-272 concepts were applied to sales and use taxation. The result would be an initial loss of revenue for our state alone estimated at $15 to $20 million per year. Much more important, the result would be to create tax loopholes and discrimination in our market place in favor of out-of-state solicitation-only sellers. The same is true for all other sales tax states.

The Mathias-Ribicoff bill, S. 1245, offers another solution in Sec. 304. That is the so-called sales tax registration number proposal whereby sales to business purchasers by out-of-state sellers without business locations in the state could be freed of use tax collection responsibility. The states would then be relegated to collect their use taxes directly from the registered business buyers. This proposal, while not nearly as drastic as the Public Law 86-272 approach has the effect of inhibiting the ability of the states to use the one most effective tool for use tax compliance, i.e., seller collection. Our audit efforts would tend to be splintered and directed at a large universe of business buyers, each of which has made relatively small purchases when compared to the auditing of sellers where the purchases are centered. Furthermore, we would be required to register thousands of service industries, farmers and professionals who purchase from out-of-state solicitation-only vendors and who are not now directly concerned in sales and use tax accounting and the filing of returns.

We understand that some proponents of S. 1245 recognize the need for revising the registration number proposal to restrict it to a smaller class of buyers that would have to be registered. We have not seen the proposed amendments to date and are unable to fully comment on their effect. Nevertheless, we would oppose any system which would undercut our audit and compliance effectiveness and which in turn would result in tax leakage and non-compliance.

One problem that small businesses are concerned with is having to report frequently very small amounts of tax liabilities to a number of states. It has been claimed that in many instances more expense is involved in preparing the returns than the amount of tax reported. We recognize this problem. We have the ability under our state law to adjust reporting periods so that they have some relationship to tax liability. For example, although our basic reporting period is quarterly, we have 134,000 accounts on an annual reporting basis. Some of our sister states have monthly reporting requirements without the degree of administrative flexibility that we have under our state law. *So long as no escape of taxation would be permitted* by Federal legislation, we can see no serious objection, if such legislation is to be enacted, that it contain a provision requiring reasonable tax reporting intervals for businesses without a business location in a state and with small tax liabilities.

3. Approval of multistate tax compact

We would respectfully request that Congressional approval be given to the present form of the Multistate Tax Compact. As a purely legal proposition it may

be argued (and we are of the view) that Congressional consent is technically unnecessary. Nevertheless, consent at this point would stimulate a healthy growth of the cooperative efforts of the states to ameliorate a number of the problems of multistate taxation. The purposes of the Compact are to promote further equity and uniformity in tax systems and to facilitate determination of the proper tax liability of multistate taxpayers. The Compact and the Multistate Tax Commission have made progress to this end. We suspect that some of the opposition to strengthening of the Compact by Congressional approval arises from those who view with alarm the idea of the states working together so that there will be full tax coverage with less escape caused by slippage in piecemeal dealings between the states and the multistate taxpayers. The opposition to joint auditing by the Multistate Tax Commission is difficult to understand because this cooperative device relieves multistate businesses of the inconvenience of multiple audits.

We would like to see the Congress approve the Compact without at this time adding additional authority to the Multistate Tax Commission. We believe it would be a mistake to create a Commission whose findings and recommendations take on the characteristics of regulations or adjudications binding upon the several states. The appropriate role of the Compact and the Commission should be advisory. For this reason, we do not favor the concepts of S. 2092 (Magnuson) whereby membership in the Commission becomes coercive and the Commission in effect becomes a third level of government.

In approving the present Compact we think it would be advisable for Congress to provide for a periodic review of the accomplishments and effectiveness of the Compact and the Multistate Tax Commission in achieving the purposes set forth as its aims. This alone would provide a strong incentive to the cooperating states to act in a reasonable and responsive manner to develop solutions to problems of multistate taxation. We believe this would also serve to strengthen the membership of the Compact.

The California administration desires our state to become a fullfledged participant and voting member of the Multistate Tax Compact. As the most populous state in the Union, we believe we can be a constructive force in assisting the several states to work together in the interests of tax uniformity and amelioration of multistate taxpayer problems.

4. The "Louisiana plan"

The concept of this plan is to allow full-scale taxation of all sales of tangible personal property made in the United States, regardless of nexus. The idea has appeal. It attempts to provide a simplified method of taxation for those with no present nexus with a number of states or those with minimum nexus.

We have at least one serious reservation. That is, whether under the Due Process Clause of the Fourteenth Amendment Congress can extend nexus to include the mere entry of a product into the destination state. As was stated by the court in the case of *National Bellas Hess Inc.* v. *Department of Revenue of the State of Illinois*, 386 U.S. 753: "And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.'" We have no serious questions concerned with removal of Commerce Clause barriers, but certainly existing Constitutional case law as to the Due Process Clause gives us pause.

We also believe the pattern of the proposal should be changed so that Congress would not prohibit collection of conventional sales and use taxes based upon seller solicitation nexus approved in *Scripto* unless the individual seller without a business location elects to be taxed under the blanket uniform tax provisions.

Only very recently did we receive the first draft of the basic concepts of the proposal. Without an actual bill draft we are unable to completely foresee all of the problems and are not sure we fully understand all of what is intended. Only by framing bill language will the problems fully surface. We anticipate that there would be problems of interplay of the blanket tax with the conventional tax and with elections in and out of the two systems. Also, compliance problems are evident.

If the business community is receptive to the concepts of the "Louisiana Plan" we would be willing to try to cooperate in drafting modifications and technical provisions that would be necessary to make the plan workable.

Exhibit "A"

August 10, 1973, *Washington, D.C.*

COMMENTS TO THE STAFF OF THE SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE OF THE COMMITTEE ON FINANCE, UNITED STATES SENATE, BY CHARLES H. OTTERMAN, CHIEF COUNSEL, CALIFORNIA STATE BOARD OF EQUALIZATION

INTRODUCTORY

These comments are in response to the invitation of Senator Walter F. Mondale, Chairman, Subcommittee on State Taxation of Interstate Commerce, dated July 10, 1973, for my views on the major problems involved in the imposition of sales and use taxes by the several states and their local subdivisions as related to interstate commerce.

California, the most populous state in the Union, now imposes sales and use taxes at the rate of 4¾% and collects locally imposed sales and use taxes for its 58 counties and 407 cities under a uniform law at the rate of 1¼%. Thus, the combined uniform rate in our state is 6%. In addition, a ½% local sales and use tax is administered by the state for the Bay Area Rapid Transit District, consisting of three counties. The sales and use taxes, both state and local, are administered by the State Board of Equalization, California's major revenue agency.

If our sales and use tax rates continue at their present levels, we anticipate that for the 1973–74 FY the state levy will yield $3 billion and the local levies will be $790 million for the cities and counties and $35 million for BARTD. This tax is California's most important source of state General Fund revenue (nearly ⅓). The sales tax has been imposed since 1933. We have over 450,000 retail business outlets registered for sales and use tax collection purposes. Cost of collection for 1973–74 FY will probably be under $1 per $100 of revenue.

THRESHOLD QUESTION

We all know the history as to how the Congress became concerned with state taxation of interstate commerce. It needs not to be repeated here like a tired phonograph record. Nevertheless, I believe that the Senate Subcommittee should examine fundamentals so as to put the sales and use tax problems in their proper focus and perspective before accepting any federal legislative approaches which interfere with the ability of the several states to impose and fully administer sales and use taxes. Nationwide, the sales tax is undoubtedly the most important revenue source left to the states. The income tax is dominated by the Federal Government while the property tax is historically allocated to local government. Federal interference in sales taxation should be approached with caution.

I hope the following points will be kept in mind:

The jurisdictional nexus outlines for state sales and use taxes have been well defined by the United States Supreme Court in a series of cases from the 1939 decision in *Felt and Tarrant*, [1] with further clarification in *General Trading Co.*[2] and in *Scripto*[3] and with limitation on the states in *Miller*[4] and *Bellas Hess*.[5]

The Special Subcommittee on Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, after studying sales and use tax compliance costs of businesses engaged in interstate commerce, found that the costs were not excessive. For the companies studied, the participants collecting sales taxes on nearly all sales had costs which when compared with their gross receipts were lower than those of local over-the-counter retailers. For the companies selling goods into other states, the prevailing system for collecting sales taxes was not found to be costly.[6]

The decision in the *Bellas Hess* case has in great part removed the complaints of mail order sellers doing an interstate business.

Seller collection, rather than consumer payment, of sales and use taxes is the very essence of efficient administration of this type of tax.

Sellers doing business across state lines can quite easily understand the nexus guides that have been declared by the United States Supreme Court. Furthermore, they have in their own possession all of the facts necessary to enable them to

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[1] *Felt and Tarrant Mfg. Co.* v. *Gallagher*, 306 U.S. 62 (1939).
[2] *General Trading Company* v. *State Tax Commission*, 322 U.S. 335 (1944).
[3] *Scripto, Inc.* v. *Carson*, 362 U.S. 107 (1960).
[4] *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340 (1954).
[5] *National Bellas Hess Inc.* v. *Department of Revenue*, 386 U.S. 753 (1967).
[6] Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives. State Taxation of Interstate Commerce, Vol. 3, pp. 811–813. (1965).

know whether they are present and have liability to the market state and to collect and report use tax on interstate sales.

All of this leads me to suggest that there is a substantial question of whether the Congress should interfere *at all* with state sales and use taxation. Certainly any approach which cuts back on state jurisdiction rather than lending a helping hand to the states is wrong in principle.

COMMERCE CLAUSE BALANCE WITH ESSENTIAL STATE NEEDS

Some bills propose to apply the jurisdictional limits applicable to income taxation under Public Law 86-272 to sales and use taxation. This approach, which allows escape from taxation of solicitation-only sales across state lines, would cause severe revenue losses to the several states and would create tax havens for those multistate businesses which could avoid having a business location in a market state.[7] More importantly, it encourages gross discrimination in the market place by giving a competitive edge equal to the state tax to the favored solicitation-only businesses vis-a-vis the resident businessman. No state, and certainly not California, can agree that Congress should encourage unfair discrimination for multistate business. That is a major reason why the Cranston-Tunney bill, S. 282, is sponsored by the California State Chamber of Commerce.

To a lesser extent, the COST approved registration number proposal, with its business buyer payment for solicitation-only sales, cuts into the ability of the states to manage and administer their own sales and use tax laws in the most effective manner. At present, the states have a bow with two strings for use tax collections. We can look to the interstate seller who has nexus under the established case law, and we can also look to the buyer located in our own state. Why should the Congress cut one of our bow strings and relegate us to a less efficient tax collection method? Because it is said that "small businesses" claim they have very serious problems in determining their sales tax liability and collecting the tax for the states in which they do not have a business location.

Many of the "small business" complaints arise from the differences in the tax bases and exemptions and administration provisions contained in the various state sales and use tax laws. But these differences arise from the inherent sovereignty of the states. This sovereignty is needed. The states cannot print money. They must operate on balanced budgets and they must have the ability to balance and adjust their own tax structures and cash flow to fit their budgetary needs and accommodate to some special problems of their local businesses and citizens. For the Congress to require the states through use of its Commerce Clause powers to march in "lock step" in order to cure the relatively minor complaints of some "small businesses" in my humble opinion would be an unfortunate overuse of Congressional power. Again, the *Bellas Hess* case has removed much of the hue and cry from one major segment of small business.

Businesses, large and small, undertaking to exploit the market across state lines should not complain so long as their burdens in the states where they sell are no greater than the burdens of local merchants with whom they compete. Differences in base, rate and administrative provisions in the various state laws need to be accepted as part of the price to be paid for our federal system.

The registration number proposal has the practical effect of requiring our audit program to be diluted and structured in a less productive manner than at present. Seller collection is the most efficient method. By forcing our audit and compliance focus to be in two directions—we lose full control and tax leakage is encouraged.[8] California would object to the mandatory use of a registration number procedure imposed upon it by federal law.

LOCAL SALES AND USE TAXES

It is my view that the most legitimate current complaint of multistate sellers in the sales and use tax field relates to their problems of compliance with local governmental levies of these taxes. Local entities are slow to give up their privilege of fixing their own rates, base and administrative system. Differences between various features of local taxes, as well as proliferation of the employment of sales and use taxes by local entitles, has placed burdens on multistate businesses and indeed intrastate businesses which border on the unreasonable. Even theb ound-

[7] Although California has not made a comprehensive update study since we supplied revenue loss estimates to the House, we believe a present estimate of between $15 million and $20 million annual revenue loss would be found.

[8] We cannot put a definitive dollar price tag on the mandatory registration number proposal, but the effects would be significant in the use of our budget dollars and audit recovery.

aries of some local jurisdictions are not easily ascertainable to a seller without a business office located in a particular local jurisdiction.

We in California recognize that multistate sellers should not be required by local taxing jurisdictions or by a state to collect non-uniform local taxes solely on the basis of a nexus derived from solicitation in a local jurisdiction.[9] Reasonable standards should allow, however, any statewide layer of uniform state-administered local taxes to be treated in the same manner as state taxes. Should the Congress legislate in this area so as to inhibit the seller collection of non-uniform local taxes, a reasonable time period should be allowed to permit the states to correct their non-uniform patterns of local sales and use taxes. The provisions of S. 282 by Senator Cranston address themself to this problem. If any restrictive federal legislation is deemed necessary by the Congress, I would recommend that this bill be the model for sales and use tax provisons.

THE HELP CONGRESS SHOULD GIVE

The Congress should by legislation sanction interstate agreements to allow the enforcement of sister state taxes. It should also reverse *Miller Bros.* so as to permit nexus for regular deliveries into a state. It should foster the means by which states may enter into cooperative auditing and the full exchange of information. For mail order sales the Congress should remove Commerce Clause bars and allow the home state to impose its own sales tax unless the mail order seller voluntarily collects the tax of the destination state.

Senator MONDALE. Our next witness is the Honorable Owen L. Clarke, deputy commissioner of corporations and taxation of the State of Massachusetts, on behalf of the National Association of Tax Administrators. Mr. Clarke, we are pleased to have you.

STATEMENT OF HON. OWEN L. CLARKE, DEPUTY COMMISSIONER OF CORPORATIONS AND TAXATION, STATE OF MASSACHUSETTS, ON BEHALF OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, SUBCOMMITTEE ON TAXATION OF INTERSTATE COMMERCE

Mr. CLARKE. Thank you very much, Senator.

My name is Owen L. Clarke, deputy commissioner of corporations and taxation for the Commonwealth of Massachusetts, and I am chairman of the Special Subcommittee of the National Association of Tax Administrators on Taxation of Interstate Commerce, and I appear on behalf of that committee.

I have submitted a detailed statement to the committee, which I will request be included in the record, and I have a brief summary of that statement that I would like to discuss with you.

The problem relating to the taxation of corporations engaged in interstate commerce has been of prime concern to State tax administrators ever since the U.S. Supreme Court decisions in the *Stockham Valves* and *Northwestern Lumber* cases.

The administrators have been responsible for changes, both legislative and administrative, in many of the matters which impelled Congress to enact Public Law 86–272 following the court decisions.

There are those, however, in the business community who urge that much more needs to be done and that only through the enactment of Federal legislation can any real progress be made.

Without affirming that Federal legislation is necessary, State tax administrators have participated openly and actively with business

[9] It must be admitted that our Bay Area Rapid Transit District tax does not presently meet the standards of S. 282. This tax is expected to phase out within a few years, leaving only our state-administered Bradley-Burns Uniform Local Sales and Use Tax Law.

representatives in serious attempts to resolve the outstanding problems.

The business community as a result of these discussions has submitted to Congress, in S. 1245, its proposed solutions to the unresolved problems, as well as to the problems on which there is some general agreement. Their solutions, in many respects, parallel and support the position which the States take on these matters. It is important, in considering any Federal legislation that we recognize the areas of agreement which have been reached between taxpayer and tax department, lest we allow the few remaining, but very important unresolved issues destroy the possibility of further progress.

It is not correct for anyone to assert that the entire business community now supports the bill now pending before the Congress, or that the States oppose it in totality. To everyone, who has labored over these disparate proposals, it is obvious that it is impossible to draft, or to enact, a bill which can be said to have all-encompassing widespread support. The issues are far too complex, and even devisive, to be settled satisfactorily for any large number of taxpayers or any large number of State tax departments.

The NATA subcommittee has a bill which is now being circulated throughout the country. The procedures which each State follows in analyzing, suggesting changes and amendments, and in securing necessary approval from legislative and Executive authority is a time consuming but of course, it is a required process.

More time is needed by the NATA committee to complete its work.

At this point, however, as chairman of that committee, I wish to enter on the record the major recommendations which the committee majority expects to make and which, we think, can be said to have some support in many States.

It is necessary, however, to point out that I speak only as a tax administrator from one State and, while chairman of a committee, the committee members can only speak for their individual State and even then with the reservation that their State approval requires more than the committeeman's own approval.

But, within that context, I would like to set forth the major concepts that this committee thinks are viable.

I. First, the question of jurisdiction to tax income.

The present standards for imposing income taxes, which were established by the Congress in 1959, with the enactment of Public Law 86-272, will be reaffirmed. The States will stand on Public Law 86-272. The States do not seek to impose income taxes on small corporations. It was to eliminate the compliance burden of small corporations that Congress passed Public Law 86-272 and the States, except for one quantitative suggestion, do not seek to change Public Law 86-272.

That one qualification would be to allow a State, into which a corporation makes substantial sales to impose an income tax.

II. The second concept which is a very important concept, is full accountability.

If Congress is to deny a State the right to impose an income tax on a corporation, because the activities of the corporation in that State are minimal, then the Congress must make it clear that no income can be allocated by the corporation to such nontax State. The rule should state that it is conclusively presumed that a corporation has not derived any income from a State if that State is denied the power to

impose an income tax on that corporation. Enactment of this principle is one of the most important issues facing the States today.

III. Total attribution of income. The entire income of a corporation shall be attributed only to those States which have the jurisdiction to impose an income tax on corporations. Such jurisidiction shall be recognized even though a State may not in fact have a corporation income tax law. Further, the total income shall be subject to apportionment. To whatever extent income is taxable, including dividends, such income shall be apportioned rather than allocated.

IV. Affiliated group. Corporations are affiliated if the 80-percent ownership rule of the Internal Revenue Code applies. The State should require, or the corporation should be allowed to elect, to file a combined return of affiliated corporations. Intercorporate dividends, and other recognized intercorporate transactions are eliminated in a combined report. Intercorporate dividends should also be eliminated if a combined return could be filed, even if such combined return is not filed.

V. Foreign source income. Jurisdiction to tax by a foreign country ought to be recognized to the extent that there is a nexus.

There is some dispute as to when nexus should fall. One suggestion is that nexus is determined on the basis of the right of the foreign country to estop a corporation from conducting any business activities in that country. If jurisdiction exists the country will be treated the same as a State with jurisdiction. If foreign jurisdiction does not exist, the same rules will apply as in the case of a nonjurisdiction State.

VI. Optional three fraction formula. A maximum ceiling beyond which a State may not tax will apply. Every State may tax on a basis less than such ceiling. The regular three fraction formula of property, payroll and sales will be applied to the total income for full apportionment. If a denominator is less than 3⅓ percent of income, an appropriate factor shall be substituted and special formulas shall be developed for special industries. The sum of the numerators in the taxable States shall equal the denominators for those States, which has just been discussed by Mr. Walker.

VII. Sales and use tax. A bill which is now pending before the Senate Finance Committee, Senate 282, has the support of many States, and our committee is expected to recommend it as a part of its draft. However, if there is to be a decision relative to the compliance burden, relative to local tax jurisdiction, the committee requests that the matter be kept in mind as a balance between the absolute necessity to close the loophole of interstate tax avoidance, with a reasonable method for dealing with the tax compliance burden created by multiple local taxing jurisdictions.

So, in conclusion, Senator, Congress and particularly the Senate Finance Committee, when considering possible enactment of legislation relating to these complex interstate matters, must recognize that an extremely large portion of State revenues is involved. We are dealing with State corporation and sales tax receipts which represent, in some States, more than one-half of the revenues collected for payment of public services.

It would seem, therefore, abhorrent for Congress to enact legislation relative to these which does not have the support of the States.

It is for this reason that the NATA Committee requests additional time to finalize its work and submit a bill for congressional approval.

Senator MONDALE. Thank you very much, Mr. Clarke. We have a vote on, so I am going to have to run over to the Senate. I will be back in about 5 minutes.

Thank you very much.

[The prepared statement of Mr. Clarke follows:]

STATEMENT BY OWEN L. CLARKE, CHAIRMAN OF NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

SUMMARY

1. *NATA Draft.*—A special sub-committee of the National Association of Tax Administrators (NATA) is preparing a draft of a bill to be submitted to Congress.
2. *Income Tax Jurisdiction.*—The states reaffirm the rule under P.L. 86-272. They seek, however, to have a quantitative rule added which will allow a state, into which substantial sales are made, to impose an income tax.
3. *Full Accountability.*—If Congress denies a state the power to impose an income tax, a corporation cannot attribute any income to such state.
4. *Attribution of Income.*—The total income of a corporation must be attributed only to the states which can impose a tax. Only the factors within such taxing states shall be used to apportion income.
5. *Sales Tax Jurisdiction.*—Scripto and General Trading Co. standard is retained. If a restrictive rule on local tax jurisdiction is considered the standard under the National Bellas Hess should be reviewed.
6. *Maximum Attribution.*—A ceiling, above which a state may not tax income, is provided. Each state may tax less than ceiling.
7. *Formula.*—Three factors of property, payroll and sales will apply. Special formulas for special industries.
8. *Affiliated Corporations.*—A state may require or a corporation elect to file a combined return if it is a member of an affiliated group. Intercorporate dividends eliminated if a corporation is eligible to file a combined return.
9. *Foreign Source Income.*—Jurisdiction of a foreign country is recognized if there is corporate nexus. Dividends would be eliminated if affiliated rules applied.
10. *Sales and Use Taxes.*—Provisions of S. 282 would apply. Attempt to reduce tax avoidance and compliance burdens now being reviewed by states.

STATEMENT

Mr. Kenneth Bach, President of the National Association of Tax Administrators has submitted to the Senate Finance Committee a statement, in general terms, which represents the views of a large number of the states with respect to the important issues relating to corporation income taxes and sales and use taxes as those taxes are imposed on multistate businesses.

In order to reduce the general terms to specific detailed proposals, the NATA has created a special subcommittee on the taxation of interstate commerce of which I am chairman. The function of this committee is to draft a bill on behalf of the state tax administrators which will provide solutions to the complex problems confronting both the taxpayer and tax departments on a basis which can receive substantial support from as many states as possible. It is obvious to all that no bill can be drafted which will receive unanimous or close to unanimous support.

This NATA committee indicated at this round table conference, which was held by your committee on August 8 and 9, that it expected to have available for this public hearing a draft which, would be acceptable, within the limitations noted, as a viable solution to the problems which were brought before that conference for discussion.

The NATA committee does have a first draft now being analyzed and reviewed by the state administrators. Every state, of course, must be considered in this process and we have not had sufficient time for the states to present their views and comments which might be incorporated in a consensus draft. The committee does not, as of today, have a consensus draft to submit.

In order, however, that the propositions which have received rather wide spread support may, at this time, be entered on the record the committee would indicate at least majority support for the following positions.

I. JURISDICTION TO TAX

Income Tax

For income tax and capital stock tax purposes PL86–272 remains as the keystone jurisdictional rule. Both industry and the states have, with perhaps one notable loophole, accommodated their activities to conform to the solicitation rule. Under the present solicitation rule it is possible for corporations engaged in making substantial interstate sales to avoid the imposition of a state tax simply by having the sales approved outside the state and the goods shipped from a point outside the state. The committee will recommend that, to the extent such sales are in substantial volume, and are made by a corporation that cannot be classified as a small business, jurisdiction to impose an income tax be extended to the state into which the sales are made.

Other than such refinement, however, PL 86–272 is reaffirmed as the jurisdictional standard.

With respect to PL 86–272, however, the committee will recommend a clarification of an interpretation of that law which is the source of much of the controversy between the states and the business community. Since the Congress has decided that small business ought not to be burdened with multiple tax compliance problems and, in order to accomplish that result, has restricted state authority to impose income taxes on such businesses, it would seem to be obvious that large multistate operations were not to be involved in the scope of this restriction. However, there is an abundance of experience which indicates that large corporations are making substantial sales into a state and, while claiming that in such state, under PL 86–272, they are not subject to the taxing authority, nevertheless seek to allocate substantial amounts of income to that state.

An analysis of the discussions which preceded the enactment of PL 86–272 discloses that Congress was concerned with the possible compliance problem of the nations many small businesses and took action to minimize compliance burdens. There is no indication that Congress intended to create a large class of exempt income at the expense of the states. There is no specific language in PL 96–272 which affirmatively supports the exempt income classification. It is only an interpretation of PL 86–272, and the realigning of business methods, which provides for the exemption.

This is, in the opinion of the committee, an extremely important issue and one which only Congress can resolve. If the Congress is to define what states can tax a corporation, then it should make it clear that those states shall be entitled to tax all—not simply part—of the corporations income.

The committee will recommend that it is conclusively presumed a corporation has not derived any income from sources within a state if that state is denied the power to impose an income tax on that corporation by PL 86–272.

To the extent that a corporation has sales payroll or property in a non-tax state, such sales, payroll or property shall not be included in either the numerator or denominator of the appropriate factors in any taxable state.

Sales and Use Tax

The jurisdictional rules derived from the U.S. Supreme Court decisions in the Scripto and General Trading Co. cases will constitute the basis for the imposition of state and local sales and use taxes. The committee is cognizant of the wide spread tax avoidance made possible under the protection afforded by the interstate commerce clause. Interstate buyers and sellers of property have been able to acquire and transfer property without payment of sales or use tax and the states have been confronted with an almost impossible task of attempting to identify and collect from the buyers long after the sale.

On the other hand the committee recognizes the compliance problems faced by business, particularly small business, in dealing with the multiple local taxing jurisdictions. These compliance burdens exist whether such local jurisdictions have autonomous administrative authority or, as is the most common method, the administration is carried out under a uniform state ordinance. A serious attempt has been, and continues to be made, to reconcile the problems of revenue loss and reasonable compliance within the framework of standards already agreed upon, in broad measure, by taxpayers and tax departments under S. 282, titled the Tunney-Cranston bill.

Gross receipts

Since the problems relating to the imposition of a gross receipts tax are limited both in relation to the scope of such taxes as far as compliance burdens are concerned and as to the number of states—three or four—which rely on such levies for

revenue the committee will recommend that no legislation is required with respect to such taxes. The committee will also recommend that no legislation is required with respect to so-called capital account taxes as distinguished from capital stock taxes.

II. MAXIMUM CORPORATE INCOME OR CAPITAL ATTRIBUTABLE TO TAXING JURISDICTION

Most of the bills submitted for Congressional approval support the principle that, if there is to be federal legislation, a ceiling on the net income to be subjected to tax should be established. Every state would be allowed to recede from such ceiling if its tax policy should so determine. The taxpayer would have the option of arriving at tax liability under the state tax law or under the federal law.

The committee will recommend that the base for determination of net income shall be defined under state law. Since most states, either by statute or by administrative regulations, adopt federal taxable income as the starting point for the determination of state net income, a relatively stable uniform tax base can be projected.

To the extent that the three-factor formula using property, payroll and sales reasonably measures and relates to the activity of the corporation, it is used as the device for apportioning the net income. If, however, the denominator of any factor is de minimus, or, if the corporation is engaged in unique activities, such as professional sports, contracting, radio and television networks, then appropriate factors would be substituted.

Similarly the maximum capital stock tax would be determined by the same apportionment formula applied to the value as determined under state law.

III. TAXATION OF AFFILIATED CORPORATIONS

In order to provide for the proper attribution of income to a state of a corporation which is controlled by stock ownership by another, a method of consolidating or combining affiliated corporations must be provided.

The committee will recommend that the most feasible and acceptable standard to be found is based on an 80% ownership rule. It will recommend that a corporation may elect, or a state may require, the filing of a combined return by combination of any one or more of the affiliated corporations.

Intercorporate dividends and other intercorporate transactions affecting income would be eliminated in the determinations of the income of the affiliated group. Such income would then be attributed to the corporation over which the state has jurisdiction or would be prorated according to the apportionment formula if the state had jurisdiction over more than one of such affiliated corporations.

Dividends of affiliated corporations would be eliminated only with respect to dividends paid during the period of affiliation. Such dividends would be eliminated so long as the corporation could qualify for reporting on a combined basis whether or not such combined report was made.

IV. APPORTIONMENT FORMULA

With only isolated exceptions, the states support the use of the traditional Massachusetts three-factor formula for apportioning income. The committee will recommend three factors, but will also indicate that there are a substantial number of specialized industries, or corporate activities, such as professional sports, construction contractors and other similar personal service corporations, which require substitution of one or more appropriate factors.

There is general acceptance of the methods for determining the property and payroll factors. The recommendation will be made to value property at basis for federal income tax purposes rather than federal adjusted basis.

The sales factor will follow the destination rule, now applicable in most states, to the extent that the corporation is taxable in the destination state. If it is not taxable in such state then the sales in such state shall not be included in either the numerator or denominator of the sales factor of any state. This same principle applies to the property and payroll factors as well and provides for full accountability of income.

This is the mechanical device by which the jurisdictional rule under "I Jurisdiction to Tax" is to be implemented. Since it is conclusively presumed that no income can be attributed to a state which is denied the power to impose an income tax, the states which do have the jurisdiction to tax should apportion the total income

of the corporation in accordance with the actual factors which apply within such states. No state, among those which have jurisdiction to tax, should artificially inflate a factor by including property, payroll or sales which are otherwise attributable to a non-jurisdictional state.

V. FOREIGN SOURCE INCOME

Should a foreign country be subject to the same jurisdictional rule as a state in the United States as far as PL 86–272 is concerned?

If Corporation "A" has a federal net income of $1,000,000 and does business in nine states, but PL 86–272 allows only seven of those states to tax the corporation, then those seven states will apportion the $1,000,000. None of the property, payroll or sales in the two non-jurisdiction states will be included in the factors of any of the seven jurisdiction states.

Suppose, however, the corporation does business in Germany in the same way it does business in the two non-jurisdictional states. Does this mean that Germany does not have jurisdiction to tax Corporation "A"? If a corporation is doing business in another country does that other country have its own jurisdictional right, derived from its own national sovereignty, to subject the corporation to tax liability?

It would appear that, if a corporation has any nexus to a foreign country, the jurisdiction to tax the corporation automatically arises in that country.

The jurisdictional rule must be viewed from two points; (a) the right of each national government to impose whatever taxes it may wish on a corporation which is doing business in such nation and, (b) the right of each national government to determine how each of its own political subdivisions shall impose such taxes.

The committee, though with some serious reservations, will recommend that the national jurisdictional rule ought to be followed. If, therefore, a corporation conducts business activities in a foreign country in such a manner that such foreign country could estop the corporation, unless the corporation submitted to the tax laws of such country, whether or not such country imposed a tax, then the jurisdiction of the foreign country would be recognized. The corporation, in such event, would determine its property, payroll and sales factors as though such country were a state which, under PL 86–272, had jurisdiction to impose an income tax.

If such foreign country could not stop a corporation from conducting business activities in such country, then no foreign jurisdiction would be recognized. In such event, the corporation would determine its property, payroll and sales factors as though such country were a state which, under PL 86–272, was denied the power to impose an income tax. The property, payroll and sales of such non-jurisdictional foreign country would not appear in the factors of any jurisdictional state.

VI. LOCAL TAXES

Local governments which have been authorized by state legislators to impose income taxes would do so under the same rules applicable to a state. Appropriate adjustments would be made by such local governments so that the maximum income to be apportioned within a state would not exceed the income apportioned to such state on the state return. The denominators of the local apportionment fraction would be the numerators for that state and the numerators would be determined as though the subdivision were a state.

A political subdivision could not require the filing of a combined report of income of the state if the subdivision did not require one. Similarly, if a corporation elected to file a combined return with a state, then it would be required to file the same combined return with the political subdivision in that state.

VII. SALES AND USE TAXES

There is currently pending before the Congress S. 282—Tunney-Cranston bill—which has received substantial support from a large number of states.

The committee will include the provisions of S. 282 in their recommendations. The committee still seeks a reasonable accommodation, particularly with small businesses on the compliance problems involving the many local taxing jurisdictions.

It is this search for a workable solution in this sales tax matter which is the basic reason why the committee draft is not finalized as of this date.

That there is substantial tax avoidance, if not evasion, with respect to the sale of property in interstate transactions is admitted by all. The committee attempt to respond to this compliance—revenue loss problem is continuing and within the

provisions of S. 282 they are confident that an acceptable compromise may be effected.

Senator MONDALE. Our next witness is Hon. Ralph Turlington, chairman, Committee on Finance and Taxation, Florida House of Representatives, and chairman, Governmental Operations Task Force of the National Legislative Conference.

Representative Turlington, we are very pleased to have you with us this morning. I apologize for the delay, but we have, as you well know, two things going at the same time.

STATEMENT OF HON. RALPH TURLINGTON, CHAIRMAN, COMMITTEE ON FINANCE AND TAXATION OF THE FLORIDA HOUSE OF REPRESENTATIVES, AND CHAIRMAN, GOVERNMENTAL OPERATIONS TASK FORCE OF THE NATIONAL LEGISLATIVE CONFERENCE, ACCOMPANIED BY DR. EUGENE TUBBS, MEMBER OF THE COMMITTEE ON FINANCE AND TAXATION, AND MINORITY LEADER PRO TEM OF THE FLORIDA HOUSE OF REPRESENTATIVES

Mr. TURLINGTON. With me is the minority leader pro tempore of the Florida House of Representatives, Dr. Eugene Tubbs. He is also a member of the House Committee on Finance and Taxation. We are of opposite parties but we are traveling together to make the point that this is not in any way a partisan issue, in Florida, or anywhere else. It is a question of equity in taxation; equity to the taxpayer and to the States.

I would like to first comment that my service in the State legislature is some 23 years. During this time I have seen remarkable progress in State government throughout this country. State government now has apportioned legislatures which are representative of all the people. I think that State government is on the move and is now in a position to be more responsive to meeting the needs of people than ever before.

Senator MONDALE. I noticed in Florida that a good deal of courage has been shown in your revision and reform of your State tax laws and it has gotten a good deal of national attention.

Mr. TURLINGTON. Yes, we have received some national attention. We have revised our tax structure in the last 2 or 3 years. I hope in the passage of our legislation that we exercised fairness to all taxpayers including business. Of course there will be controversy about these issues, and I agree with those that have said, there is no way for your subcommittee, or anyone else, to resolve these issues to everyone's satisfaction. There are always going to be some differences. I am one that believes there is an opportunity for constructive legislation that can move forward the interests of the taxpayer, the interests of the States, and the interest of all of the persons within this country generally.

But, as anyone with legislative experience knows, you generally do not move until you have to move. Those that have conflicting interests are going to disagree until they are sure that legislation is going to have to move forward with or without them. Then you suddenly find that you can resolve legislative differences. I believe that the States are clearly entitled to your full consideration in being sure that their interests are fully protected if there is to be Federal legislation. What is involved here, is most important to the States.

I, as well as you, watch professional football on television.

Senator MONDALE. You have a Minnesotan running the Dolphins down there. We are trying to get him back.

Mr. TURLINGTON. I am not sure which game it was I was watching, but the New York Stock Exchange this last Sunday ran an advertisement during the game. In the advertisement they pointed out the great opportunity that the American public has to invest in America, and the growth of America, through investment in the securities of corporate business, which I, as a small investor, hope is a good piece of advice. They said one of the greatest places in which to participate in this type of growth and to benefit from it would be through the purchases of stocks that are listed on the New York Stock Exchange, and while these companies that are so listed represent less than 1 percent of all of the corporate business in the United States in number of corporations, they represented over 75 percent of all of the profits.

Now, if you would also take into account that these corporations are doing business almost invariably in more than one State, you recognize that when it comes to the taxation of business, if you are not in the business of being able to equitably tax interstate business, you are not even in the ball game. So, this certainly is of vital interest to the States and it is also a vital interest to the little businesses within a State. The reason for this is because it is not fair for a company to be able to operate in a multistate situation and not pay taxes proportionately and fairly in comparison with the local business.

Those then are the things that are essential to any legislation that is to restrict State tax discretion.

The most important feature that needs to be in any legislation is a jurisdictional standard that provides a sales volume test for nexus. Now, you look at the way the overwhelming amount of business is conducted in this country today. This idea about having an office domiciled in a State in order to really be in business in that State is a myth. Take a look at your national advertising. That is where the sales are made. Take for example the national company for which I happen to be an independent contractor. The sales that I make in Florida are not solely a result of my local efforts, but are made as a part of a national operation. Clearly, whether they do, or do not, have an office in my State, they are making sales there, and I and other Florida independent contractors represent a significant part of the Florida income that is earned by the national firm. If the Congress does legislate in this area there should be some type of a jurisdictional standard that enables a volume of sales to be used for the establishment of taxing nexus.

Now, this morning I noticed someone was saying that they could not do this because the records are kept by territories. Also, they are telling you that you could use the two factors formula, but when you start going into the two factor formula, trying to explain what is in Florida, and what is in Minnesota, you will find that there are all kinds of explanations. Clearly if you set your mind to it, you can very easily apportion sales, even among companies that are working on a territorial basis. The real crux of this question about sales being a basis for nexus, is an attempt by some businesses to simply avoid nexus, and to throw much of their income into a "nowhere" status. They recognize that you can establish nexus on a volume of sales,

and there will be little "nowhere sales income," and an attempt at tax avoidance is really what basically is at stake.

I think there is another difference involved here.

Senator MONDALE. Is it your statement then, that S. 1245 would result in some artificial rules that would help create nowhere income?

Mr. TURLINGTON. Yes, and there is some of that in the present law. The gentleman from California this morning pointed out a company that apparently is making sales in excess of $10 million annually in California for which there is no nexus under present law. I think that is wrong.

Senator MONDALE. Did I understand he was not objecting to that?

Mr. TURLINGTON. I think that he was objecting. I think California and most States want to include in a Federal statute a quantitative sales volume basis of nexus.

Senator MONDALE. What would this be based on?

Mr. TURLINGTON. Established on sales.

Senator MONDALE. As I understand it, according to the commissioner of taxation of Massachusetts, the States are not arguing with the present Federal law which, as I understand it, we are talking about income taxes?

Mr. TURLINGTON. Yes sir.

Senator MONDALE. Who said unless you have an office or some connection like that within a State, and not merely a salesman or mailings within the State, that the States could live with the distinction?

Mr. TURLINGTON. I think Mr. [Owen Clarke's, of Massachusetts, position would be quite definitely in favor of establishing nexus based on a quantitative volume of sales. Clearly if a company is doing $10 million worth of sales in California, they are in business in California I believe earlier this morning, you asked whether this type of taxation caused companies to change slightly or otherwise modify their sales structure. My answer to you would be "Yes." I have an illustration in Florida. Our tax is a fairly new tax, but we have a company there that is a large national company. They are seeking to make just a very few slight changes so as to escape the jurisdictional nexus under present law. Their volume of business in Florida clearly is large and they are earning income in Florida. We ought to be entitled to fairly tax along with all other States.

Senator MONDALE. I believe Mr. Walker said he did not think there was much of that in California.

Mr. TURLINGTON. I would say in California that probably there would be less, that they would notice this less because it is more difficult not to have the physical presence in California than it is not to have a physical presence in Minnesota, or Florida.

I would say that the sales nexus would be more helpful to the modest sized and small states. You know, if you are going to tax those with a physical office in the State, the companies just simply will not put an office or salesman in your state and, thereby, this technique to avoid your tax is used. But, watching the way sales are made by national organizations, which is the real volume of corporate profits in America, they really have a profit presence there. If I were selling Bayer aspirin or Anacin, I would have a real income presence in almost every State in the United States, and I do not see any reason

why the Congress, if it is going to pass legislation in this field, should not give the States an opportunity to have, or enforce, nexus in this kind of a situation.

Senator MONDALE. Does Florida seek to tax the corporation doing business in Florida with just a salesman? I gather you can under present law, but you have to find an office or something there.

Mr. TURLINGTON. Yes; we are. Of course, as I said, we are very new and we are building our corporate income tax department. So, we have not had any litigation or other rulings which I can cite to you for very much experience. The experience I mentioned about a particular company, you know, seeking technically to move out from the State, I picked this up in discussion with a representative from Jacksonville. The company was closing its Jacksonville office and moving its warehousing to Georgia. "Nowhere income" is involved in this. It is a very large corporation. I think they have figured that they will be able to avoid nexus in Florida by making just this slight adjustment and pay no compensating tax to any State. I am satisfied that their sales in Florida are in the millions of dollars. They are highly nationally advertised, and I see no reason why we should not be entitled to tax our fair share of their income.

Now another issue that I think may never be completely resolved without legislation that ought to be settled on the basis again of fairness to States including the large number that are not centers of commercial domicile is the dividend issue. I listened with great interest to the COST Committee this morning. Mr. Peters from the American Telephone & Telegraph Co., and I am sure he is a very excellent representative of that excellent company, when he gave you his illustration to show that dividend really ought to be allocated to the State of commercial domicile. What he was really saying was all of the dividend income that is in that wonderful and remarkable national organization ought to be legally taxable only to the State of New York. Then, the part that he did not follow up on, would be their presentation when they say to the State of New York: "We like it here in New York as long as you do not tax this type of income that has been brought to New York from the other States. If you really choose to tax this income, well, then, we will look for another State in which to locate our commercial domicile."

Senator MONDALE. Under that principle, is that just a matter of choice of the corporation?

Mr. TURLINGTON. Commercial domicile?

Senator MONDALE. Yes.

Mr. TURLINGTON. You can move the commercial domicile of a company.

Senator MONDALE. The company, A.T. & T., say, could move to Nebraska, and say this is our domicile?

Mr. TURLINGTON. Yes. I am not a tax expert, Senator. My experience is from attending meetings and sitting down and conversing with various people from various types of organizations, and just sort of hearing out how they feel. There may be some technical difficulties in some particular situations where they may have some difficulty.

Senator MONDALE. If they would move to Minnesota, maybe we could work it out.

Go ahead. Pardon me. I am sorry.

Mr. TURLINGTON. But the argument that they make, here in Washington, D.C., about the logic of where these types of income ought to be allocated, and the argument that they make to the particular States about taxation policy, when you put the two of those things together, what they are really saying is that that income really should not be taxed at all or if taxed, taxed but very little, when really it is just as much a part of the income earned by that form of an operation as any other income. We, as States, are actually the victims of a concept that started off many years ago, in Massachusetts. The thing that really has come out of organizations like the National Association of Tax Administrators and the Multistate Tax Commission is a growing expertise on the part of the States where they are beginning now to fully understand what goes on. And I think that is probably what accounts for the establishment of your subcommittee. Had the "dog" continued to sleep, I do not think you would have had the panel of five members of the COST Committee here this morning.

Now people are beginning to become more aware. I think that is a part of why State governments are becoming more aware of how these things are interrelated. Also, I think your subcommittee does have very challenging responsibilities ahead. There are some real considerations that are involved here which I think if handled properly, and with fairness to taxpayers and to the States, can help us out. They can also help business.

In the meetings that I have attended, they have led me clearly to the conclusion that those companies that honorably report their income and apportionment factors to the States are actually discriminating against themselves. It is the same old story. We must have an audit system so you can tell where this income honestly is earned. I do not think that we States have any business objecting to fair rules as to how this is to be accomplished. We do object to those who seek to have penalties and restrictions put into any form of legislation that would not enable us to find the answers to those questions. I am perfectly ready to have some restrictions, provided that we can also have a good audit and find where the income is, so as to do away with "nowhere income."

Senator MONDALE. Would you object if the courts were to make those determinations, or would you prefer legislation?

Mr. TURLINGTON. I would say frankly, as a legislator, if you want my honest judgment about it, I think Congress can make a better, and more intelligent long-range decision on this, than through the accident of litigation.

Mr. TUBBS. I would concur with that, Senator Mondale.

Senator MONDALE. Thank you very much. I am sorry, but we have to push along because we are running badly behind schedule.

Thank you very much.

[The prepared statement of Mr. Turlington follows:]

STATEMENT OF RALPH D. TURLINGTON CHAIRMAN, COMMITTEE ON FINANCE AND TAXATION, FLORIDA HOUSE OF REPRESENTATIVES AND CHAIRMAN, GOVERNMENT OPERATIONS TASK FORCE, NATIONAL LEGISLATIVE CONFERENCE

SUMMARY

1. Any federal legislation must incorporate proper safeguards to protect the states' right to tax.

2. Jurisdictional standards need to be amended to provide a sales volume test for nexus.
3. "Nowhere income" must be eliminated, *i.e.*, all taxable income must be subject to state taxation.
4. All taxable income should be apportioned among the states on the basis of the three-factor formula.
5. Dividends of all types must be part of the tax base of corporate income.
6. Consolidated returns must be allowed. Section 209 of the bill is not an administratively feasible alternative to consolidation.
7. Exemption registration procedure in Section 304 of the bill will undermine the state's ability to enforce its sales and use tax law.
8. Court of claims, as presently constituted, does not appear to be the appropriate court to try disputes arising under this bill and Public Law 86-272, as amended.
9. Congress should grant its consent to the Multistate Tax Commission.

STATEMENT

Mr. Chairman and members of the committee, I am Ralph D. Turlington, Chairman, Committee on Finance & Taxation of the Florida House of Representatives and Chairman, Government Operations Task Force of the National Legislative Conference. I appear here today to testify with respect to S-1245 introduced by Senator Mathias. Having been a legislator for 23 years, a former Speaker of the House and currently Chairman of Finance & Taxation Committee of the Florida House of Representatives, I feel that I am quite familiar with the issues involved in S-1245. In addition, I am currently Chairman of the Government Operations Task Force of the National Legislative Conference.

The Florida Legislature enacted a corporate income tax in a special session in November, 1971. As Chairman of the Committee on Finance & Taxation, I was the chief sponsor of this legislation. During the drafting stage and at committee hearings on this important measure, we fully considered and debated all of the issues involved in S-1245 which deal with the corporate income tax. After extensive hearings and debate, Florida decided to pursue the full apportionment route, by which all taxable income, based upon a three-factor formula of sales 50%, property 25% and payroll 25%, is apportioned among the states. Florida decided to piggyback the Internal Revenue Code using federal "taxable income" thereby including dividends received as part of the taxable income to be apportioned. Florida also decided to allow consolidated returns for affiliated groups on the same basis as the U.S. Internal Revenue Code. Florida, as you probably know, deviates from a complete piggyback of the Federal Code by taxing interest on government securities and exempting foreign income.

I believe that federal legislation setting jurisdictional guidelines and methods for the apportionment of taxable income, with proper safeguards to protect the state's right to tax, are desirable in order to achieve uniformity for state taxation. Furthermore, the federal legislation should protect the multistate business from having more than 100% of its taxable income being subjected to taxation in the various states in which it does business. In order to support federal legislation in this area, however, the states must be assured that all corporations will actually report all of their taxable income to the states. The states need a mechanism to insure that all taxable income is subject to taxation, while at the same time, corporations need assurance that not more than 100% of their income will be subject to state taxation. Federal legislation must provide for either multistate audits to be performed under the Multistate Tax Commission or provide that some federal agency, such as the Internal Revenue Service, will ensure that corporations are in fact reporting all of their taxable income for proper apportionment among the states. This will protect corporations from the unfair competition of other corporations which do not properly report their income as well as ensure the states that they are receiving all of the tax to which they are rightfully entitled.

As presently drafted S-1245 does not achieve equity for the states and, for this reason this bill may not be best vehicle. This bill restricts the states right to tax without seeking equity among the taxpayers. The jursidictional guidelines follow essentially the concept of Public Law 86-272. But in so doing, this bill has permitted two large tax loopholes.

First, section 101 of the bill sets forth jurisdictional standards which must be satisfied before a state may impose a corporate income tax on the corporation. These jurisdictional standards focus only on the way a corporation conducts

business in a state and not on the amount of business done in a state. A corporation could establish a regional office and warehouse in one state and solicit orders from surrounding states. Regardless of the amount of business derived from the surrounding states S-1245, as presently drafted, would not subject that corporation to tax in any states but the ones in which the regional office and home office are located. This emphasis on form of conducting business fails to recognize the right of a state to tax a corporation which is earning substantial amounts of income within the state.

I would propose that this section be amended to provide that a corporation with total sales volume of approximately $2,000,000 per year which derives sales in excess of approximately $300,000 per year from a state be subject to tax in that state. This would not cause any compliance problems for a truly small business since these volume figures hardly describe a small business. This volume test is valid in that a corporation doing this volume of business in a state is using the state as a market and is eligible to receive valuable state services and protection while doing business in that market. I repeat—the present draft places a premium on the form of conducting business and not on the corporations size or market effect within a state—which is not equitable to the states.

Second, S-1245 does not solve, or attempt to solve, the problem of "nowhere income". Under S-1245 all taxable income is apportioned to the various states on a sales destination basis. But, if the state to which the income is apportioned does not have sufficient nexus to tax this income then, because there is no provision for throwback rule in the bill, the income so apportioned escapes taxation. Two important concepts of taxation are:

(1) that all income of a corporation should be subject to taxation and,

(2) that all taxable income should be apportioned among the states able to impose a tax because of the nexus rules.

This can be accomplished in either of two ways. The bill should provide for either a throwback rule, or the sales factor in the bill should be amended so as to provide for the exclusion of sales in both numerator and denominator that are deemed to be made in states not having sufficient nexus to tax this corporation.

Notice, this does not mean that all income will in fact be taxed, but simply that all income will be subject to tax. This "nowhere income" really discriminates against small, intrastate business which must compete with the large, interstate business. The income of the intrastate corporation is all subject to tax, whereas, because of the way in which it conducts business, the interstate corporation may not be subject to tax in the state due to the lack of nexus. This bill, in reality, creates unfair competition in favor of the large, multistate corporations as opposed to the small, intrastate business.

Probably the most controversial area in respect to the taxation of corporate net income is in the area of the taxability of dividends. Dividends constitute a source of income from a variety of investment forms, and the problems of dividend taxation cut across industry lines in many different ways. Dividends arise principally from payments received from "controlled" (wholly-owned or partly-owned) subsidiary corporations; from foreign corporations which remit to their U.S. parent; and from pure "investment" sources, such as the dividends received by corporations investing their idle cash in corporate securities.

The federal treatment of dividends is basically dependent upon the dividend source. If a corporate taxpayer receives dividend income from a domestic (U.S.) corporation, the Internal Revenue Code grants an automatic deduction for 85% of that dividend receipt (100% if the paying and receiving corporations are members of an affiliated group). This deduction eliminates severe double taxation at the federal level, since the dividend-paying corporation has earned income subject to U.S. tax and did not receive a deduction for its dividend payment in computing its federal taxable income.

Intertwined with the taxability of dividends is a fundamental principal of state taxation which should be explored to some extent at this juncture. Historically, states have "allocated" or assigned to one particular state 100% of certain types of income derived from corporate activities. Typically dividends, interest, rents, royalties, and capital gains were "allocated" in full to the state of "commercial domicile" of a corporation. What this simply means is that the dividend income received by a corporate taxpayer would be "allocated" by almost every state in which it does business so as not to be taxable in those states, while being subject to tax in full in the one place where it has its commercial domicile. Of course the state of commercial domicile could, and in many cases does, choose not to tax dividend income at all. As a result, if all states "allocated", no dividend income received by such a corporation would be taxed anywhere.

In contrast to the "allocation" of certain items of income (the most significant of which is dividend income), the balance of operating income derived by corporations doing business in more than one state is typically "apportioned". That is, dividends are apportioned among the states in which the business is conducted. The methods of apportionment vary, but a three-factor formula based on payroll, property and sales is the method most widely accepted.

The Florida Corporate Income Tax Code does not attempt to allocate any items of income to the commercial domicile of a corporate taxpayer. It endeavors to apportion 100% of corporate net income, from whatever source derived, and to attribute to Florida its apportionable share of all of that net income. This method of state taxation is sometimes called "the new Massachusetts approach", since that state recently changed from the allocation/apportionment method to 100% apportionment.

When business representatives discuss the dividend question they tend to operate in the frame of reference with which they are familiar in most other states—namely, that dividend income is "allocated" to a particular jurisdiction rather than being subject to tax in a multiplicity of places. This historical practice has, I think, tended to result in an allocation of certain types of income to a very few states where commercial domicile is concentrated. New York, California and Illinois are the major commercial domicile states.

Obviously under "allocation" procedures, corporate taxpayers need only convince one legislature—the legislature in their commercial domicile—that dividend income should not be subjected to taxation. Thus, one finds that some commercial domicile states exempt, in fact, all or a major portion of the dividend income received by their corporate taxpayers.

The arguments against taxing dividends are persuasive. Dividends constitute the one type of corporate income which does not have a corollary deduction for the paying corporation. So there is a definite potentiality for double taxation in the federal tax scheme. As previously indicated, however, Congress alleviated double taxation at the federal level.

On the other hand the subcommittee should be aware that there are reasons why dividend income from various sources should not all be treated alike. Dividends from foreign, corporate activities might well be excluded from taxable income in the states on the grounds that they should not extend their tax base to the international operations of the corporate community. Similarly, a case can be made for excluding from income dividends which are received from "controlled" corporate affiliates—such as those which are 100%-owned or 80%-owned—on the ground that these corporate entities are merely an extension or "branch" of the parent, and not a suitable subject for double taxation. (An elimination of dividends within a controlled group can also be achieved through the filing of consolidated returns.)

A less persuasive case can be made for excluding dividends which are received from ordinary investment activities since dividends received from this source enter into the general operation, finances, and activities of corporate taxpayers to the same extent as their other operating receipts.

Opponents of dividend taxation suggest that dividends should be taxed to no greater extent by the states than by the federal government. This essentially means that all foreign dividends, and at least 80% of all dividends received from domestic corporations, would be removed from the state tax base. As to the latter it is well to consider the probable rationale for the federal tax policy, which I believe is a reluctance to tax the same income twice. It does not follow from this reasoning however, that the states should be forced to adopt the federal tax treatment. It is not true that income received by corporate taxpayers in a state, or even income apportioned to a state from out-of-state corporate entities, would have been taxed first by that state at the subsidiary level. It would be coincidential if that were, in fact, the case. And although the operating income of the subsidiary may have been taxed by another state, that in itself does not provide a reason for the states to relinquish taxability of the parent if it is a corporation doing business in the state.

S-1245, therefore, should be amended to allow full taxation of income from whatever source, including dividends, with full apportionment among the states having nexus. There is no reason for a holding company to escape taxation as it performs very valuable management services which create income in the subsidiary. They also receive the services and protection of commercial domicile in

the state. Most of the dividend income problems can be solved by allowing consolidated returns. And S-1245 should so provide.

The provision of S-1245 as contained in Section 209 is not workable at the state level and is thus not a substitute for the consolidation question. The provision is akin to Section 482 of the Internal Revenue Code which even the Internal Revenue Service has great difficulty in utilizing. The states just do not have the administrative expertise to enforce this type of provision.

Apportionment of taxable income should be based upon the well accepted three-factor formula. However, the apportionment formula should be applied to all taxable income, including dividends. If the nexus standards continue to allow for taxable income to be apportioned to states without the right to tax such income—then, as previously stated, the apportionment formula must be revised to provide for either a throwback rule or, in the alternative, deletion from the numerator and the denominator of the sales factor of sales made in these states. The "distinction concept", determining where a sale is located, is workable. But, without these changes in the sales factor the bill cannot achieve accountability of all income for taxation.

In the area of sales and use taxes S-1245 purports to codify existing jurisdictional standards arrived at through court decisions. This codification is nullified somewhat by section 101(4) which relieves the seller, with no business situs within the state, from collecting or paying the sales or use tax if he obtains a registration number (section 304) from the purchaser. This would seem to open the door to relieving solicitation—only, out of state sellers, from collecting use tax from in-state, non-retail buyers, and thereby undermining the state use tax system with tremendous tax loses.

Also, removing the acceptance of this exemption certificate by the out-of-state seller "in good faith" can be very disastrous to the administration of these taxes. This good faith requirement has long been a major tool for protecting the state against an out-of-state seller accepting a resale certificate with respect to sales of items which he knows, or should have known, were not purchased for resale. The difficulties of audit which would be created by this exemption certificate provision as now contained in S-1245 are staggering to contemplate. This provision must be changed to coincide with existing state laws.

Section 401 of S-1245 would grant jurisdiction to review *de novo* any issues relating to a dispute arising under this act or under Public Law 86-272, as amended. This implies to me that by enacting this section, Congress would be saying that state courts not are competent to arrive at just results. If this is the intent of Congress I cannot accept it. It is insulting to the states. I am not persuaded that there is a need for a federal court for this purpose.

I would also request that this subcommittee support the Multistate Tax Commission. The Commission represents the cooperative effort of twenty-one (21) member states and fifteen (15) associate member states, working together to resolve the problems of state taxation. The Commission has recently made great progress in trying to arrive at uniformity of state action in this area. In order to achieve this highly desirable uniformity of taxation and efficiency of tax administration, the states need the continued benefits that flow from the joint and cooperative efforts that this Commission has encouraged and achieved. The states need the Commission to conduct legally cooperative audits for the states so as to protect the honest taxpayers who are properly reporting all of their income, as opposed to the other taxpayers who are attempting to slip some of their income between the cracks. Continued success of the Commission may well depend upon the encouragement of the Congress through congressional consent to its activities.

Thank you for the opportunity you have granted to me to be heard on his very important tax measure.

Senator MONDALE. Our next witness is Hon. George Kinnear, director of the Washington State Department of Revenue on behalf of Gov. Daniel J. Evans. I will to advise the staff that Governor Rampton indicated he wanted to testify and asked that his statement be received. If there are later scheduled hearings, he has asked that he be permitted to testify. Thank you very much. We are pleased to have you.

STATEMENT OF HON. GEORGE KINNEAR, DIRECTOR, DEPARTMENT OF REVENUE, STATE OF WASHINGTON, ON BEHALF OF GOV. DANIEL J. EVANS

Mr. KINNEAR. Mr. Chairman, I have filed a statement for myself as director, and at his request, for Governor Evans who could not be here today because he had a prior appointment in Moscow, U.S.S.R. I also want to mention that while he is Chairman of the National Governors' Conference, Governor Evans is speaking solely for himself and the State of Washington. And I have been informed that you would be asked by Governor Rampton for an opportunity later to file a statement for the Governors' Conference.*

Now, the testimony of both Governor Evans and myself is unequivocally in opposition to S. 1245, and in full support of S. 2092, which has been called generally the ad hoc bill introduced by Senator Magnuson last session and this session, and which is now before you.

The thrust of Governor Evans' and my recommendation in opposing S. 1245 is, in the Governor's words, that "it would not provide uniformity in tax administration, but to the contrary, its primary impact would be to provide preferential jurisdictional exemption, and thus create new areas of nonuniformity."

Now, both of us do acknowledge that there are definite problems facing the business community, serious problems across the country in dealing with many States, that we believe call for the establishment of national standards. I might add that the States face some serious problems in dealing with the larger national and multinational corporation also, in which areas they would be assisted by having national standards in legislation.

Now, second Governor Evans and I do recommend specifically the enactment of consent legislation for the multistate tax compact. The principal thrust of S. 2092 in title I is toward this point. S. 2092 does propose to merge the multistate Tax Commission approach in title I with the Federal standards approach in the remaining titles II through V.

Governor Evans says in his filed statement:

> I think this proposed consent legislation is the right way to go. The Multistate Tax Commission has been hampered in its efforts to become a fully successful agency for solving the tax problems arising between the States and the multistate businesses by the failure of Congress to enact consent legislation. I believe strongly in the great potential of the Multistate Tax Commission as an agency of the States.

One point that has not been widely discussed about the Commission I would like to bring to your attention, Mr. Chairman. It has proved a valuable asset beyond the areas of specific legal authority.

In a short time, it has become a valuable educational device for its members. In other words, the average administrator, after he is appointed, concentrates heavily on the interstate problems that confront him immediately, and which are his primary responsibility. The MTC has created a new source of invaluable aid and information to every State administrator. They quickly become acquainted with their peers throughout the country, and they constantly gain expertise from repeated contact with experienced and able men in other States, and become familiar in rapid fashion, not possible before, with those

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* See p. 393.

problems of national scope which have now become a part of their responsibility. Their perspective grows to a degree and at a rate not before possible.

Regarding titles II through V, I have filed a commentary, previously printed in the Congressional Record, containing their details. These titles address themselves to the very problems raised by the Cost Committee today in support of Federal standards, but do it in terms of standards of administration rather than through jurisdictional exemptions.

I do want to state a word about the work of the Subcommittee of the National Association of Tax Administrators chaired by Mr. Owen Clarke of Massachusetts, who spoke here a moment ago. Some of the concepts contained in the original draft of S. 2092, written some 2 years ago, have been improved upon, and I urge that the committee and the staff draw on the proposals of the Clarke Committee. I respect the judgment of its chairman and members, and broadly support their conclusions, even though I have not seen them in final form.

There is one more important issue which was not considered by the ad hoc committee in S. 2092, which I urge your committee to consider. I urge Congress to reverse the jurisdictional relation established by the *National Bellas Hess* decision. I believe you are familiar with this, Mr. Chairman. You were commenting on the exemption to mail order houses a minute ago.

It is a simple matter of fact that National Bellas Hess and similar businesses are competing for the same market with local businesses. Mr. Turlington also commented on this a moment ago, and I would like to quote briefly from Justice Fortas minority opinion. He pointed out that:

> Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein.

The State of Louisiana has presented a recommendation for establishing Federal standards uniform application of the State sales and use tax. Among other details, it would correct the preferential inequities of the *Bellas Hess* case. I have only seen an outline of the plan, and no draft of proposed legislation, but will state my unqualified support for the substantive proposals presented by Mr. Traigle to this committee.

I particularly wish to express support for Mr. Traigle's proposals that there be only a single use tax collected and paid by any multistate business to each State in which it is making sales and this at a single rate combining local taxes levied with the State tax. There have been suggested constitutional problems, and I can see some problems. I am convinced however that State legislation that would achieve this simplified use tax collection system could be drafted to avoid constitutional problems.

However, I do oppose the Louisiana proposal to involve the U.S. Department of Commerce and the Federal district courts in State administrative decisions. The use of the Department of Commerce as a depository for filing State tax returns, is, I believe, unnecessary. With the present rate, for example, of 8¢ stamps, the difference in cost for a company selling in all States would be $4 to inquire of each

State as against 8¢ for writing to the Department of Commerce. The $3.92 differential hardly justifies moving the Department of Commerce into State administration and for a picayune service. Most multistate companies do not do business in all States, and I am sure they can all afford this.

I would also oppose having State administrative decisions reviewed in Federal courts. Experience proves that this assures no degree of national uniformity.

Finally, not only the administrative actions, but the statutes considered, will be State laws and State decisions. The Federal legislation will establish procedural standards only. Why should State law or administrative decision be mandatorily presented to Federal courts for determination?

I might add that Federal courts in many sections of the country are now having extreme difficulty in keeping abreast of their calendars. What clear reason would there be for increasing their burden?

Thank you, Mr. Chairman.

Senator MONDALE. Thank you, Mr. Kinnear. We will place your full statement and that of your Governor, Governor Evans, in the record at this point. We very much appreciate your comments. It appears that the Traigle proposal may provide the basis for some compromise. To be sure, it has not been analyzed from a constitutional point of view or from an acceptability point of view in terms of local governments; whether local governments would be willing to agree to some kind of composite of ranking of their local taxes must be explored. But your statement certainly encourages me to believe that it ought to be further reviewed.

Mr. KINNEAR. Could I add one word on this problem of your local sales tax, for instance?

Senator MONDALE. Yes.

Mr. KINNEAR. I think if you do have a multitude of individual local governments to pay use taxes to, you create absolutely impossible positions for out-of-State businesses, and for many in the State. It is just as bad for the State administration if you did not provide for a single collection procedure because your geographical, political lines of cities are not clear, and you cannot, the average business could not, tell by an address who they are selling to.

Senator MONDALE. Yes. So that makes sense to you from that standpoint. Well, thank you very, much.

(The statements of Mr. Kinnear and Governor Evans follow:)

STATEMENT OF GEORGE KINNEAR, DIRECTOR, DEPARTMENT OF REVENUE, STATE OF WASHINGTON

My name is George Kinnear. I am Director of Revenue for the State of Washington and have served in this position since January, 1965. During these 8½ years I have been a member of the executive board and officer of the National Association of Tax Administrators for seven years, including 1½ years as President. I also served for 2½ years as first chairman of the Multistate Tax Commission and subsequently as a member of the executive committee for two years. For something over two years Mr. Leonard Kust and I labored as cochairmen of the Ad Hoc Committee which drafted the Interstate Taxation originally introduced by Senator Magnuson two years ago, which is now before the Senate as S. 2092. I also have had the honor of acting as Chairman of the Western States Association of Tax Administrators and a member of its executive board, as well as serving on the executive boards of the Tax Institute of America, the Federation of Tax Administrators, and the National Tax Association. During this period I have also con-

tinued my previous activity as a member of the section of Taxation of the American Bar Association and particularly on its local and state tax committee.

I do not list this record of activity solely to provide a biographical sketch, but to try to inform you of the extent of my activities and interest during this period and working with the Bar, with business tax representatives and with the other states in a continuing effort to develop an adequate and reasonable legislative answer to the considerable problems confronting both multistate businesses and state governments in dealing with one another in the field of taxation. I believe I have come to know quite thoroughly the nature of the conflicts of opinion, the practices in which injustice and non-uniformity do exist and the actions where special advantage have been taken or sought.

I am appearing before this sub-committee of the Senate Finance in support of S 2092 and in opposition to S 1245. My comments will stress selected issues but I have included, as an appendix to my written testimony, a copy of the explanatory commentary filed with S 2092.

There is a substantial agreement favoring a uniform formula for the division of multistate business income among the states and a consensus, including major business support, that the collection of sales and use taxes by interstate business should be governed by uniform standards based upon codification of the General Trading and Scripto decisions of the U.S. Supreme Court. (*Scripto Inc. v. Carson*, 362 US 207, 210-211, 4 L ed 2d 660, 663, 80 Ct 629; *General Trading Co. v. State Tax Com.*, 322 US 335, 88 L ed 1309, 64 Ct 1028, 1030.)

COMMENTS IN OPPOSITION TO S 1246

The supporters of the original Willis and Rodino bills, who now support S 1245, have consistently presented their legislation based on the argument that there is a serious need to establish, through federal legislation, *uniformity* in the imposition of state taxes upon multistate businesses.

There were two general arguments presented in support of this position. The first is that the national economy was being seriously hampered by the non-uniform tax administration of the states. This argument I propose falls flat when one considers a direct result of the massive increase in commerce between the states since World War II. It is the success and continuing growth of the multistate business that has caused our increase in tax liability, and such tax problems as have developed.

The second argument has been that small businesses, operating in more than one state face a particular burden because of their inability financially or organizationally to be aware of variations in tax laws or in regulations of different states. There are businesses that face this dilemma. Every effort should be made to eliminate unnecessary red tape or inequitable treatment. The majority of the states are prepared to work for this objective.

The states, however, do not expect to surrender their jurisdictional right to tax all business profiting from activities within their borders. These "small" companies need not expand their business into other states and when they do so they should expect to pay additional taxes and meet reasonable regulatory or taxing requirements in the same way they must pay additional warehousing expenses and other costs of doing business. Their expansion is a matter of their own voluntary choice. They should be treated as fairly as humanly possible but their selected situation provides no justification for tax exemption and a resulting preferential status over their instate competitors.

It is my judgment that legislation based upon the premises of S1245 would create tax advantages which would encourage movement of business by outweighing other economic factors and, finally, these proposals would shift and distort the normal and economic growth of various areas of the country, and in particular the Pacific Northwest, to their detriment.

Business should grow, expand and shift naturally in accordance with developing economic circumstances with encouragement from time to time by favorable actions of state or local governments, chambers of commerce and other groups with knowledge of local advantages. This natural development of business throughout the country whould neither be frozen, channelized, nor shifted by a broadside federal decision which must necessarily be taken without regard for local economics and without any regard for local interests and conditions.

MULTISTATE TAX COMMISSION

I would like to give special attention to Title 1 of S2092. This Title provides congressional consent to the Multistate Tax Commission as the appropriate

agency to administer any uniform standards established under federal legislation. This proposal would provide a merger of the Compact approach and federal legislation approach. It was proposed to preserve the administrative authority in the states while at the same time establishing standards that would by means of their origin be uniform throughout the nation.

While the Willis Bill was first introduced in Congress, the House of Representatives was assured that this legislation was necessary because the states would not and could not work together. The initial work on drafting the Compact had begun in January 1966 before the first floor debates on the Willis Bill. The statement was made that the efforts to develop a Multistate Tax Commission was merely "smokescreen."

The fact is that the Compact was ready for presentation to legislatures in January of 1967 and by June of that year eleven states had adopted the Compact and the Commission became a reality in the fall. It was without funds until after the legislative sessions in the following year so it was unable to be staffed until late in 1968.

The Commission's annual reports show that a great deal of constructive effort and mutual understanding has been achieved between business and state representatives since its creation.

The Multistate Tax Commission is a practical vehicle for cooperative state action, designed to provide a single agency with which business can discuss its problems with any or all states, and to stimulate action, state by state, by supplying them the analytical tools and data they need to deal with mutual problems.

In judgement, the Multistate Tax Commission is more than just an agency for joint state action, however, It is a new concept for reaching nationwide decisions on tax matters and accommodating altered economic conditions without impairing the federal system of government.

Multistate business activities are going to increase, certainly, and change in character as well. The changes will cause presently unforeseen problems. The demand by both business and the states for greater uniformity, simplicity and equity of taxation will intensify. It is the obligation of the states—likewise that of Congress—to attend to prospective problems along with current ones. The Commission is an ideal medium to deal with them efficiently and equitably on behalf of all.

The Commission in its short lifetime has become a valuable educational device for its members, and especially the neophyte administrators. The average administrator, after he is appointed, concentrated heavily upon the instate problems which confront him immediately and which are his primary responsibility. He doesn't have an opportunity to quickly envision or focus upon issues of a regional, interstate, or national character. Attending national conventions once a year and meeting other administrators occasionally provides only limited experience in this regard.

The Multistate Tax Commission has created a new source of invaluable aid and information to every individual state administrator. They quickly become acquainted with their peers throughout the country, they constantly gain expertise from contact with experienced and able men in other states, and become familiar in rapid fashion with those problems of national scope which have now become part of their responsibility. Their perspective grows to a degree and at a rate never before possible. The resources of Multistate Tax Commission are particularly valuable as a supplement to the skills and knowledge of states with limited research capabilities. The Commission, consequently, has become a major factor in improving state tax administration nationally at nominal cost. This contribution is of value to states and taxpayers alike. It fits well with the goals of Congress as well.

In addition, the various national and sectional meetings of the Commission are a means of establishing better communications between tax administrators and their business "accounts," whose tax representatives are leaders in their profession. The value flows in both directions. Business leaders do not have to visit 50 states, or even the 36 Commission states, in order to learn what the states are planning, or to express their own recommendations.

The merits of this process have been aptly stated by Charles P. Bayley, Jr. tax counsel for Columbia Broadcasting System, who authorized the Multistate Tax Commission to include a statement in its 1969 Annual Report which contained the following:

"*Why Business should support the Multistate Tax Commission*"

"Business also has a direct financial interest in supporting the work of the Commission.

"Under present circumstances of taxpayer compliance states and localities are not about to cease increasing their rates of presently existing taxes, broadening

their tax base, and imposing new taxes. States and localities are not about to cease either attempting to tax out-of-state business to help ease the tax load on their own in-state businesses and residents or requiring the out-of-stater, conducting business activities in the state, to pay for governmental services and protection furnished. Taxpayers can do a multistate business only under these conditions.

"All business is a large taxpayer (from his point of view) in his home state. If for no other reason then than to slow down the ever-increasing tax burden in and ease his own home-state tax load, business should not only want to require out-of-state business to help share this load, but also in order to insure such result to ease the burdens of compliance by such out-of-state business in his own home state. Under uniform and reciprocal tax treatment at the same time this will ease his own tax compliance burdens in those other states with tax jurisdiction over him.

"The states and localities through the Multistate Tax Commission are attempting to the extent of their ability and taxpayers' help and cooperation to achieve that uniformity of statute, interpretation and administration necessary to facilitate tax compliance by out-of-state business. This work presently is the only effort that has a chance of achieving these goals."

The particular conclusion I am urging upon this committee is that regardless of any failures of the states in the past, the record and experience and characteristics of the Multistate Tax Commission justify confidence and reliance in its use for the purposes of administering any standards which Congress might determine to establish to assure equitable treatment of taxpayers, to facilitate their compliance with tax laws, and to provide means of avoiding or settling multistate tax disputes while preserving intact the taxing jurisdiction of the states.

It is a fact that there has been some cooling of business interest in the Commission and I know of some actions of the Commission which have not pleased all business. This, however, is the fate of any administrative official or agency and I do not take it seriously in terms of the overall potential of the organization which has been amply proven.

The major cause of whatever loss of momentum has occurred is the failure of Congress to consider and enact a consent bill for some three years. It is the opinion of the attorney generals of the member states, and it is my opinion, that the commission is a valid legal organization fully qualified to carry out its purposes. There is, however, a paucity of law on the subject and unquestionably there are honest doubts and uncertainties in the minds of many businessmen as to whether it is worth their while—legally—to work with the Multistate Tax Commission. In addition, those who are opponents of the Compact approach have leaned heavily upon Congress's failure to act and have argued that this in itself represents congressional antagonism. I do not believe it is so but of course neither I nor other members of the Commission have a basis on which to argue against this allegation. We too are in doubt as to what Congress might do.

In addition to this uncertainty, the small staff of the commission has been unable to spend all its time upon the purposes and objectives of the agency, but has had to use excessive amounts of time and money in coming to Washington, D. C. each year to discuss and confer on the possibilities of legislative action. Finally the commission is having to spend excessive amounts of its resources on fighting the major law suits which include among other attacks the charge that consent legislation is essential to the continued existence of the commission.

In urging your support for Title I, I would like to bring to your attention the following quotation from an article written by Justices Frankfurter and Landis in the Yale Law Journal of May, 1925:

"No one can scan the flood of cases dealing with jurisdiction to tax, rules for apportionment and the like, without realizing that the opportunities for taxation open to the states against common resources might find a more economic and more effective solution through negotiation than through litigation. At all events, in view of the growing burden upon time and feelings, as well as the cost in money due to conflicts and to confusion arising from the administration of independent systems of state taxation, the possibilities of amelioration and economy realizable through an alert use of the compact clause calls for more intensive study as part of a disciplined attack upon the entire tax problem."

I believe that the Multistate Tax Commission offers a most exciting promise for progress in the field of state taxation. Its possibilities for good are unlimited. It is an association of qualified tax administrators which is able to stimulate action state by state by providing the necessary information which is not now available regarding many important problems, and by providing a vehicle for cooperative state action. It is in this last attribute that your committee should be most interested.

SUBSTANTIVE LAW (S 2092, TITLES II–V)

Turning now to consideration of federal standards for state taxation, my recommendation is to adopt Titles II through V of S 2092. I am opposed to S 1245 in all respects where it is in conflict with these provisions of S 2092.

S 2092 is directed towards establishing nationwide standards of tax uniformity, whereas S 1245, regardless of its purported motives, proposes an array of preferential immunities and restrictions which benefit selective businesses. It does this by allowing the businesses to establish tax exemptions in various states of their own selection, in which they are doing business and making profits.

I will make only brief comments upon S 2092 and the issues involved. To speak at length on them would only load the record with duplicate information and advice which will be provided by others.

I do wish to direct your attention to the work of a special subcommittee of the National Association of Tax Administrators, chaired by Mr. Owen Clarke, of the Massachusetts Department of Revenue, whose findings will be reported to you separately. Some of the concepts contained in the original draft of S 2092—first written two years ago—have undergone improvements and I urge that the members of the Senate Finance Committee and its staff draw freely on the revisions that will be proposed to them by the Clarke Committee. The latter has my full support.

In addition, as one of the drafters of the Multistate Tax Compact, as an original officer and member of the Multistate Tax Commission, one of the organizers of the Ad Hoc Committee and a participant in drafting its ultimate recommendations, and as one of the sponsors of S 2092, I have constantly sought to bring about a consensus for a legislative program. There were principles which I could not compromise, such as opposing the efforts to establish preferential tax immunity. On the other hand, there were major issues such as the treatment of foreign source income, consolidated and combined returns, about which I could find no absolute right or wrong—no black and white positions. My efforts on these matters was to find a position which provided a reasonable solution from everyone's perspective—which the states and business could accept with no appreciable impact or harm. I will continue to accept reasonable proposals of this type.

There is one important issue which was not considered by the Ad Hoc Committee in drafting S 2092, which I urge the committee to consider. This is the inclusion of a corrective provision in the ultimate legislation you recommend to the Senate to repeal the jurisdictional limitation established by the National Bellas Hess decision (386 US 753, 18 L ed 2d 505, 87 S Ct 1389).

This case exempted mail order businesses from responsibility for collecting use tax whose only contact with a given state is the sale of merchandise within the state, using either mail or common carrier for deliveries, and supplemented or implemented solely by catalogues or "flyers," likewise transmitted solely in the mails.

The Committee, I am certain, is aware of the premise long established by the U.S. Supreme Court that interstate commerce should bear their "just share of state burden" so long as it is not treated prejudicially in relation to local business (*Western Live Stock* v. *Bureau of Revenue*, 303 US 250 254, 83 L ed 823, 827, 58 S Ct 546, 115 ALR 944 (1938); *General Motors Corporation* v. *Washington et al*, 377 US 436, 12 L ed 430, 84 S Ct 1564).

In National Bellas Hess the decision was against the state's claim of jurisdiction because of the lack of "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax" (*Miller Bros.* v. *Maryland*, 347 US 340, 344, 345, 98 L ed 744, 745, 74 S Ct 535).

The Court concluded with the premise this Committee understands well. "The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements. Under the Constitution, this is a domain where Congress alone has the power of regulation and control."

It is on this principle that I rely in seeking your action.

It is a simple fact that National Bellas Hess, and other similar businesses, are competing for the same market directly with local business. The availability of this market depends upon the success of the economy of the particular states. This success in our modern society depends upon a broad and indivisible mix of local, state and national economic influences, also indefinably mixed with national and state governmental influences—taxation, police, wage and labor policies, et cetera.

Any corporation should participate in sharing this expense of government where its activities are creating income for it, regardless of the form of its organization or the plan of its activities.

This, I believe is the thrust of Justice Fortas minority opinion, in which he points out:

". . . Bellas Hess is not simply using the facilities of interstate commerce to serve customers in Illinois. It is regularly and continuously engaged in 'exploitation of the consumer market' of Illinois. . . .

"Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein.

LOUISIANA SALES AND USE TAX PLAN

The State of Louisiana is presenting a recommendation for establishing Federal standards for collection of state sales and use tax which would, among other items, correct the preferential economic inequity resulting from the National Bellas Hess decision.

I have seen an outline of the Louisiana Plan and have not seen any draft of legislation. I do state my support for the general outlines set forth in the following language furnished me by Mr. Joseph Traigle, Collector of Revenue, Louisiana:

"This proposal would establish the concept that every sale of tangible personal property which has a destination in any state would give that state the right to require the vendor to collect and remit sales and use taxes on such sales either (a) in the conventional manner as is now required, or (b) in the uniform manner as is discussed hereinafter.

"Whichever of these methods may be required would be dependent upon the nature of the activities of the vendor in the state. If a vendor (a) has a place of business in the state, or (b) regularly makes deliveries into the state other than by common carrier or U.S. Postal Service, such state would be permitted to require the vendor to collect combined uniform state and local sales and use taxes but would be prohibited from requiring the collection of conventional sales and use taxes.

"Under this proposal a political subdivision of a state would be authorized to require vendors to collect conventional sales and use taxes on interstate sales delivered into such subdivisions only when such vendors (a) have a place of business in such subdivision or (b) regularly make deliveries into such subdivision (other than by common carrier or U.S. Postal Service)."

I wish to express, separately, support for the proposition in the last quoted paragraph of the Louisiana Plan.

I do believe that requiring business to collect sales or use tax for a multitude of local governments at possibly varying rates is an excessively onerous tax—and to a considerable degree, impossible. The impossibility arises out of attempting to determine the political situs (within or without incorporated areas) by street address alone. Uneven boundaries, annexations, and similar problems abound. A single rate for each state is essential as a necessary business condition for a proper tax system.

I cannot, however, support the Louisiana proposal to involve the U.S. Department of Commerce, nor use of the Federal District Courts, in administrative decisions.

The use of the Department of Commerce as a depository for filing state tax rates is unnecessary to begin with. Business has objected to facing multitudes of local sales taxes and rates but not to dealing with only 50 states. At the present rate of 8¢ the difference in cost for a company operating in all states would be $4.00 to inquire of each state as against 8¢ to write to the Department of Commerce. The $3.92 differential hardly justifies moving the Department of Commerce into state administration. Most companies do not do business in all states and those that do can afford this cost, I am sure.

If the Committee believes there is a value in establishing a single location for filing sales tax rates for the purposes of the Louisiana Plan (or any comparable plan), I suggest that this authority be added to Title I of S. 2092 and the responsibility assigned to the Multistate Tax Commission, an agency of the states. Since this is a routine, mechanical responsibility, it could be handled for all states, regardless of their relation with the Commission.

No useful purpose is served in having state administrative decisions decided in Federal courts. Experience establishes that this would provide no element of national uniformity. The Plan would require the issue to be heard in each state. (This, of course, is proper. It would be an absurd burden to expect administrators of their attorney generals to travel to the home district of every business that might protest an administrative action.)

Finally, not only the administrative action, but the statutes considered, will be state laws and state decisions.

The Federal legislation will establish procedural standards only. Why should state laws or administrative decisions be mandatorily presented to Federal courts for determination?

I know of no criticism of state courts at issue.

Further, Federal courts in many sections of the country are having extreme difficulty in keeping abreast of their calendars now. What clear reason is there for increasing their burden?

These statements of mine may appear overly terse. This is because I have not been informed of any reason or argument *for* this proposal.

Appendix A

Commentary on S. 2092

To permit a compact between the several States relating to taxation of multistate taxpayers and to regulate and foster commerce among the States by providing a system for the taxation of interstate commerce.

INTRODUCTION

The above-described bill, attached hereto and hereinafter referred to as "the Act", was drafted by an expanded Ad Hoc Committee on Taxation of Interstate Business which met in Seattle on June 8–9, 1971, to reconcile differences of opinion which had developed over the original ad hoc proposal. The Ad Hoc Committee, as originally constituted and as expanded for the Seattle meeting has no official status. It is a volunteer and self-appointed group of state tax administrators and business representatives.

The original Ad Hoc Committee grew out of conversations early in 1969 between the Co-Chairmen, George Kinnear, Director, Department of Revenue, State of Washington, and then Chairman of the Multistate Tax Commission, and Leonard E. Kust, a partner in the New York law firm of Cadwalader, Wickersham & Taft, and then Vice President and General Tax Counsel, Westinghouse Electric Corporation. These conversations were concerned with the seemingly unbridgeable gap between the views of state tax administrators and business, and the stultifying effect of the conflicts involved on the prospects for reasonable solutions for the problems of taxation of interstate business. The conversations culminated in agreement to strive jointly to organize a committee which would seek to bridge the gap in views by identifying the areas of agreement and of disagreement and working out some reasonable accord in the areas of disagreement.

The original Ad Hoc Committee was organized with the understanding that the members were not representing the organization with which they were connected nor any other organizations with which they were associated. The members represented only their own views based upon their concern with the problems involved, their experience and knowledge with respect to such problems and their good will in committing themselves to seeking a reconciliation of views as to solutions for these problems.

After a year's exposure of the original Ad Hoc proposal and its consideration by various interested groups, an expanded Ad Hoc Committee met in Seattle, Washington, on June 8 and 9, 1971. Attached is a list of the members of the Committee. The purpose of this meeting was to reconcile differences of viewpoint and to develop necessary changes in those provisions of the original proposal which, despite the effort of the original Ad Hoc Committee, remained unacceptably controversial. In addition to the twelve months exposure of the original proposal, the expanded Committee also had the benefit of the Plan developed by the Multistate Tax Commission as a guide in its deliberations.

The new expanded Ad Hoc Committee did not purport to represent any viewpoint other than that of its individual members. While the revised Ad Hoc Bill purports to be a result of a consensus of opinion expressed at the Seattle meeting, it has been aptly referred to as representing an "uneasy consensus". There was no formal vote taken or record made of the proceedings. It was recognized at the meeting that those in attendance were completely free to voice later objection to any provision of the draft. This commentary must necessarily reflect the understanding of its authors. The provisions of the revised Ad Hoc Bill and the commentary herein pertaining to the same has been developed within this context after giving ample opportunity to members of the Committee to comment on an initial draft of the revised Ad Hoc Bill.

GENERAL

The general conception of the proposals to which the original Ad Hoc Committee was committed from its beginning in 1969, is that the solutions to the problems of multistate taxation of interstate business should be implemented through a merger of the Multistate Tax Compact approach and the Federal legislation approach. The objective of such a merger of approaches is to preserve as far as possible administrative authority in the States by requiring the States to act, in certain areas, through the machinery of an interstate tax compact consented to by the Congress and serving as the agency to implement uniform standards established under Federal legislation.

Such a structure would provide flexibility for adjustment and evolution to improve the system for taxation of interstate business. With the Multistate Tax Commission under the Compact acting as the administrative agency it could implement and modify, within the limits of permissible administrative interpretation, the legislative standards under Federal law, and when the need for changes exceeded the bounds of permissible administrative interpretation the Commission could seek amendments to the Federal legislation. Moreover, under the Committee structure of the Multistate Tax Compact any proposal for amendment of the Federal legislation will have been preceded by extensive discussions between state administrators and business representatives and will presumably, therefore, be presented to the Congress with a substantial consensus of support.

Under this conception, it was agreed by the original Ad Hoc Committee and the expanded Ad Hoc Committee that Public Law 86-272 was adequate as a jurisdictional standard for income taxes; that Federal legislation should codify the existing judicially prescribed jurisdictional standard for sales and use taxes; and that it should provide an optional uniform apportionment formula for income taxes eliminating the distinction between "business" and "nonbusiness" income. It was further agreed that Federal legislation should prescribe standards for sales and use taxes; grant authority to the Multistate Tax Commission to promulgate rules and regulations implementing the Federal legislation; and that the Federal standards should be applicable to all businesses irrespective of size. There were divergent opinions concerning the tax status of dividends for income tax purposes, both in the original Ad Hoc Committee and in the expanded Committee as well as differences concerning the question of the need for and standards for requiring state income taxes to be imposed on the basis of consolidated or combined reporting. There were also unresolved differences of opinion concerning the taxation of so-called foreign source income and foreign corporations. There was also no general agreement pertaining to modification of the Uniform Division of Income for Tax Purposes Act as set forth in Article IV of the Multistate Tax Compact. Members of the business community wanted to eliminate the attribution of sales to the state of origin if the destination state lacked jurisdiction to tax. State representatives on the other hand were desirous of having all sales attributable only to a state which had jurisdiction to tax under Public Law 86-272.

Both the original and expanded Ad Hoc Committee proposals contemplate that the Congress will direct the House Judiciary Committee and the Senate Finance Committee to continue to evaluate the progress being made and, if at the end of five years the progress is not satisfactory, it is assumed that legislation implementing an alternative approach to reliance on the Multistate Tax Compact will be developed.

The following comments on specific provisions, unless otherwise indicated, pertain to the work of the original Ad Hoc Committee as revised by the expanded Ad Hoc Committee.

COMMENTS ON SPECIFIC PROVISIONS

Title I—Consent to enter into Compact and conferral of powers upon Compact Commission

Title I is structured on the Magnuson Bill (S. 1883) and is designed to provide for the consent of Congress to the existing Multistate Tax Compact.

Sections 101 and 102 provide for Congressional consent to and identification of the Multistate Compact.

The purpose of Section 103 is to prevent a corporation from electing to have its income tax liability determined by reference to the allocation and apportionment provisions of the existing Compact. Alternatively, Title III provides a maximum for income attributable to taxing jurisdiction computed under the provisions of this Act. Thus, for taxable years ending after the effective date of the

Act the allocation and apportionment rules of the proposed Act rather than those set forth in the existing Compact would be applicable.

Thus, Section 103 prevents a corporation from having, in effect, a three-way choice in compact states, *i.e.*, state laws apart from the Compact, Article IV of the Compact, and Title III of the proposed federal Act. Accordingly, Section 103 restricts a corporation to the choice of either state law apart from the Compact, or Title III of the federal Act.

Section 104 confers on the Commission the power to adopt rules and regulations for the administration of the federal standards set forth in the Act. The question of whether Congress may delegate this power to the Commission was considered by the original ad hoc committee. The ad hoc committee satisfied itself with the advice of eminent counsel that this delegation is constitutional. See *Parden v. Terminal R. of Alabama Docks Dept.*, 377 U.S. 184, 12 L. Ed. 2d 233, 84 S. Ct. 1207 (1964). Section 104 provides, however, that no rule or regulation adopted by the Multistate Tax Commission (hereinafter referred to as the Commission) will be in effect in any state if that state rejects the rule or regulation in accordance with the procedures it would use in the adoption of any rule or regulation in its administration of the tax law which constitutes the subject matter of the Commission rule or regulation. Also, section 104 provides for the participation of all the states whether or not regular members of the Commission in those deliberations and procedures to be followed by the Commission in the adoption of any rule or regulation. State sovereignty is thus preserved by affording each state the opportunity (1) of participating in the rule or regulation making function, (2) to administratively reject any rule or regulation adopted by the Commission, and (3) to use its own procedures in any proceedings pertaining to the rejection of any proposed rule or regulation. This approach, embodied in section 104, represents the rejection of the original ad hoc proposal, which would have made the Commission's regulations automatically binding on all states, and acceptance of the position that the Commission's rules and regulations should be essentially advisory. However, non-uniformity resulting from state administrative inaction, if any, is prevented.

Title II—Jurisdiction to Tax

Title II is limited in its application to the codification of existing sales and use tax jurisdictional standards, except that it prescribes the "business location" or regular delivery other than by common carrier or U. S. mail standards for local sales or use taxes which are not imposed by uniform state law and collected by the state. This standard is set forth in section 405. Any reference to capital stock and gross receipts taxes in the original ad hoc bill have been deleted with respect to the sales and use tax jurisdictional standards. No substantive change has been made from the original ad hoc proposal.

Under the Rodino Bill (H.R. 1538) the jurisdictional standard for net income taxes would be applicable only to "small" corporations but the jurisdictional standard with respect to collection of sales or use taxes would be generally applicable. As with respect to all provisions of the Act, the jurisdictional standard proposed by the Committee are, as in the Ribicoff Bill (S. 317), applicable without distinction between large and small corporations.

In the case of net income taxes, this gave rise to little difference of view among members of the Committees. In order, however, to minimize changes in existing law, it was agreed the jurisdictional limitations of Public Law 86–272 are adequate for purposes of the net income tax and are preferable to the "business location" tests of the Rodino and Ribicoff Bills.

In the original ad hoc committee, the major controversy as to jurisdiction arose with respect to the imposition of the obligation to collect a sales or use tax on interstate sales of tangible personal property. The Rodino and Ribicoff Bills would not permit States or political subdivisions to impose on a seller such an obligation unless the seller has a business location in the State or regularly makes household deliveries in the State. The Talcott Bill (H.R. 4267), on the other hand, would enlarge regular deliveries to cover all deliveries in the State other than by common carrier or United States mail, and in addition would extend jurisdiction to regular solicitation by means of salesmen, solicitors or representatives in the State, except where the solicitation is solely by direct mail or advertising by means of newspapers, radio or television. Thus, the Talcott Bill in effect codifies the decisions of the Supreme Court in *Scripto, Inc. v. Carson* and *National Bellas Hess, Inc. v. Illinois Department of Revenue.*

The merits of the differing standards were debated at length in the meetings of the regional ad hoc committee. It was recognized that the conflict was between

the interests of business, mainly of small business, opposing uudue burdens of collection of tax on interstate sales and the interests of the States in assuring reasonable effective enforcement of their tax with respect to interstate sales. In analyzing the problems it became clear, however, that neither the Rodino nor the Ribicoff Bills dealt effectively with the far more important problem of the power of political subdivisions to impose the obligation to collect sales and use tax on the interstate seller.

It is one thing for the small interstate seller to contend with the collection requirements of 50 states and quite another, and more serious matter, for both small and large business to deal with the varying collection requirements of thousands of political subdivisions. The trend among States toward allowing political subdivisions to impose sales and use taxes and to require collection of such taxes by the seller is accelerating. The Committee felt that this problem was a more serious problem than the question of whether the jurisdictional standard with respect to State power should be that in the Rodino and Ribicoff Bills or that in the Talcott Bill.

Consequently, there was a consensus that the jurisdictional standards of the Talcott Bill, codifying existing law, should be adopted but that the power of a State or a political subdivision with respect to an interstate sale should be made should be made clearly subject to the limitations of Section 405 of the Act, similar to Section 205 of the Talcott Bill. That Section provides, as does Section 305 of the Rodino and Ribicoff Bills, that a seller need not classify interstate sales according to geographic areas of a State, except those sales with destinations in political subdivisions in which the seller has a business location or regularly makes deliveries.

By cross-referencing the jursidictional provisions of Section 201 to the classification provisions of Section 405, political subdivisions will be effectively prohibited from imposing the obligation on a seller to collect tax on an interstate sale unless that seller has a business location or makes regular deliveries in the political subdivision. However, where the local tax is imposed in all geographic areas of the State on like transactions at the same combined State and local rate, administered by the State, and uniformly applied so that a seller would not be required to classify interstate sales according to geographic areas of the State, the jurisdictional standard in Section 201 would apply.

Under the jurisdictional standards of Section 101 of the Rodino and Ribicoff Bills, a political subdivision has power to impose the obligation to collect tax on an interstate sale if the seller is subject to the jurisdiction of the State, regardless of whether or not the jurisdictional standard is satisfied in the political subdivision. The effect of the classification provisions of those Bills is obscure, particularly since they refer to classification for "tax accounting" rather than for "tax collection" purposes. The latter term is used in Section 405 of the Act.

The Committee believes that both small and large business are more interested in limiting the power of political subdivisions to require collection of tax on interstate sales where there is not a clear jurisdictional presence in the political subdivision than they are in "rolling back" the present judicially prescribed jurisdictional standard with respect to State-level taxes.

In order to permit States and political subdivisions to adjust to the limitations on the power to require collection of sales or use taxes on interstate sales imposed by political subdivisions, Section 405 of the Act is not effective until July 1, 1976.

While Sections 101 of the Rodino and Ribicoff Bills, as well as comparable provisions of the original Ad Hoc Bill, prescribed jurisdictional standards for both capital stock and gross receipt taxes, the expanded ad hoc committee deleted all references to capital stock and gross receipts taxes as it was deemed more prudent to lay the proper foundation in dealing with the substantive provisions relating to the more pressing problems of income and sales and use taxes, perhaps as a future guide for resolutions of the many other interstate business tax problems.

Title III—Maximum Income Attributable to Taxing Jurisdiction

The first problem with which the original Ad Hoc Committee was confronted regarding a uniform apportionment formula for income tax purposes was the question of whether the formula should include only two factors, property and payroll, or should include a third factor, sales. The 2-factor formula which was included for general application in the original Willis Bill (H.R. 11798) encountered the determined opposition of the states and much of the business community.

The original Ad Hoc Committee agreed from the outset that there should be no distinction between large and small business and that the 3-factor formula, since

it represented the practice of most of the states having corporate net income taxes, was to be preferred to the 2-factor formula.

The Uniform Division of Income for Tax Purposes Act (UDITPA) was taken as a guide. UDITPA has been adopted by a number of states, although with variations, and is incorporated in the existing Multistate Tax Compact.

One of the least satisfactory aspects of UDITPA has been its attempted distinction between "business" and "nonbusiness" income, the latter the subject of specific allocation rather than apportionment under the formula. The Committee decided that with the exception of dividends all of the taxable income of corporations subject to the Act should be apportioned among the several states in accordance with the apportionment formula. There was a sharp divergence of opinion in regard to the question of exclusion of any income from the tax base ceiling such as foreign source and dividend income.

Title III sets forth the ceiling beyond which a state or a political subdivision cannot go in imposing its income tax for any taxable year on a corporation taxable in more than one state. References in the original ad hoc bill to capital stock and gross receipts taxes have been deleted for the reasons previously stated. As in the original proposal, the Title is not applicable to "excluded corporations" which are defined in section 504. No state or political subdivision is required to incorporate into their income tax law any of the provisions of this Title. The limitations imposed on a state's political subdivisions are identical with those limitations imposed on a state (section 305). This Title (1) sets forth an optional three factor apportionment formula; (2) exempts from state and local taxation income described in section 951(a)(1) of the Internal Revenue Code (section 306(a)); (3) exempts dividends paid by a corporation in which taxpayer owns 80% of the voting stock relating thereto and prohibits any offsetting adjustments related to such dividends; and (4) assigns all other dividend income, otherwise taxable, to the commercial domicile. In the original ad hoc proposal all dividends were subject to tax at the commercial domicile of the corporation.

The committee deemed it advisable to adopt provisions similar to the "taxable in more than one state" concept embodied in UDITPA, so as to describe the circumstances under which the apportionment formula would apply, and for purposes of determining whether interstate sales were assignable to destination or subject to the "throwback" provision. Such concept is incorporated in section 301(d). Provision is also made for tolling the statute of limitation where the taxpayer's liability changes due to the reassignment of sales.

One of the most controversial problems considered by the Committee was the question of the consolidation or combination of income of related corporations, where one corporation is subject to the jurisdiction of the State but the other corporation is not. Conflicting and apparently irreconcilable views are held with respect to the solution of the problems involved.

It is obvious that if one or more States consolidate related companies and other States do not the application of even a uniform apportionment formula will result in taxation of either more or less than 100% of the consolidated income. On the other hand, nationwide uniformity will eliminate the problem. Whatever the standards for consolidation may be, they must be uniformly applied among the States. Related corporations should either be consolidated in all of the States or in none of the States, unless a particular State and the taxpayer agree otherwise.

There was agreement within the Committee that potential "whip-sawing" of a taxpayer should be eliminated. The intransigent controversy centered on whether consolidation should be permitted and if it was on what should be the standards applicable to determination of when consolidation was appropriate.

The initial Ad Hoc Bill sought to bridge the differences in view by permitting consolidation subject to rebuttable presumptions based upon quantitative tests of intragroup flow of goods and services. These standards, however, continued to be controversial and have been abandoned in the revised Ad Hoc Bill.

Section 301(d) permits apportionable income, at the option of either the state or the taxpayers, to be determined by reference to the combined apportionable income and apportionment factors of all corporations of an affiliated group of which the taxpayer is a member. Affiliated group as used in section 301(d) is defined in section 505 to include corporations meeting the 80% of the voting stock ownership test (corporate or noncorporate) exclusive of the affiliated corporations deriving income from sources outside the United States.

This is a substantial change from the original Ad Hoc proposal which had contained the quantitative flow of goods and services test to determine when a corporation's income tax liability should be determined on a combined basis. In order to assure uniform application of combined reporting requirements under the

quantitative flow of goods and services rebuttable presumption tests, the original Ad Hoc Bill would have created a Multistate Tax Appeal Board as an independent agency of the Commission to adjudicate disputes arising under such proposal. Since section 301(d) has been redrafted to permit any corporation of an affiliated group to elect or be required by a state to file a combined report, the need for the appeal board has been eliminated and the title providing for such agency has been deleted.

It was agreed that in a consolidation dividends from affiliates should be excluded from consolidated income.

It was also agreed that foreign source income should be excluded, since consolidation should legitimately seek only to bring income earned within the United States into the consolidated income to be apportioned among the 50 States. There was strong disagreement, however, as to whether foreign source income should be defined according to Federal source rules or whether sole reliance should be placed upon the apportionment formula to determine foreign source income of affiliated corporations included in the consolidation.

The disagreement with respect to foreign source income was finally resolved by the proposal that in the case of affiliated corporations, such as Western Hemisphere Trade Corporations, possessions companies and China Trade Act Corporations under the Internal Revenue Code, where the Internal Revenue Service would of necessity in each year determine the amount of foreign source income of such companies and under Section 482 would determine that such income was clearly reflected in such companies, the Federal rules would be accepted and such companies would be excluded from a consolidation. On the other hand, any other foreign or domestic company would be excluded from a consolidation only if at least 90% of its income was from foreign sources, determined by separate application to it of the apportionment formula under Title III of the Act. For this purpose the "throw-back" rule, with respect to the location of sales for purposes of the numerator of the sales fraction, would be inapplicable, since this rule is not pertinent to the determination of where income is earned by application of the apportionment formula.

These provisions designed to eliminate foreign source income are incorporated in the definition of an affiliated corporation in Section 505 of the Act.

The optional three factor apportionment formula consists of the factors of property, payroll, and sales. The property factor is based upon the valuation of property at its original cost and leased property at eight times the gross rental. The payroll factor includes the total amount paid as compensation. Full accountability of the property and compensation factors is required since the sum of the numerators for the states in which the corporation is taxable must be the same as the denominator used in those factors. This was not expressly provided for in the original ad hoc proposal.

Section 304, the sales factor, achieves full accountability through the "throw-back rule" which assigns sales to the origin state if the destination state lacks jurisdiction to impose tax. Export sales, however, other than export sales to the U.S. Government, are assigned to the foreign destination. The committee agreed that export sales, except for export sales to the U.S. Government, should not be subject to the "throw-back" provisions. The "throw-back" provisions properly apply where the nationally imposed jurisdictional standards prevent the destination state from imposing tax, but such justification is lacking where sales have a destination in foreign countries, since such countries are subject neither to the jurisdictional standards nor the uniform apportionment formula imposed on the states.

The sales factor is generally defined as the fraction the numerator of which is the sales of the corporation which are located in the state during the tax year and the denominator of which is the total sales by the corporation everywhere during the tax year. The original ad hoc proposal did not contain any special provision for either sales to the United States Government or to foreign countries.

Sales of services are assigned to the state where services are performed based on direct costs of performance and receipts from rentals of tangible personal property are assigned to location of the property. Sales of real estate, if the corporation is engaged primarily in the sale of real estate, are assigned to location of the real estate. Sales of other tangible personal property are assigned on a destination basis. All other receipts are eliminated from both the denominator and numerator of the sales factor.

Section 305 of the Act is based upon Section 206 of the Rodino Bill.

As discussed earlier, Section 306, dealing with exclusions from apportionable income, exempts foreign source income and assigns dividends received from sub-

sidiaries meeting the 80% ownership test to the taxpayer's commercial domicile. Offsetting adjustments for interest and other expenses are prohibited.

Title IV—Sales and Use Taxes

Uniform standards with respect to sales and use taxes were perhaps less controversial than any of the areas to which the Committee addressed itself. The Committee was largely able to agree on the standards contained in the Rodino, Ribicoff and Talcott Bills, with some modifications deemed to be an improvement.

The provisions of this title in the draft are comparable to the provisions in the original ad hoc bill, and the Talcott Bill. Section 401(a) defines a location of a sale to be in the destination state and permits a contiguous state or political subdivision thereof to enter into reciprocal collection agreements as provided for in Section 406. Section 406 in turn, when authorized by state law and reciprocal agreement, requires a seller with a business location to collect use tax on sales he makes into a state which does not have jurisdiction to require collection under Section 201. Section 401(b) provides a use tax credit for prior sales taxes to another state. Section 401(c) provides for a refund for the overpayment of a use tax. Section 401(d) places a limitation on credit for prior taxes for the respective taxes which are measured by periodic payments made under a lease. Section 401(e) exempts vehicles and motor fuels from the provisions of Title IV.

Section 402 is the same as Section 202 of the Talcott Bill. It exempts household goods and motor vehicles from use tax if acquired and used by the person for a period of 90 days or more before he brings the property into the state for use there as a resident.

Section 403 deals with the treatment of transportation charges with respect to interstate sales. This section conforms to Section 203 of the Talcott Bill without precluding a state from requiring an instate purchaser to pay tax on freight charges.

Section 404 concerns the use tax collection liability of sellers on sales claimed to be exempt by the purchaser. It relieves the seller from any liability if the purchaser of the property furnishes to the seller a certificate or other written form of evidence indicating that the property is acquired for an exempt purpose.

Section 405 has been commented on in reference to jurisdictional limitations provided in Section 201. It should be noted that while Section 405 by its language only precludes classification of interstate sales for use tax collection purposes by a seller, the purpose of Section 405 is to require uniform state collection and administration of local sales or use taxes imposed on interstate sales. Because the provisions of Section 405 may have some significant effect on local revenues, Section 523 postpones its effective date to on or after July 1, 1976.

Title V—Definitions and Miscellaneous Provisions

The definitions contained in part A of this Title generally are those set forth in the original ad hoc proposal which were based upon the definitions contained in Part A, Title V of the Rodino and Ribicoff Bills, with minor changes except any references to gross receipts or capital stock taxes are deleted from the definitions. Section 501 defines a net income tax, Section 502, a sales tax, and Section 503, a use tax. Section 504 defines an excluded corporation which term is used in Section 301(a) to delineate the scope of Title III. Thus, the income tax provisions of the proposed bill do not pertain to an excluded corporation. An excluded corporation generally includes various financial organizations and public utilities.

Section 505 defines an affiliated corporation and is based upon Section 1504 of the Internal Revenue Code with changes in structure and modifications to take into account companies controlled by a noncorporate common owner. The term "affiliated corporation" defines corporations which can be required or permitted to file a combined report, as provided in Section 301(d). There is excepted from an affiliated corporation (1) excluded corporations defined in Section 504, (2) Western Hemisphere Trade Corporation as defined in Section 921 of the Internal Revenue Code, (3) possession companies as defined in Section 931 of the Internal Revenue Code, (4) corporations entitled to the special deduction for China Trade Act corporations under Section 941 of the Internal Revenue Code, and (5) corporations substantially all of the income of which is derived from sources without the United States.

Section 506 defines sale to include leases and rental payments under leases for the purposes of Title IV. Section 507 defines an interstate sale and Section 508 defines destination. Section 509 defines business location. This term is used in the Act only in regard to sales and use tax jurisdiction. Section 510 defines the location of property and Section 511 defines the location of an employee for Title III income apportionment purposes. Section 512 defines state and Section 513, state law,

Section 514, taxable year, Section 515, compensation, Section 516, commercial domicile and Section 517 defines dividends.

Part (b) of Title V contains the miscellaneous provisions. Section 518 permits the imposition of franchise tax as a revenue measure even though technically imposed on the privilege of engaging exclusively in interstate commerce. Section 519 prohibits geographical discrimination. Section 520 indicates that the proposed act does not repeal Public Law 86-272 with respect to any person or to increase or otherwise effect the power of any state or political subdivision to impose or assess a net income tax with respect to an excluded corporation. Section 521 prohibits out of state audit charges. Section 522 limits the liability with respect to unassessed taxes which a state or political subdivision would have no power to impose after the date of the enactment of the proposed Act. Section 523 pertains to effective dates. The provisions of the Act will take effect on the date of its enactment unless otherwise provided. Section 405 (pertaining to local sales and use taxes) is to be effective on or after July 1, 1976, and the Act is effective for unassessed taxes as provided in Section 522.

STATEMENT OF HON. DANIEL J. EVANS, GOVERNOR, STATE OF WASHINGTON

My name is Daniel J. Evans. I am Governor of the State of Washington. I wish to thank Senator Mondale and the subcommittee of the U.S. Senate Finance Committee for this opportunity to present a statement of my support for S. 2092 together with comments on other multistate tax legislation now before Congress. My opposition includes vigorous opposition to S. 1492.

Eight years ago, the so-called Interstate Taxation Act (commonly known as the "Willis Bill") was first introduced in the U.S. House of Representatives. This touched off extended nationwide discussion of the tax jurisdiction of states and their economic and governmental relations with multistate business taxpayers. The State of Washington was drawn into the argument at an early stage. The Director of the State Revenue Department and an Assistant Attorney General took an active part over the ensuing 16 months in drafting a multistate tax compact directed toward achieving uniformity in state tax treatment of multistate business through action by the states. This compact was proposed originally by the National Association of Tax Administrators but the effort was carried forward on an ad hoc basis between State representatives with the assistance of the Council of State Governments.

Subsequently, in 1967, twelve states enacted the compact and organized the Multistate Tax Commission. The Commission's activities grew and its membership expanded to 21 regular member states and 15 associate states. One of the latter states, Alabama, has also adopted the compact, conditioned, however, on Congressional consent.

A number of bills before you propose to establish federal rules for uniformity in this area of state taxation. I wish to divide my comments on the proposed legislation into two principal parts. First I want to state my support for and belief in the value of the Multistate Tax Commission. Title I of S. 2092 proposes to designate the commission as the administrative agency for whatever substantive law Congress might enact relative to state taxation of multistate businesses. I think this proposed consent legislation is the right way to go.

Second, I will comment generally on the proposed substantive provisions leaving detailed discussion of various proposals to Mr. George Kinnear, Director of Revenue of the State of Washington, and to the other administrators better acquainted with the technical details of tax impact administration. *Congressional Consent for Multistate Tax Commission* (*Title I, S. 2092*)

The statutory purposes for creating this Commission as they appear in the language of the compact read as follows:

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

Within the scope of these purposes are other objectives which this committee and Congress should understand. One accomplishment of the Commission has been to make a positive response to a widely-voiced criticism of the states that

they could not and would not get together and act jointly on tax decisions affecting multistate businesses across the country.

The states had previously been relatively weak and dilatory in many areas of government. This condition was acute during the difficult years of the 30's when the economics of the times hurt all of America but particularly strapped the states and local governments for revenues to carry on even routine services. This weakened condition extended through the war years when available revenue and administrative planning had to be centered in Washington, D.C. Since shortly after World War II, the states have shown consistent progress, imagination and increased capacity in their administrative programs.

The supporters and opponents of the compact and many congressional committee members agree that the main objective of the Commission at all times has been to achieve maximum uniformity in the administration of state taxes as they affect companies engaged in multistate business. However, with the exception of S. 2092, and its lineal predecessors, the proposals presented in Congress commencing with the Willis Bill and proceeding through those introduced by Representative Rodino and Senators Ribicoff and Mathias, would not provide uniformity in tax administration.

To the contrary, their primary impact would be to provide preferential jurisdictional exceptions and thus create new areas of non-uniformity between competing businesses.

All the time, of course, the less mobile and flexible businesses in any state would be forced to compete in the market against the tax-favored firms this measure would benefit.

We simply don't need tax loopholes of this magnitude.

The Multistate Tax Commission has been hampered in its efforts to become a fully successful agency for solving tax problems arising between the states and multistate businesses by the failure of Congress to enact consent legislation. The Attorney General of Washington State advises me that the compact commission is a legal and constitutional entity and does not require a congressional consent bill to qualify its actions. Its opponents continue to argue this question, however, and their arguments have created unjustifiable but continuing doubts in the minds of many businessmen and some state administration as to whether they should work with the commission or not. A consent bill would eliminate this burden.

I believe strongly in the great potential of the Multistate Tax Commission as an agency of the states. My convictions were expressed in the enclosed statement I made to the Seattle Chamber of Commerce in 1968 which outlined the business advantages and purposes of the compact commission. (Enclosure A.) The Commission was barely "underway" then, but I believe this statement remains true.

I foresee increased need for the Multistate Tax Commission. If Congress should enact a bill providing subsidy directives or jurisdictional definitions affecting the state tax authority, Congress would have only two alternative actions. The first would be to leave determinations to the various federal courts, a move that assuredly would not assure uniformity. (I know it has been suggested that the Court of Claims might hear disputes. The Court of Claims is not qualified by experience to adjudicate these issues and serious administrative problems would be created for a large majority of the states in dealing with the Court of Claims on tax issues.)

Alternatively, Congress could turn administrative responsibility over to the IRS or some other federal agency. I would protest this choice. I cannot believe that Congress would take such an overt step towards destroying the independent administrative authority and political integrity of the states. This decision would create non-uniform tax administration within each state; state and federal authorities would find themselves separately interpreting the same laws for different classes of taxpayers. This would be anathema to instate business taxpayers and undoubtedly would receive the condemnation of all businesses excepting those granted exemptions in particular states. Since tax revenues constitute the life blood of any government, this could only result in downgrading the states and lead, I am sure, to an inevitable federal dictation of all state tax regulations and administration.

In this era of the 70's, when power and authority, business and commercial activities, and all the functions of national life are shifting more and more rapidly across state lines, calling for decisions and problem-solving actions that do not fit neatly into existing political geographic compartments, the need has become imperative to meet new situations with better techniques and new agencies. With this in mind, the states have created the Multistate Tax Commission. I urge

Congress both to enact "consent to its activities" and to utilize the Commission as the appropriate agency for administering federal legislation affecting the state tax jurisdiction.

Comments on Substantive Provisions of S. 2092 (Title II–V)

In general I wish to express my full support for S2092 and my opposition to S. 1245. Drafting of S. 2092 involved compromise on a number of points on which the states and businesses were widely separated prior to the formation of the Ad Hoc Committee. Sound compromise is, of course, an important art of American government.

S. 2092 was drafted by an Ad Hoc Committee of business and state representatives, each nationally recognized as an expert in state taxation. The general concept of this proposal is that the solutions to the problems of multistate taxation of interstate business should be implemented through a merger of the multistate tax compact approach and the federal legislation approach. The objective of a merger is to preserve administrative authority in the states by requiring them to act through the machinery of an interstate tax compact, consented to by Congress, and serving as the agency to implement uniform standards established under federal legislation.

I emphatically support this concept.

The National Association of Tax Administrators under the leadership of Kenneth Back, President, District of Columbia, has appointed a special committee, of State Administrators to draft suggestions in order to maximize consensus for ultimate legislation. A final draft is now in preparation. Mr. George Kinnear, the Director of Revenue of the State of Washington, has assured me that the committee and its chairman, Mr. Owen Clark of Massachusetts, are able and dedicated administrators in whom he has full confidence. While studying S. 2092, I urge the committee to give substantial weight to the NATA proposals.

Objections to S. 1245

With regard to S. 1245, I take sharp exception to several principal points.

One objectionable feature is the bill's definition of "business location". The use of "business location" as a base for state tax jurisdiction carries out the concept in the original Willis bill and provides preferential exemption from state tax liability without advancing the alleged purpose of uniformity. These limitations would not create tax uniformity. The business location test as drafted would sharply curtail the jurisdiction of many states over complex multistate or international corporations. The latter would be able to manipulate and shift affiliated corporations, agents and employees and carry on business activities in a given state so as to evade the "business location" test and thus gain tax exemption.

This is of particular interest to the State of Washington because of the effect S. 1245 restrictions would have on the state's present authority to impose and enforce its business tax on gross receipts. The existing legal procedure established by *General Motors Corp. v. State of Washington*, 377 US 436, 12 L ed 430, 84 S Ct 1264 (1964), would be overruled. As a matter of fact, there is no true problem of non-uniformity on a nationwide basis involved in this instance since only Indiana and West Virginia have a similar tax. Also, this tax is levied in the state of origin solely on an activity conducted within that state.

On page 1058 of Volume 3 of the Report of the Willis subcommittee the following conclusion is set forth:

"The particular competitive relationship between two firms, one paying a gross receipts tax and one not, will depend on the complete set of taxes paid by each and the way in which these taxes affect the costs of producing and selling goods. *It is far from obvious that products taxed on a gross receipts basis are uniformly taxed either more or less heavily than those originating in non-gross receipt tax states.* The present state of knowledge is not adequate to explain the precise competitive effects of each state tax system. *It is clearly not possible, however, to conclude that the payment of a gross receipts to the state of origin necessarily implies tax costs higher than those on competing firms taxed by other means.* Further, sellers are in a position to participate in the political processes of the origin state if the taxes imposed on them cause significant competitive disadvantages." (italic supplied)

I object to the limitation of S. 1245 which conflicts with the principle of "full accountability" of the income tax base to the states which have collective jurisdiction to tax. The State of Washington does not presently have a net income tax but the principle involved is so important that I believe it necessary to support it in advance of the time we do have an income tax. The voters of Washington will have such a choice before them in November 1973.

I also oppose the provision that would relieve vendors from the obligation of collecting sales and use tax when receiving a "buyer registration". This bill would exempt most multistate businesses from the collection of use tax, and force the states to create expensive, impractical administrative systems. Here, too, it would overrule existing case laws set forth in the Scripto and General Trading decisions. (*Scripto, Inc.* v *Carson*, 362 US 207, 210–211, 4 L ed 2d 660, 663, 80 S Ct 629; *General Trading Co.* v. *State Tax Com.*, 322 US 335, 88 L ed 1309, 64 5 Ct 1028, 1030).

This jurisdictional limitation would seriously impair state revenues and provide major tax exemptions without affording any degree of uniformity between taxpayers.

It is interesting that such a proposal is still supported in light of another finding of the Willis Subcommittee favorable to the states. The committee said, "Autonomy in the formation of tax systems carries with it the temptation and the opportunity to discriminate against the out-of-state businessman. To a very large extent, the states, with only occasional prodding from the Supreme Court, have treated the stranger on a parity with a native." (Vol. 3, Ch 26 (D)).

I believe firmly, along with the U.S. Supreme Court, that (1) it should be a goal of federal government policy that interstate sellers be treated on a parity with local sellers, and (2) that tight jurisdictional limitations would, in the words of the court, "open the gates to a stampede of tax avoidance" to the detriment of local business (Scripto v Carson, ibid). I urge that the committee instead adopt the provisions of Title IV of S. 2092 dealing with sales and use taxes.

Congressional legislation should include a provision reversing the decision of the U.S. Supreme Court in *National Bellas Hess* v. *Illinois*, 386 US 753, 18 L ed 2d 505, 87 S Ct 1389. I believe the minority opinion written by Justice Fortas correctly states the economic and legal principles which should be approved by Congress. Justice Fortas said in part:

". . . Bellas Hess is not simply using the facilities of interstate commerce to serve customers in Illinois. It is regularly and continuously engaged in 'exploitation of the consumer market' of Illinois . . .

"Bellas Hess enjoys the benefits of, and profits from the facilities nurtured by, the State of Illinois as fully as if it were a retail store or maintained salesmen therein.

"While this advantage to out-of-state sellers is tolerable and a necessary constitutional consequence where the sales are occasional, minor and sporadic and not the result of a calculated, systematic exploitation of the market, it certainly should not be extended to instances where the out-of-state company is engaged in exploitating the local market on a regular, systematic, large-scale basis. In such cases the difference between the nature of the business conducted by the mail order house and by the local enterprise is not entitled to constitutional significance. The national mail order business amounts to over $2,400,000,000 a year.

"Vol. 3 (1965), at 770–777. But the volume which, under the present decision, will be placed in a favored position and exempted from bearing its fair burden of the collection of state taxes certainly will be substantial, and as state sales taxes increase, this haven of immunity may well increase in size and importance." (18 L ed 2d, Pages 512, 513)

There are other important issues between businesses and the states, such as the treatment of dividends, foreign source income, apportionment and allocation, and alternatives to the "throwback" proposal. These are matters which call for compromise in order to reach any solution. I have confidence in the ability of the tax administrators and legal advisors who participated for nearly two years in the ad hoc effort that culminated in S. 2092. On these points I will defer to the opinions and recommendations of other state representatives including the Director of Revenue of the State of Washington.

Congress should take definitive action in this session. Changing business conditions and related government decisions are occurring rapidly and increasing the severity of the problems we are discussing here. Thus, we—the states—urgently need to finalize the rules affecting the relationship of multistate businesses and state administrations at the earliest possible moment to prevent restrictive political interference with the development of our nation's economy. This requires statesmanship on the part of tax administrators and business representatives and I believe that many of both groups have shown this quality. I pray that your committee will proceed to develop legislation that will meet the necessity for uniformity while protecting the autonomy and fiscal vitality of the states and then proceed to enact legislation at the present session of Congress.

THE MULTISTATE TAX COMPACT

(by Governor Daniel J. Evans, Speech to Seattle Chamber of Commerce, Seattle, June 28, 1968)

The Multistate Tax Compact and Multistate Tax Commission are designed to provide interstate uniformity of taxation for businesses operating in two or more states. A prime purpose of the Compact is to eliminate duplicate taxation and bring about uniform regulations and rules in all the 50 states and their subdivisions.

The Multistate Tax Compact has taken a number of steps to bring about this uniformity in tax administration which affects multistate businesses. Among the many advantages to the business community offered by the Compact are:

1. *Prevention of overlapping and duplicate taxes.*—Sales and use tax credits and the Uniform Division of Income Act are examples of steps taken to prevent this duplication.

2. *Eliminates charges for out-of-state audits.*—The Compact initiates procedures for the Multistate Tax Commission to conduct one audit of a taxpayer. This audit can be used by all member states and the United States for tax purposes only. The cost of the audit is charged to the state requesting the work. There is *no* cost to the taxpayer.

3. *One place for tax problems.*—The Compact provides one agency for all multistate tax problems. This allows business to present its problems, ideas and thinking on multistate tax matters in one place instead of 50.

4. *Simplified reporting.*—The Compact, through the Commission, is developing methods to simplify the reporting of taxes when more than one state or subdivision is involved. The provision of the Compact which allows businesses with sales of $100,000 or less to pay a flat rate on the basis of percentage of volume is an example of this simplification.

5. *Solving of interjurisdictional problems.*—The Compact provides for an arbitration board to settle disputes over apportionment and allocation of taxes. The board is convened at the request of business and listens to appeals from the final administrative determination of a state. This item goes into effect with the Commission, by the adoption of a regulation, determines there is a need for it. The rulings of the Board are binding on all Compact states in which the taxpayer does business.

Our sales program is very unique in that the Spear Engineering Company does not have *any* hired salesmen or sales force. All of our business is developed by placing advertising copy of our products in various advertising media, mostly on a national scale, such as: Better Homes and Gardens, New York Times, Wall Street Journal, National Observer, Fortune Magazine, Farm Journal, Successful Farming and several other media. Our total advertising expenditure to date in this area amounts to over $2,550,000.00. As a result of this extensive advertising program, we have developed nationwide sales in several basic directions:

First, we obtain sales from individual customers including home owners and business establishments for our nameplates as ordered from the advertising placed in the various media mentioned above.

Second, we have a few hundred independent dealers around the country who take orders door-to-door for our products at the retail level (or at whatever price them deem to sell) and send the orders in to us with accompanying remittance at a wholesale price. Most shipments in this area are made direct to the independent dealers in bulk. These dealers are solicited by advertising copy in our ads and by package enclosures in the shipment of our products.

Third, as a result of certain advertising copy placed in some of the media mentioned above, we obtain contacts with business establishments (manufacturers, Universities, Colleges, Financial Institutions, Insurance Companies, ect.) who buy our products for their own use or for business gifts to their customers at Christmas time, etc.

Fourth, some of the business firms will use our markers as "premium Merchandise" to develop their own sales on a promotion basis.

Fifth, a few stores and other retail outlets handle our nameplates and we call this area of sales our resale category, but the sales here are at a very modest amount and are sold to the stores, etc. at a fairly high discount. We do "drop-ship" our nameplates for a number of the mail order houses and we could include these sales, also, in the resale area.

Our total sales volume including all of the above areas has amounted to approximately $7,000,000.00 over the past twenty years. Practically all shipments of our

product are made by Parcel Post and our total amount of postage (not including letter postage) to the United States Post Office Department has amounted to over $500,000.00 (25,000.00 per year) since 1949.

Our year round average employment is about twenty-five employees with some having been with us as long as seventeen years. Since 1949 we have paid out approximately $1,300,000.00 for labor and administrative and office help.

Our primary pruchases of materials include aluminum, brass, bronze, hardware (nuts, screws, bolts, etc.), paper products and various and sundry factory supplies. These purchases since 1949 have amounted to approximately $800,000.00.

Our business primarily, therefore, consists of selling nameplates by mail and manufacturing them to customer's order. In general, the orders are small, with the majority of the orders being for single units. In 1969, for example, we manufactured approximately 180,000 units with an average net sale price per unit of $3.09. Although the actual figures are not available without extensive analysis, it is estimated that the average net price per sale or per order is somewhere between $4.00 and $4.50. This would mean that last year on approximately $560,000.00 of sales we would have handled 125,000, or more, individual orders for our nameplates.

Our company has had a great deal of experience in handling paper work, as evidenced by the handling of over 125,000 orders last year. I believe that the following estimates of single order costs of the expenses for handling the tax situation are fair and reasonable, based on our past experience.

We have analyzed the question of the probable expenses involved in collecting, accounting, recording and paying State and Municipal Sales and Use taxes. Remember, please, that had we been doing this in 1969, we would have examined over 125,000 orders in an attempt to make the proper distribution of Sales and Use taxes to the various States and Municipalities who have them. The probable additional expenses to our company are as follows:

First, we would be required to use considerable advertising space to do this which, in 1969, would have amounted to $5,160.00 and we would further estimate that the probable loss of sales due to the advertising copy to collect taxes could amount to as much as 5% which would lower the effectiveness of the advertising by $8,600.00.

Second, we note that our Colorado customers, although they must feel obligated to pay both the State and Municipal Sales and Use taxes, very seldom ever include any amount for that purpose. Therefore, on a nationwide basis, we can readily assume that although we adequately advertise for inclusion of the Sales tax with each order, only half would pay. It would not be practical on such small orders to spend the cost of postage, envelopes, etc. to contact these customers again to collect the tax, and we could further assume that on an overall 2% tax base amounting to $11,200.00 of tax on the 1969 sales of $560,000.00 we would be "holding the bag" for an amount approximating one-half of that, or $5,600.00.

Third, our probable office expenses for handling the assumed tax situation during 1969 would be about as follows:

Fixed expenses

	Annual expenses (125M orders)
Scrutinize order and post for tax liability at $0.02 [1]	$2, 500. 00
Punch information into card record at $0.02 each [1]	2, 500. 00
Summarize cards every 30 days at $0.005 [1]	625. 00
Fill out forms every 30 days at $0.005 [1]	625. 00
Business machine rental (IMB, etc.) at $500 per month	6, 000. 00
Supervising accountant	9, 000. 00
Assisting typist for accountant and business machine operator	4, 200. 00
Additional space rent at $100 per month	1, 200. 00
Total fixed annual expense	25, 650. 00

[1] Additional personnel.

Variable Expenses

These are expenses which would be determined by the number of taxing liabilities and the required reporting period to these liabilities (per month, quarter or other period).

These expenses could range from $6.00 for 50 (States only) up to $12,000.00 for 100,000 (Municipalities) taxing liabilities. These figures are based on estimated

costs as follows: checks @ $.04, postage @ $.06, and envelope @ $.02, or a total of $.12.

Of course, the variable expenses listed above are problematical, since it is not really known as to the number of taxing liabilities which might be incurred. However it is interesting to note—that and probably one of my most important points—that the variable expenses could reach the very high figure of $12,000.00 per year.

We will now ask the burning question—how can our company afford to spend considerably over $30,000.00 per year to collect a probable amount of around $11,000.00 or $12,000.00 Sales and Use taxes on our total sales? It is rather obvious that we could not possibly afford to do so and the paper work problems with the other attendant difficulties are just far more than we could cope with.

In our twenty years of existence we have made only two modest price increases in our products, and we feel that this is quite a record. We do find, however, that the mail order buyer (our customer) is extremely sensitive to the price he pays for a product. Although we have estimated a modest loss in sales of only 5% by adding on a tax collection statement in our ads, it could be considerably more loss than this amount. Further, who pays for the necessary advertising to collect the taxes from the mail order buyers?

We have always contended that the only sensible and practical way for the taxing authorities to collect Sales and Use taxes is from their own residents. For example, if a customer buys some product from outside their own State then they should, in some way, be obligated to pay the tax direct to the State taxing authorities, either as part of their income tax report or on some other basis. Frankly, I do not personally believe that business could survive a "mass tax collecting program" and it would appear that adequate legislation is needed.

To summarize our picture, it would appear that many States and Municipalities are expanding their tax collection activities and they are attempting to force sellers who do business in foreign States and Municipalities only by mail to collect said taxes. If such action by the collection authorities is legalized, then such action must affect our business adversely. We have been told by legal counsel that such impositions on us might well be unconstitutional and invalid. This is small comfort to us, since we do not want to, nor can we afford to, engage in long legal contests with several States and Municipalities.

It is rather obvious, gentlemen, from my testimony that the Spear Engineering Company could not continue to exist under legalized authority for the States and Municipalities to force us to collect Sales and Use taxes from our customers. Your Committee and the Congress should study the matter very carefully, as it is most important to the business community to be relieved of the terrible intricacies of taxation on Interstate Commerce.

You have been kind, Mr. Chairman, along with your Committee to allow me to be here and I thank you for the privilege of being a witness with this testimony.

Senator MONDALE. We will next hear from a panel representing small businesses making sales in interstate commerce, the panelists are John Holmes from Oregon, Fox B. Conner of New York, Robert George of Wisconsin, and Mark Dalquist of Minneapolis, who are represented by Harold T. Halfpenny from Chicago, Ill. We are very short on time as you know, so we have asked each panelist to limit himself to 3 minutes.

STATEMENT OF JOHN R. H. HOLMES, PRESIDENT OF HARRY & DAVID, MEDFORD, OREG.; FOX B. CONNER, PRESIDENT OF ALLCOCK MANUFACTURING CO., NORTH WATER STREET, OSSINING, N.Y.; ROBERT GEORGE, HARP & KETTLE CHEESEHOUSE, MADISON, WIS.; AND PRESIDENT OF MAID OF SCANDINAVIA, MINNEAPOLIS, MINN., ACCOMPANIED BY HAROLD T. HALFPENNY, ESQ., CHICAGO, ILL., COUNSEL TO THE NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS

Mr. HALFPENNY. My name is Harold T. Halfpenny, attorney, and I would like to introduce our panel here.

To my right is Mr. Dalquist, who is president of Maid of Scandinavia, of Minneapolis, Minn. And next to me is Mr. George, representing the Wisconsin Cheese Organization. And to my left is Mr. Fox Conner who is president of Allcock Manufacturing Co. in Ossining, N.Y., and next to him is Mr. John Holmes of Harry and David of Medford, Oreg. These men have been selected, Senator, by several hundred small mail-order organizations and I would like permission to have their statements put in the record.

Senator MONDALE. The statements will be made a part of the record.

Mr. HALFPENNY. And they will make a brief summary of their remarks.

Senator MONDALE. They may proceed.

Mr. HALFPENNY. And Mr. George will be the first one to make comments.

Senator MONDALE. All right, Fine.

STATEMENT OF ROBERT B. GEORGE, OWNER, HARP & KETTLE CHEESEHOUSE

Mr. GEORGE. My name is Robert B. George from Madison, Wis. I own and operate the Harp & Kettle Cheesehouse, a retail store and mail-order cheese business, located at 310 East Broadway in Madison. I am here today representing my own business, and also to appear in behalf of the approximately 50 other members of the Wisconsin Gift Cheese Association, a group of mail order cheese firms.

Briefly summarizing, first I would like to say that to my knowledge, none of our members have been forced to comply with any other State sales tax laws, although we are apparently all subject to them, as requests have been made in the past for our members to comply. The only reason that I can offer that no pressure has been put on us is that none of us have a nexus with other States and that we are too small to bother with.

Nonetheless, we are liable for years back. The basic requirements of the multistate tax compliance are the same for most any business. Determination of the liability for sales under applicable laws, of collecting, accounting, reporting, and depositing the tax and the cost of the additional time, advice, personnel, equipment, and facilities are more than a business the size of most of us can afford.

But, in addition to these basics, there are other characteristics of our particular businesses that further magnify our inability to comply. First, the size of our businesses. All but perhaps five or six of our members gross less than $200,000 in mail order sales a year. Yet, it is estimated that the group does about $60 or $70 million a year, total.

Second, our business is very seasonal. Eighty-five to 90 percent of our year's mail order sales are compressed into 6 or 7 weeks at the end of the year.

Third, the size of each order is small. The average order is $22, split into 3.8 shipments for an average tax liability on shipments of under $7.

Also the nature of our business is unique. We are dealing mainly with gift shipments where the shipment often goes to someone other than the purchaser, often into a different State, and often the recipient will be liable for the use tax. Many of our gift assortments contain

a mixture of products, and in certain States would be partly taxable and partly exempt. This is true in our State of Wisconsin.

And finally, trying to properly inform the customer of this tax liability for his "cash with order" purchase would be confusing to explain in our catalog instructions.

These are a few reasons we feel that the gift cheese mailers of Wisconsin could not continue operation if forced to comply with out-of-State taxation. The threat of the strain on our small businesses, that now exists, should have no place in our free economy. Being permitted to continue to evade the existing law is not the answer. It is our urgent plea that the Senate pass S. 1245 with its uniform jurisdictional standards, and amnesty for unassessed liabilities so that the small mail order operators can look to the future without fear of the ever-accumulating tax liability and penalties we now face.

Thank you, Mr. Chairman.

Senator MONDALE. Thank you.

[Mr. George's prepared statement follows:]

TESTIMONY OF ROBERT B. GEORGE, OWNER, HARP & KETTLE CHEESEHOUSE, MADISON, WIS.

My name is Robert B. George from Madison, Wisconsin. I own and operate the Harp & Kettle Cheesehouse, a retail store and mail order cheese business, located at 310 E. Broadway in Madison. I am here today representing my own business, and also to appear in behalf of the approximately 50 members of the Wisconsin Gift Cheese Association, a group of mail order cheese firms. These Wisconsin businesses have developed a new market of millions of pounds of "plus" sales of this dairy product so vital to the economy of our dairy State.

Our family started Harp & Kettle Cheesehouse in 1948, selling cheese from a roadside store. We mailed price lists to those early customers on the back of a penny post card. Today we are still in the same roadside store and it is still pretty much a family operation, with from 6 to 7 employees during most of the year.

Since we opened our store, we have specialized in offering a wide array of fine Wisconsin cheeses of the quality and variety and cure not readily found in stores across the nation. Visitors from other States have stopped at our store, liked what they bought, and have written back for us to send them more. As a result, selling by mail has become an increasingly important part of our business, and now accounts for about half our sales. We mail colorful catalogs to our customers showing the bulk cheeses, assorted cheese and food packages, and other items compatable with our line of cheese items. Our catalog lists delivered prices, postpaid to any point in the U.S.A., and we enclose an order blank to simplify ordering.

Although Wisconsin didn't have a sales tax at the time, somewhere along the line as we were drifting into the mail order business we were alerted that some of the States with sales taxes were demanding that mail order firms collect and remit sales tax on shipments sold into their States from outside. Although none of our members had been forced to comply, when the hearings were held in 1962 by the House Judiciary Subcommittee on State Taxation of Interstate Commerce, we were so concerned over the threat of being harassed by out of State taxing authorities, that our Association arranged to be represented at those 1962 hearings.

It wasn't until those hearings were scheduled that most of us became aware of the seriousness of the situation. Our members were informed of our dilemma and we were asked to complete a questionnaire pertaining to the effect these various sales and use taxes would have on our businesses, if enforced. Nearly all our firms responded that if they were required to comply with all these laws of the States from which they received orders and mailed cheese to, there is no doubt the costs of compliance would force them out of the mail order business.

It was argued by those in favor of the taxation of interstate business, that orders secured from residents of their State by out of State sellers should be taxed because such sales otherwise would have been made locally by their in-State merchants, and that we therefore were providing unfair competition, as their customers could order by mail from us and avoid their State tax. We showed this was not the case in our industry because we were offering a product pretty much

unique to our State and also, that no price advantage to the buyer existed, for if they ordered by mail from us rather than buying the cheese locally in their stores (if available), the costs of mailing it to them would more than offset any savings they might make in avoiding their State's tax on the sale.

Basically, we wonder why we should be subject to comply with other States' sales and use taxes, because our activities are all confined to the State of Wisconsin. We address and prepare our catalogs for mailing and deliver them to our local post office. The resulting orders are received in our mail box, then processed, packed and filled, and turned over to our post office or other carrier, for delivery. We have no employees or salesmen operating outside Wisconsin; we maintain no office, warehouse, inventory, or other facilities in any other State. We don't feel a sale to a person from Illinois, for example, should any more be subject to Illinois sales tax when we fill the order they send us by mail, than when they stop into our store when travelling past, and buy the same merchandise to take home with them to use.

Because ours are very small businesses, challenging the validity of these various laws in court is out of the question financially. For that reason, we appreciate and welcome the opportunity to participate in these hearings and present our position in this complex problem.

Any seller, whether large or small, would be required to go thru certain procedures, if forced to comply with the laws of out of State taxing bodies, no matter how simple the transaction was. First, he would have to secure legal advise to determine whether the sale were received from, or to be shipped to, or both, a State or one of the thousands of other out-of-State taxing authorities having sales and use tax laws. The provisions of the applicable laws would have to be determined to see if the product is subject to their laws, to what extent, and at what rate of taxation. All details of these laws would have to be known in order to properly collect, report, and remit the tax to the State and/or other authority.

Secondly, the mechanics of collection, accounting, reporting, and deposit of the tax would be required. To do these jobs would mean additional legal, supervisory, and other trained personnel, as well as investment in additional equipment, office space, supplies, and related facilities necessary to handle the additional work.

These are just basic requirements that would be necessary for simple compliance. These items alone would eliminate many firms from doing business across State lines. But in addition to these basics, there would be other complexities due to the nature of the mail order cheese business that further complicate our ability to comply.

Our businesses are small, with all but perhaps 5 or 6 of our members doing less than $200,000.00 mail order sales a year. The costs of compliance cannot be absorbed by such small firms.

Also, our business is very seasonal. At Harp & Kettle, 80 to 90% of our year's mail order business is done during the last 6 or 7 weeks of the year. This is because this time of year provides the most ideal shipping weather for our semi-perishable product, and also, many individuals and firms order our products as Christmas gifts. Although we only use an average of 5 or 6 employees during the first 9 months of the year, primarily in over the counter sales, we need 20 to 25 during the last 3 months to handle the mail order rush. Christmas gift orders must be shipped out on schedule, as they aren't very effective or acceptable if received after the holidays. It's difficult enough to process our orders and do the packaging and mailing on schedule with this inexperienced seasonal help, but to also face the staggering job and expense of sales tax compliance in all the other States would be out of the question for us to accomplish.

The size of the order in our industry is another factor that would make compliance extremely expensive. Our average order as received from the purchaser is about $22.00. This order involves 3.8 different shipments, so we are talking about tax compliance on individual shipments that average less than $7.00 each.

The nature of our orders, too, is quite unique. Many of our orders, especially during the Christmas gift season are ordered by a person or firm to be delivered to someone else. Some orders call for a shipment to the buyer, plus several or many shipments to gift recipients in several different States, and on different shipping dates. We would have to determine the tax liability in not only the State of the purchaser, but also in each State and taxing subdivision he ordered shipments made to. In this regard, it is my understanding that in some cases, to properly handle the tax, we would be required to write the recipient of the gift and demand they pay a use tax on the shipment they received as a gift!

We sell taxable and tax exempt items. Under the Wisconsin selective sales and use tax, food and drugs are exempt, as well as packaging materials and containers used to convey products to the consumer. Under our tax alone, we have to compile

charts for our store clerks and typists to determine what portion of a particular gift assortment is taxable and how much is exempt . . . cheese is exempt, but candy is taxable; a carton is an exempt container but a basket is a taxable container; salted almonds are an exempt food, but chocolate covered almonds are taxed; regular fruit cake is an exempt food but bite-sized miniatures are a confection, and taxed . . . imagine the job to determine our liability in all the States and local taxing units with varying rates and requirements, just to set up the charts on the different mixtures of product and containers in the assortments we pack. Securing and constantly updating this information could not be done on visual charts certainly, and it would mean the acquisition of computer equipment and personnel for our small operation.

Sales tax requirements would be confusing to the customer. One of the basic rules in preparing a direct mail catalog is to keep directions and instructions as simple as possible. Because of these unusual characteristics of our products and business, it would be virtually impossible to inform the customer properly, how much tax if any, is due on his order. And if he mis-calculated the tax, a billing for pennies due would cause even more lost customers.

I have attempted to briefly point out some of the reasons the gift cheese mailers of Wisconsin feel they could not continue operation if required to comply with the existing laws of the various out-of-State taxing authorities. There are other mail order industries over the country selling quality products of their area that are in much the same situation as we: Fresh fruit and tree-ripened citrus fruit, maple syrup, wild rice, Christmas holly, live lobsters, desert cacti, frozen prime steaks, smoked pheasant, local handicrafts, and many other products that lend themselves to mail order distribution because of unusual quality, perishability, limited or seasonal supply, or lack of widespread distribution.

The sort of restraint on our small business that now exists should have no place in our free economy, which has been built on the concept of the free flow of goods between the 50 United States. Being permitted to continue to evade the existing laws is not the answer.

It is our urgent plea that the Senate act to pass S. 1245 with its Uniform Jurisdictional Standard, and amnesty for liability with respect to unassessed taxes, so the small mail order operator can look to the future and make plans without fear of the ever-accumulating tax liabilities we now face.

Mr. HALFPENNY. Our next witness is Mr. Dalquist, president of Maid of Scandinavia.

STATEMENT OF MARK DALQUIST, PRESIDENT, MAID OF SCANDINAVIA

Mr. DALQUIST. Thank you.

This statement is in regard to the Mathias-Ribicoff bill, S. 1245, and the problems and hardships which could occur if this bill limiting interstate taxation is not passed.

We are a mail order company selling unusual cookware, bakeware, and cake decorating equipment to more than one-half million housewives in all 50 States and some foreign countries. We handle over 300,000 orders each year and provide prompt service to our customers, and their reorders are the mainstay of our business. We collect the Minnesota sales tax from our Minnesota customers, and remit the proceeds to the Minnesota Commission on Taxation with no undue difficulty. But the possible imposition of sales tax responsibility to some 49 other States and numerous counties and municipalities is a constant threat to our survival. Our data processing department has prepared some estimates of the time, expense, and problems involved in this procedure. These are shown on the last page of my statement, which has been submitted for the record. I will not comment on them except to say that we figure that at the very least it would cost us one-third of the amount of the tax collected to do the collecting.

Senator MONDALE. Just the cost?

Mr. DALQUIST. Just our cost, not counting the State costs of audits for enforcement.

There are other disadvantages of sales tax responsibility to all the States, and I shall explain some of them.

We started in the basement of my house in 1946, and now have 150 employees. I can safely state that this would not have been possible if we had been subject to all the States' sales taxes. I believe mail order is one of the few ways remaining in which a person can start from scratch and build his own business.

Also, in response to those who fear a large loss of tax revenue, I will show how the Federal Government and all State governments have benefited from our small business.

In 1952 we began making the Bundt cake pan. This is a high, round tube pan with fluted sides which no other company produced. We advertised this pan in our catalog and at first sales were only moderate, but as people began to see and use the pan and some magazines used the pan for food editorials, its popularity soared and to date many millions of these pans have been produced. Nearly all these sales have been through the usual distribution channels, that means they were subject to taxes in the various States. The business activity generated has certainly provided all the States as well as the Federal Government many times the revenue the States have lost from the relatively small amount of merchandise we have sold by mail order. This could not have happened without our presence in the mail order business.

Another interesting factor was discovered last fall in making a survey of customers who had not ordered from us for 3 years. The largest category of response was from those who said that even though they liked to order from us, they now had a store close to them selling the most popular items in our catalog—not our stores, but independent owned stores in those various locales—and they could buy more easily locally. This indicates that as mail order items gain popularity, they will appear in local stores, thus limiting mail order growth and providing the States with sales tax revenues they would not have had otherwise.

I would like to add here in concluding that I feel that the mail order business is a legitimate business, beneficial to the whole country, and I do not think it is right or fair that it should be subject to the threat of elimination by the imposition of the burden of collecting taxes for all of the States and subdivisions.

Thank you.

Senator MONDALE. Thank you very much.

[Mr. Dalquist's prepared statement follows:]

TESTIMONY OF MARK S. DALQUIST, PRESIDENT, MAID OF SCANDINAVIA, MINNEAPOLIS, MINN.

This statement is in regard to the Mathias-Ribicoff Bill, S. 1245, and the problems and hardships which could occur if this bill limiting interstate taxation is not passed.

We are a mail order company selling unusual cookware, bakeware and cake decorating equipment to more than half a million housewives in all fifty states and some foreign countries. We handle over 300,000 orders each year and provide prompt service to our customers, and their reorders are the mainstay of our business. We collect the Minnesota Sales Tax from our Minnesota customers, and remit the proceeds to the Minnesota Commission on Taxation with no undue difficulty, but the possible imposition of sales tax responsibility to some 45 other states and numerous municipalities is a constant threat to our survival. Our Data

Processing Department has prepared some estimates of the time, expense and problems involved in this procedure, and are shown on the last page of this letter.

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I know you will give this matter deep consideration, and I hope the information will be of help to you.

These figures are based on an annual sale of three million dollars;

1,500 hours per year labor for tax collections and internal upkeep ($11,000 a year labor costs at $9.00 per hour).

275 hours per year computer time for daily, weekly, monthly updating and paying of tax ($11,000 a year raw computer rental at $42.00 per hour).

20% increase in our computer file and processing sizes making growth to a larger computer sooner, thus adding greatly to overhead expense.

Record retention increase approximately six times based on a six month retention at present except for Minnesota which is three years and assuming all states are three years. (We are presently using 350 lineal feet which would mean a growth to 2,100 lineal feet.)

Additional administrative costs to company cannot be figured because each state and local government has various laws as to what is taxable and non-taxable. This would mean each of our 7,000 items would have to be coded as to tax status by each state. (7,000 items times 46 states or 322,000 codes would have to be stored in our computer.)

This would mean an additional cost of approximately $40,000 out of a collected tax of approximately $120,000 which is 33⅓ per cent of the total amount remitted to the states.

Mr. HALFPENNY. The next witness is Mr. Holmes, president of Harry & David, Medford, Oreg.

STATEMENT OF JOHN R. H. HOLMES, PRESIDENT, HARRY AND DAVID

Mr. HOLMES. My name is John Holmes. I live in Medford, Oreg. and am president of Harry & David and its subsidiary Jackson & Perkins Co.

Harry & David's primary business is the merchandising of fine food and fruit gifts by mail. It is the owner and operator of several hundred acres of fruit orchards in Medford, and the originator of the Fruit-of-the-Month Club.

Jackson & Perkins Co. merchandises roses, bulbs, seeds, and many other flowering plants, also by mail.

Substantially all of our companies' retail sales are made by mail or telephone to the national market. We have no salesmen, solicitors, manufacturer's representatives, or "missionary men" calling on our retail customers or prospects. Our corporate headquarters is in Medford, Oreg., and, except for Jackson & Perkins' rose growing operation and its wholesale salesmen who call on nurseries and garden centers, we maintain no places of business in any State other than Oregon, nor do we have employees in any State other than Oregon.

I strongly urge this committee to recommend legislation which would preclude individual States and localities from forcing vendors to collect sales or use taxes on goods moving in interstate commerce, particularly on sales made by firms such as ours, which have neither a place of business nor employees in such States or localities. Our reasons for this position are as follows:

Since our sales are made solely by mail and phone, neither our customers nor our companies impose any burden on the individual States, nor do we add to the cost of operation of those States' governments. Since most of our products are not generally available in local stores, we do not compete directly with retailers in such States.

Second, without passage of legislation to preclude the States and nearly 8,000 other political subdivisions from erecting tax barriers, there will certainly occur some impeding of the free flow of goods within the natural market that is this country. While interstate commerce must certainly pay its own way, conflicting, proliferating, and constantly changing State and local tax laws affecting goods moving in interstate commerce are long overdue for resolution at the Federal level.

Third, to small businesses, the expense of simply keeping abreast of the myriad tax rates of various political subdivisions—to say nothing of actually collecting the taxes from its customers, maintaining accounting records, and filing sales and use tax returns—would seem to be an unreasonable burden to impose upon such businesses.

Our own companies have the use of a computer, but if we were required to collect taxes for all 50 States and thousands of political subdivisions, our costs would increase more than $30,000 per year. I can assure you, gentlemen, that this is a significant penalty for our companies. And what is a company like Harry & David (of which there are many) to do, when its customers order its gifts, with payment in advance, for their friends who often reside in another taxing area? How are we to ever recover the taxes due from our customers and/or the gift recipients? Do we include with the customer's order form a gigantic table of State and local taxes, and then require him to sift through this table to determine the tax for each of his gift recipients? Do we go to the expense of invoicing him later for the few cents that his taxes would amount to if he does not figure the tax in the first place—or misfigures it? Do we compound this annoyance to our customers by raising our prices to pass through the cost of the tax and the cost of collecting it? Or are we to absorb the $30,000 as the cost of insuring the not-quite-free flow of our goods in interstate commerce?

Businessmen truly need a fair and intelligent guideline on which they can rely, regarding State and local taxes. In 1961, during con-

gressional hearings, State tax administrators proposed that they, rather than the Congress, develop such guidelines. We now have the Mathias-Ribicoff bill, an evenhanded, uniform guideline which is or can be supported by virtually every interested party or group, and which will insure the free flow of goods in our economy, and the economic strength that can result from it which we so badly need today. Thank you.

[Mr. Holmes' prepared statement follows:]

TESTIMONY OF JOHN HOLMES, PRESIDENT, HARRY & DAVID, MEDFORD, OREG.

My name is John Holmes. I live in Medford, Oregon and am President of Harry and David and its subsidiary Jackson & Perkins Company. It is my privilege to appear before you today, to give the testimony of our companies concerning Interstate Taxation.

Harry and David's primary business is the merchandising of fine food and fruit gifts by mail. It is the owner and operator of several hundred acres of fruit orchards in Medford, and the originator of the Fruit-of-the-Month Club.

Jackson & Perkins Company merchandises roses, bulbs, seeds, and many other flowering plants, also by mail. J&P owns and operates several hundred acres devoted to growing roses in the South Central area of California.

Substantially all of our companies' retail sales are made by mail or telephone to the national market. We have no salesmen, solicitors, manufacturer's representatives, or "missionary men" calling on our retail customers or prospects. Our corporate headquarters is in Medford, Oregon, and—except for Jackson & Perkins' rose growing operation and its wholesale salesmen who call on nurseries and garden centers—we maintain no places of business in any state other than Oregon, nor do we have employees in any state other than Oregon.

I strongly urge this committee to recommend legislation which would preclude individual states and localities from assessing and collecting sales or use taxes from out of state sellers on goods moving in interstate commerce—particularly on sales made by firms such as ours, which have neither a place of business nor employees in such states or localities.

Our reasons for this position are as follows:

First, our customers prefer to buy from our companies because of the quality and unusualness of our products and services. Since our sales are made solely by mail and 'phone, neither our customers nor our companies impose any burden on the individual states, nor do we add to the cost of those states' governments. Further, since most of our products are not generally available in stores, we do not compete directly with retailers in any such states.

Second, *without* passage of legislation to preclude the states and thousands of other political subdivisions from erecting tax barriers, there will certainly occur some impeding of the free flow of goods within the natural market that is this country. While interstate commerce must certainly pay its own way, conflicting, proliferating, and constantly changing state and local tax laws affecting goods moving in interstate commerce are long overdue for resolution at the Federal level.

Third, to small businesses, the expense of simply keeping abreast of the myriad tax rates of various political subdivisions—to say nothing of actually collecting the taxes from its customers, maintaining accounting records, and filing sales and use tax returns—would seem to be an unreasonable burden to impose upon such businesses. And what of the cost to the states and political subdivisions to effectively administer their laws? I suspect a "cast of thousands" is required to do so, and I also suspect the cost of this cast would easily exceed the take of the taxes.

Fourth, let me return to the subject of costs of compliance for businesses, whether large or small. These costs are incurred primarily in the area of staff work—i.e., they are overhead costs. These overhead costs are not trivial. If a small businessman tries to absorb them, his profit will be reduced and his incentive to free competition, the heart of our private enterprise system, will be weakened. Further, this weakening of incentive is not due to *operating* problems, which most American businessmen are eminently capable of handling—but rather, it results from a requirement to act as a tax collector for a multitude of states and political subdivisions. This businessman must figure the tax, attempt to collect it, record it, and then pay it over to the taxing authority. The businessman gains nothing for his business or his customers in so doing. And if the businessman does *not* absorb these added overhead costs, but instead passes them along to his customers, he adds to the burden of an especially sensitive problem today—inflation.

Our own companies have the use of a computer, but if we were required to collect taxes for all 50 states and thousands of political subdivisions, our costs would increase more than $30,000 per year. I can assure you, gentlemen, that this is a significant penalty for our companies. And what is a company like Harry and David (of which there are many) to do, when its customers order its gifts, with payment in advance, for their friends who often reside in another taxing authority? How are we to ever recover the taxes due from our customers (and/or their recipients)? Do we include with the customer's order form a gigantic table of state and local taxes, and then require him to sift through this table to determine the tax for each of his recipients? Do we go to the expense of invoicing him for the few cents that his taxes would amount to if he does not figure the tax in the first place, or misfigures it? Do we compound this annoyance to our customers by raising our prices to pass through the cost of the tax and the cost of collecting it? Or are we to absorb the $30,000 as the cost of ensuring the not-quite-free flow of our goods in interstate commerce?

Businessmen truly need a fair and intelligent guideline on which they can rely, regarding state and local taxes. In 1961, during Congressional hearings, state tax administrators proposed that they, rather than the Congress, develop such guidelines. That was twelve years ago. Those of us in the mail order industry are well aware of the difficulties in structuring fair and intelligent guidelines, and none of us believes that state tax administrators are deliberately throwing up obstacles to the development of such guidelines. But we now have the Mathias-Ribicoff Bill—an evenhanded, uniform guideline which is or can be supported by virtually every interested party or group—and which will ensure the free flow of goods in our economy, and the strength that can result from it which we so badly need today.

Thank you.

Mr. HALFPENNY. Our last witness is Mr. Fox Conner, president of Allcock Manufacturing Co., of Ossining, N.Y.

STATEMENT OF FOX B. CONNER, PRESIDENT, ALLCOCK MANUFACTURING CO.

Mr. CONNER. My name is Fox B. Conner, and I am president of the Allcock Manufacturing Co. of Ossining, N.Y. The Allcock Manufacturing Co. is a small corporation having an average of about 30 employees. Our principal product in the United States at the present time is our HAVA-HART animal traps.

When we started in business making and selling these humane animal traps, it was our desire to sell the traps through regular trade channels, but this effort was not immediately successful owing to the fact that many of the people interested in animal trapping live in rural areas, and also due to the extreme bulkiness of the traps.

As a consequence of this situation, we sold the traps by mail order and to other companies doing mail-order business. We set up regular discount schedules, and due to the rather extensive mail-order advertising we have done in the past, we have now developed a good volume of business through normal trade channels.

At the present time, about four-fifths of our traps are sold to the trade and one-fifth by mail order. The mail-order checks come in, and we put the money in the bank, and we do not segregate the orders at all except in the State of New York where we are domiciled, and where we collect and remit all taxes.

I have submitted with this statement a copy of what we are doing now in New York State to show what is the problem in just one State. We did $2,400 worth of mail-order business in New York State, and we collected $142.27 from 50 different communities. In New York State, the sales tax, as I understand it, can go now down to school districts, and I do not think you can even call the State department

of education and find out whether an order has come from a particular school district. I happen to live in the town of Ossining, or I have a post office address in the town of Ossining. I live in the town of Newcastle, and my kids go to school in the town of Ossining. But the school district is not the same as the taxing authority. You can theoretically have the school district with one rate of tax, and the tax at a different rate in New York State. So this is just a summary of what my feelings are.

[Mr. Conner's prepared statement follows:]

TESTIMONY OF FOX B. CONNER, PRESIDENT, THE ALLCOCK MANUFACTURING CO., OSSINING, N.Y.

My name is Fox B. Conner, and I am President of the Allcock Manufacturing Company of Ossining, New York. The Allcock Manufacturing Company is a small corporation having an average of about thirty employees. Our principal product in the United States at the present time our Havahart animal traps.

When we started in business making and selling these Humane Animal Traps desire to sell the traps through regular trade channels, but this effort was not immediately successful owing to the fact that many of the people interested in animal trapping live in rural areas, and also due to the extreme bulkiness of the traps, which made it undesirable for an ordinary retail hardware store to stock the trap.

As a consequence of this situation, we sold the traps by mail order and to other companies doing mail order business, such as Sears, Roebuck & Co., J. C. Penney, Abercrombie & Fitch, etc. We set up regular discount schedules, and, due to the extensive mail order advertising we have done in the past, we have now developed a good volume of business through normal trade channels.

At the present time about four-fifths of our traps are sold to the trade and one-fifth by mail order. We find that where traps become available in the local stores, people do not normally purchase by mail, so that our mail order business now primarily represents people who cannot be readily reached through trade channels. This is confirmed by the fact that a good percentage of our mail orders are shipped to rural routes.

Ours is a very small company, and not highly organized. We believe it would be economically impossible for us to keep track of sales for all the possible taxing entities. My reasons for making this statement are outlined below.

We do not own a computer or even a modern electronic billing machine. We have one girl who types invoices. When we receive an order for Havahart traps by mail, this girl types a cash invoice in such a way that with one typing she types a shipping label and two copies of an invoice. Since the money is received in cash, the day's receipts, and sometimes more than one day's receipts, are lumped together and deposited in the bank, and the corresponding sales are entered in our sales book.

There is no segregation of orders made as to States or local communities. Our average mail order sale is someplace in the neighborhood of $9.00, and we figure 50% of this amount is available to pay for all advertising and all expenses in connection with the processing and shipping of the order. If we attempted to segregate and pay sales taxes to all the present taxing authorities it would not be profitable, because I am sure the cost of doing this would be greater than the profit margin presently available.

Since it is mail order advertising that is creating the demand for our traps, and giving us local distribution, this would mean that our mail order business would have to come to an end. If this happened, then the local trade would wither on the vine, because when we sell directly to the trade we do not make a sufficient margin to carry on enough advertising to move the traps. It might be possible, by raising prices considerably, to continue this business, but I don't think it could be continued on our present price setup. Our whole operation might likely come to an end if we had to raise our prices much, as our traps are quite expensive by comparison with snap traps even under our present pricing setup.

I feel that at the present time, when we are selling four traps to the trade to one trap by mail order, our mail order sales nearly all represent sales to people who cannot presently obtain their traps locally, either because of the fact that they live in remote areas, or because local stores do not stock the traps.

We obviously could not afford to buy or rent a computer to keep track of sales and use taxes. We have tried to work out various ideas as to how these taxes could be collected. In every case, we have decided it would cost more for us to collect the tax than the total amount of the tax. We have some experience in segregating the tax because of New York State's present sales tax law, where we have to collect taxes for many cities in New York State. A copy of a recent New York State return is attached to show what is involved.

At a hearing of the Associated Industries of New York, where New York State tax men were present, I suggested that we might raise our prices 5% and send this amount on our total mail order sales to New York State, and they could try to pay the various other States and Communities who were levying and collecting sales tax. This was firmly rejected by the New York State tax people, and I believe one of the reasons it was rejected was that the State tax people know very well they cannot pay the cost of collecting and distributing the tax, and still make any money out of it.

For example, we do about $100,000 mail order business each year. If we collected $5,000 and sent it to some central government agency to be distributed as sales or use tax, in my opinion it would cost more than the $5,000 to keep up with the changing state laws and the actual physical distribution of the money in piddling amounts to the hundreds of taxing entities concerned.

I am not enough of a lawyer to understand all the provisions, but from what I have heard and read about what you are trying to do for us through the passage of this bill, I believe it will solve my problem and the problems of thousands of firms such as mine. I have no property or payroll any place except in Ossining, New York.

ST-100

New York State Department of Taxation and Finance
33

New York State and Local Sales and Use Tax Return

Page 1

Under Articles 28 and 29 of Tax Law
December 1, 1972 - February 28, 1973

Use Pre-addressed Form and Return Envelope for filing your return.
Keep duplicate for your records.

COPY

PLEASE KEEP THIS COPY FOR YOUR RECORDS.

Complete page 2 of this form before making entries below.

SUMMARY OF BUSINESS ACTIVITY	A	B	C
	$ 131,554.13	$ 2,405.72	

ENTER TYPE OF BUSINESS

Manufacturing

Summary of Taxes Due

1	Sales and Use Taxes	$ 142	27
2	(a) Credits (attachments required)		
	(b) Prepayments (attach Form ST-330)		
	(c) Total Credits and Prepayments		
3	Sales and Use Taxes Due	$ 142	27
4	Add: Late Filing Charge		
5	Amount Due including Late Filing Charge — Pay this amount	$ 142	27

Attach remittance payable to "New York State Sales Tax Bureau" and mail to your New York State District Tax Office or applicable PO Box on or before March 20, 1973.

SIGNATURE OF VENDOR

TITLE: PRESIDENT — DATE: 3/12/73

SIGNATURE OF PREPARER (IF OTHER THAN VENDOR) — DATE: 3/12/73

ADDRESS: c/o Allcock Manufacturing Co.
North Water Street

Did you complete the other side of this form?

For office use only

Sent Report and check to:
P. O. Box 3000
White Plains, N. Y.
10602

ST-100 (2-73) (SUPERSEDES 12 72 PRINT)

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ST-100 (Back) (2-73-33) (SUPERSEDES 12-72-33 PRINT) State and Local Sales and Use Tax Page 2

Taxing jurisdiction (a)	Rate	Taxable sales and services (to nearest dollar)	Purchases subject to use tax (to nearest dollar)	Sales and use taxes (dollars and cents)	Code
New York State	4	$365.40		$15.06	[illegible]
Albany		33.31			[illegible]
Allegany	6				[illegible]
Broome	6	20.06		1.21	[illegible]
Cattaraugus except		31.74		2.28	[illegible]
Olean city					[illegible]
Salamanca city	7				[illegible]
Cayuga		9.27		.70	[illegible]
Chautauqua	7	84.07		5.74	[illegible]
Chemung except		32.09		2.31	[illegible]
Elmira (city)	7	20.59		1.44	[illegible]
Chenango	6	24.76		1.49	[illegible]
[illegible]	7				[illegible]
Columbia	6				[illegible]
Cortland	7				[illegible]
Poughkeepsie (city)	6				[illegible]
Erie	7	60.76		4.26	[illegible]
Essex		1.63		.12	[illegible]
Franklin		23.69		1.63	[illegible]
Fulton	7	32.65		2.[illegible]	[illegible]
Genesee	6	11.23		.72	[illegible]
Greene	6	19.35		1.16	[illegible]
Hamilton	7				2022
[illegible]		14.05		.98	[illegible]
Livingston	7				[illegible]
Madison except		27.53		1.65	[illegible]
Oneida city					
Monroe		83.33		5.66	[illegible]
Montgomery except					[illegible]
Amsterdam city	7	10.68		.72	[illegible]
Nassau	7	60.03		4.20	2542
[illegible]	7	30.61		2.15	[illegible]
[illegible]		80.06		5.64	[illegible]
Ontario except	7	17.76		1.25	[illegible]
Canandaigua (city)	7				[illegible]
Geneva (city)	7				3242
[illegible]	7	11.50		.81	347[illegible]
Fulton city	7	1.70		.12	3532

Taxing jurisdiction (a)	Rate	Taxable sales and services (to nearest dollar)	Purchases subject to use tax (to nearest dollar)	Sales and use taxes (dollars and cents)
Oswego city		$1.68		$.0[illegible]
Otsego	6	51.26		3.[illegible]
Rensselaer except	6			
Troy city				
St Lawrence except	7			
Ogdensburg city	7			
Mechanicville city	6			
Saratoga Springs (city)				
Schuyler				
Steuben except		1.84		.1[illegible]
Hornell city	7			
Suffolk		153.46		11.[illegible]
Sullivan	6	[illegible]		[illegible]
Tioga		3.15		
Tompkins except		11.50		.[illegible]1
Ithaca city		37.63		2.63
Ulster except	5	5.56		[illegible]
Kingston city				
Warren except		6.25		[illegible]
Glens Falls city				
Washington		23.73		1.[illegible]3
Wayne				
Westchester except		552.51		26.[illegible]
[illegible] city		9.20		.55
Yonkers city	7	67.93		3.[illegible]3
Yates	7			
New York City	7	342.61		[illegible]
REPORT BELOW SALES AND USE TAXES SUBJECT ONLY TO LOCAL TAX (see ST-[illegible] Instructions [illegible] C and D)				
New York City	3			
TOTAL		$2,405.72		1[illegible]2.[illegible]7
ENTER ON PAGE 1.		BOX B	BOX C	[illegible]

Mr. Halfpenny. We appreciate the opportunity to appear, and I would like to submit for the record some letters in support of our position from companies in Oshkosh, Wis.; Westfield, Mass.; Greenwood, S.C., and Colorado Springs, if I may be permitted.

Senator Mondale. By all means, those letters will appear.

Mr. Halfpenny. And I do want to say that the one from Colorado Springs, the Spear Engineering Co., testified in the House and had prepared testimony that he was going to give in the Senate some time ago, but unfortunately waiting for this hearing, passed away. His statement has been adopted by his son, and I trust that we will have some solution to this problem before many of our other small businessmen pass away.

Senator Mondale. You want it in their lifetime?

Mr. Halfpenny. Yes, Senator. And I would like also to have permission, separate from that, to enter for the record a statement from the Chicago Association of Commerce and Industry for their 19,000 members supporting S. 1245, and a statement on behalf of the Automotive Service Industry with their over 6,000 members also supporting S. 1245.

Senator Mondale. The statement will be received and made a part of our record of these hearings.

[The letters and the statements referred to by Mr. Halfpenny follow:]

Miles Kimball Co.,
Oshkosh, Wis., September 12, 1973.

Senator Walter F. Mondale,
Chairman, Senate Subcommittee on Interstate Commerce,
Senate Office Building,
Washington, D.C.

Dear Senator: This letter is to urge favorable consideration of S. 1245, the sales and use tax bill.

BEST COPY AVAILABLE

Our company has since 1935 been selling small gift items (average retail value, $1.80) to customers through direct mail. Because of the small size of the orders received, computing and attempting to collect sales taxes is an all but impossible task. Some counties in Tennessee, for example, levy a ½% sales tax. Since it is impossible to determine the county our customers live in, and with an average tax liability of 4½¢ per order, the cost of administration becomes much greater than the tax itself.

While computerization might seem to be an answer, in fact many of our orders are incomplete with items back ordered or cancelled. Because all of our sales are cash with order, the issuing of small refund checks would prove an onerous burden.

The cost of filing returns in the many jurisdictions with sales and use taxes might well exceed the amount of taxes remitted.

We have no warehouse, sales agents or any other connection in other states. Equity—as well as common sense—commends the removal of this barrier to the free flow of interstate commerce.

Truly yours,

ALBERTA KIMBALL,
Chairman of the Board.

WHITE INDUSTRIES, INC.,
Westfield, Mass., September 14, 1973.

Senator WALTER F. MONDALE,
Chairman, Senate Subcommittee on Interstate Commerce,
Senate Office Building, Washington, D.C.

DEAR SENATOR MONDALE: We as a small business mail-order concern selling in all 50 states strongly support S 1245, the Mathias-Ribicoff Bill which will enable Congress to eliminate the "sales and use" tax threat which has been hanging over our heads these many years.

Our company does not own property nor does it operate warehouses, sales offices or have any tangible contact with other states other than through the mails. We collect and remit a sales tax on sales made within the boundaries of Massachusetts.

However, unless a Bill like S 1245 is passed, we shall continue to live under the serious threat of demands by the other 49 states and possibly thousands of municipalities, to collect "sales and use" taxes and remit individually to them.

Collecting, keeping records and remitting to our own state is a costly procedure in this day of ever-shrinking margins for small business. The nightmarish thought of possibly having to repeat this process for every other state and countless municipalities prompts this urgent appeal to you.

We strongly support the testimony that will be presented before your Sub-Committee on September 18 and 19 in regard to the mail order industry's need for a Bill such as S 1245.

Respectfully yours,

K. STANLEY ZOLYN.

GEORGE W. PARK SEED CO., INC.,
Greenwood, S.C., September 12, 1973.

Senator WALTER F. MONDALE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MONDALE: I understand that your Subcommittee on Interstate Taxation will have public hearings September 18 and 19. I would like to add my thoughts to this hearing by way of this letter.

We operate a small family mailorder business, serving America's gardeners by mail. We have customers in all fifty states and Canada, and we feel that we are making a real contribution to our nation's gardeners. We have the most complete selection of flowerseeds in this country, a very complete line of vegetable seeds, and many helpful garden accessories.

Since we do have customers in all of the states, cities, and counties, and practically every political subdivision in the country, it would be extremely difficult for us to collect sales taxes and file the necessary forms required should they all demand this of us. We feel that legislation is needed at the Federal level to eliminate this possibility. It would be economically impossible to maintain a sufficient staff to file the potential tax returns, keep the necessary records, and provide the information they would demand.

You are no doubt aware that many of the larger cities already have sales taxes and undoubtedly this would lead to them demanding that we be tax collectors as well, and of course, this would then open "Pandora's Box" to all of the other political subdivisions we have in this nation. This, of course, would be taxation without any representation at the ballot box by us, and of course, the burden of collection would be placed on our small firm.

I'm sure there are other ramifications to this problem, but to those small businesses engaged in Interstate Commerce, many of us would find it impossible to continue to operate, if we had to collect the sales taxes from the many areas which levy them.

Since our average spring order is $9, our average fall order approximately $12, you can readily see that it would cost us more to simply collect the taxes and to remit to the taxing agency than could possibly be justified. It seems to me that it is certainly not in keeping with the great precents of this nation that one small business would have to be the tax collector for all the potential political subdivisions we have.

Thank you for reading my letter, and allowing me to present my thoughts in this way.

With best wishes.

Yours very truly,

WILLIAM J. PARK, *President.*

SPEAR ENGINEERING CO.,
Colorado Springs, Colo., September 11, 1973.

Mr. HAROLD HALFPENNY,
Halfpenny, Hahn & Roche,
Chicago, Ill.

ENCLOSED, MR. HALFPENNY: You will find a typed copy of my Dad's testimony. I couldn't seem to improve on his words at all and I thought since he had spent such a concentrated effort on the subject, it would be appropriate, even though he is deceased, to allow his testimony to remain exactly as he wrote it.

Of course, as you may have surmised, my sentiments are his exactly and, if we were to be required to collect tax for all of the states in the union, the additional expense would put us out of business.

I think his testimony is quite enlightening as far as the problems that would be encountered in the mailorder type of business, which we are engaged in here at Spear Engineering. Please submit this testimony to the committee on the basis that a similar testimony was given as far back as 1962 and so, perhaps, this testimony carries a little more weight than someone who has testified for the first time.

You may have already received a copy of my Dad's testimony as it was dictated on April 27, 1970, and if so, you will find, this is just a copy—word for word—of that testimony. Please use it in any way you can think of to accomplish our mutual desires and that is the prevention of interstate taxation

Sincerely, and Have A Nice Day!

JOHN W. SPEAR, *President.*

STATEMENT OF WENDELL C. SPEAR, BEFORE THE SENATE FINANCE COMMITTEE, U.S. SENATE, DICTATED APRIL 27, 1970

Mr. Chairman, and members of the Committee, my name is Wendell C. Spear, President of the Spear Engineering Company, Colorado Springs, Colorado.

This testimony has been prepared on the basis of trying to show the probable expenses to my company in the collection, accounting, reporting and payment of State and Municipal Sales and Use taxes assuming that our mail order sales in Interstate Commerce were subject to legal collection of such taxes.

The Spear Engineering Company was founded by myself in January 1949 with the primary object to design, develop and sell by *mail* nameplates for rural mailboxes, household use on lawns, lamp posts, etc. and for business use in the area of identifying nameplates for desks, doors, directional signs, etc. The attached brochure will give you our basic line of products. The Spear Engineering Company plant and office is located at 3107 Stone Avenue, Colorado Springs, Colorado 80907, and does not have any subsidiary operations, branch plants or sales office operating outside of our plant location.

Our company was started with extremely modest capital and has grown consistently in size, quality of product and improvement in service over the past

twenty years. We normally ship all our nameplates within 48 hours after receiving the customer's order and have a well established reputation of supplying quality nameplates at fair prices. In fact, every ad and every piece of literature we have used in our twenty years carries the statement "Satisfaction Guaranteed or your Money Back" which seems to have given us a rather solid foundation.

6. *Standard forms.*—Forms are being developed to standardize reporting among the states. This is another step towards uniformity and standardization.

7. *Continuous research into the problems of multistate taxation of business.*—This important function allows the Commission to find ways to solve the multistate tax problems of today and the problems of tomorrow.

A major purpose of the Compact Commission will be to deal with future problems in relation to multistate taxation. Multistate business is on the increase and will certainly change in character. We live in times of rapid change. These changes will cause new, presently unforseen, problems. Along with this, intensified demand for uniformity, simplicity and equity will increase. The Commission provides the proper medium to proceed efficiently with consideration of these new problems.

The approach of the Compact to multistate tax problems is to reduce the diversity in tax laws and regulations and replace that diversity with uniformity. This approach leaves the administration of state tax programs in the hands of state tax administrators and the state Legislatures. Both are responsible to the people of the State concerned and both are more familiar with local economic conditions. State taxes administered by the actions of the National Congress will be unable to meet the needs of the individual states, discriminate against local business and will sap the states of their fiscal and policical strength.

Under proposed Federal legislation, local businesses will be forced to compete with out-of-state firms who can legally avoid paying many of the taxes levied on the local merchant. The Compact will place the local firm and the out-of-state firm in a position to equitably compete with each other.

The concerned efforts of the states to protect their political sovereignty through the right to tax and to protect the multistate businessman by bringing uniformity and equality to multistate taxes make the Compact a necessary and workable instrument for use in today's complex economy.

Statement of the Chicago Association of Commerce and Industry

My name is Harold Halfpenny, I am a partner in the Chicago law firm of Halfpenny, Hahn & Roche and I am a member of the Board of Directors of the Chicago Association of Commerce and Industry and of its State and Municipal Revenue Committee. I am presenting the following statement on behalf of the Association.

The Chicago Association of Commerce and Industry, which represents substantially every major commercial and industrial business enterprise in the Greater Chicagoland area, respectfully urges that favorable action be taken on S. 1245, the Interstate Taxation Act of 1973.

The Association's Board of Directors approved this measure because it will bring order to the present chaotic system of taxing interstate commerce by state and local governments. It is the Association's view that the lack of uniformity in the system of state taxation of interstate commerce results in confusion, excessive taxation of multi-state companies, and imposes a serious burden on those engaged in interstate commerce.

Congressional concern with state taxation of interstate commerce intensified after the ruling of the U.S. Supreme Court in Northwestern States Portland Cement Co. vs. Minnesota (358 U.S. 450). This decision created considerable concern and uncertainty as to the amount of local activities within a state that would be regarded as forming a sufficient jurisdictional nexus to support the imposition of a tax on net income from interstate operations. Congress acted in the area of taxation of interstate income by passing Public Law 86–272, the Interstate Income Law, in 1959. This Association supported that legislation as a step in the right direction; that of providing uniform rules for the taxation of interstate income. The Act set forth minimum jurisdictional standards under which a state could tax the income of an interstate business. Passage of the bill by the Congress clearly reflected a judgment as to the need for Federal legislation in order to establish meaningful uniformity in this area. But, it was a first step only, and much more needed to be done and indeed still needs to be done.

A report of the Senate Finance Committee on the bill that eventually became the Interstate Income Law expressed its concern with the growing complexity of tax structures devised by the several levels of government. The report of the committee recited contemplated legislation to deal with the problem of interstate taxation with a view toward elimination of overlapping areas of taxation, avoiding competition for the tax dollar, improving administration and collection practices, coordination and simplification of revenue laws, all in order to ease the taxpayer's burden of compliance with the various tax laws. The Committee concluded that . . .

"This lack of coordination and uniformity has resulted in the creation of sprawling diverse revenue systems with underlying potential for great harm to the economy of the county and to the individual taxpayers to such an extent that remedial action appears necessary."

The Interstate Taxation Act of 1973 (S. 1245), has substantial support in the business and industrial community. It is our view that it meets many of the earlier objections of the states and it provides an adquate base for taxation by state and local governments.

A most important feature of the bill with respect to interstate sales and use taxes is Title I setting forth uniform jurisdictional standards. The bill provides that no state or political subdivision shall have the power to require a person to collect and remit a sales or use tax with respect to an interstate sale of tangible personal property unless the person—

(1) Has a business location in the state or political subdivision; or

(2) Regularly makes household deliveries in the state or political subdivision other than by common carrier or by mail; or

(3) Regularly engages in the state or political subdivision in solicitation of orders for the sale of tangible personal property by means of salesmen, solicitors, or representatives (unless such solicitation is carried on solely by direct mail or advertising by means of printed periodicals, radio or television).

Further, a seller without a business location in the state is not required to collect or pay a sales or use tax when such seller has obtained in writing the buyer's registration number as set forth in the Act.

What this means, with one notable exception for the State of Louisiana, is that where a company's only means of sales activity in a state is by direct mail or advertising and its orders are sent through the U.S. mails or by common carrier, such a company is not required to collect or pay a sales or use tax to that state. It is the view of the Association that this is a most significant and appropriate provision.

A company is deemed to have a business location in a state only if, (1) it owns or leases real property in the state, (2) has one or more employees located in the state, (3) regularly maintains a stock of tangible personal property in the state for sale in ordinary course of business, or (4) regularly leases to others tangible personal property for use in the state. The business location jurisdictional test also applies to the corporate net income tax, gross receipts tax, or capital stock tax of a corporation, and is a sensible test which will contribute to uniform tax administration.

The Act requires a purchaser with a business location in a state to obtain a registration number from that state. Persons selling to that purchaser may rely upon such registration as a conclusive authority for not charging a sales or use tax as long as the seller does not have a business location in the state and he obtains the registration number from the purchaser. This procedure should be of assistance in state tax administration and be particularly helpful to small businesses.

There is one exception to the jurisdictional rules, and it will apply only in cases of sales into the State of Louisiana. The Act provides that an advance payment type of sales or use tax, whereby the seller is required to collect and pay as an agent of the state, is not covered by the uniform jurisdictional standards. Any such law in effect on January 1, 1973 is within the exemption. Only Louisiana has such an advance sales tax in effect and is exempted from the uniform jurisdictional standards provided for in the bill. Therefore, a company will be required to collect or pay a sales or use tax for sales into Louisiana, notwithstanding the fact that it has no business location there, makes no regular household deliveries there, or does not utilize salesmen, solicitors or representatives in that state. It is important to note that Louisiana is the only state to which the jurisdictional standards do not apply.

There are other provisions in the bill relating to attribution of income and the method by which income should be apportioned among the states. Title II relates to maximum income or capital attributable to taxing jurisdiction. The bill provides an optional Three-Factor Formula, (property, payroll and sales) for ap-

portionment of income or capital of interstate corporations. A taxpayer could still elect to use a different apportionment formula if state law so provides, but the Three-Factor Formula serves as a maximum.

All income except portfolio dividends and other items noted below would be apportioned according to the Three-Factor Formula, if it resulted in a lower tax. Portfolio dividends would be allocated according to commercial domicile. Foreign source income generally and inter-corporate dividends would be excluded, both from the allocable and the apportionable income. "Gross-Up" for foreign tax credits is not included in the tax base.

With respect to the sales factor in the formula, the "throwback" rule is discarded. The bill assigns sales by destination in a state as the simplest, most equitable procedure. Income from sources outside the U.S. is not included in the tax base at all. Section 207 of the bill provides that corporate dividends are to be excluded from income apportioned among the states by formula unless the taxpayer's principal business is dealing in securities. Section 208 then provides for allocation of dividends, except dividends from affiliates, to the state of commercial domicile. It is the Association's view that no dividends should be taxes, since the income from which the dividends are paid has already been taxed. To the extent dividends are taxable, (i.e., portfolio dividends) they are allocable to the state of commercial domicile.

If it is established that two or more affiliated companies have engaged in non-arm's length transactions which cause a meterial distortion of income apportioned by a state, the state may require, or the taxpayer may elect to determine, apportioned income by consolidating the income of parties to the non-arm's length transactions. The provisions on combined reporting and consolidated returns are designed to help avoid situations where companies are "whipsawed" between conflicting approaches of different states and subjected to multiple taxation on the same income, and to avoid the situation where more than 100% of a company's income is subject to state taxation.

Title IV of the bill would give jurisdiction to the Federal Court of Claims to hear appeals on the provisions of the Act. The objective of establishing this court as the sole arbiter is to have a single Federal court that could develop expertise in the area of interstate taxation and provide for uniform application of the Federal Law.

The Chicago Association of Commerce and Industry respectfully submits that the enactment of S. 1245 is most desirable because it will establish reasonable and legitimate uniformity in the state taxation of interstate business, which has long been overdue. The Association appreciates the opportunity to present this statement.

STATEMENT OF THE AUTOMOTIVE SERVICE INDUSTRY ASSOCIATION

My name is Harold T. Halfpenny; I am a lawyer with the firm of Halfpenny, Hahn & Roche, 111 West Washington Street, Chicago, Illinois. I appreciate the opportunity to appear here and I would like to submit a statement as legal counsel for Automotive Service Industry Association.

The Automotive Service Industry Association is a national trade association with a membership of over 5,000 independent automotive wholesalers, warehouse distributors, parts rebuilders, and manufacturers of automotive replacement parts, tools, equipment, chemicals, paint refinishing materials, supplies and accessories. The members of this industry are engaged in furnishing and distributing the replacement parts and accessories that are required to service and repair the eighty million motor vehicles in operation in the United States today.

To satisfactorily perform this service, repair parts for any of the many models of automobiles must be readily available at all times and in all parts of the country. The members of this industry are accordingly located in, and ship products into, all of the fifty states.

The representatives of many businesses who have appeared before the subcommittee have told of the cost of complying with the multiplicity of state and local requirements. This cost results from not only the act of collection, but also the necessity for keeping track of the different requirements of the different states. These requirements vary, not only as to the rate of tax, exemptions, and products taxed, but also in the degree of connection with the state which will subject the seller to the necessity for collecting. Some states require collection only when the out-of-state seller has a place of business or salesmen in the state. Others attempt to require collection where there is little if any connection with the state by the out-of-state seller.

This greatly increased collection activity on the part of all states has added to the confusion and uncertainty already experienced by interstate sellers.

The position now is the same as it was in 1959, with regard to state income taxes. At that time, Congress found that the confusion and uncertainty surrounding the question of when a seller would be required to pay a state income tax in itself imposed a burden on interstate commerce. Congress responded by adopting PL 86–272, which defined the jurisdictional standards which must govern the states in imposing income taxes. That law has been upheld, in the face of constitutional challenges.

The present confusion surrounding sales and use tax requirements is even more drastic than was the similar income tax situation in 1959. And as in 1959, it has been demonstrated that this is not a matter which can be left to case-by-case decisions by the Courts. Only Congress can eliminate the burden on interstate commerce which results from these state requirements. It should now, as it did in 1959, settle the matter as it did by PL 86–272, by defining state jurisdictional requirements.

That action would be appropriate not only as an exercise by Congress of its constitutional mandate to protect interstate commerce, but would also be entirely consistent with the basic philosophy of the division of power between the various states. It should be remembered that the *USE* Tax is imposed on the buyer, and that the seller merely collects it. A state, in attempting to require that a foreign corporation act as a tax collector for taxes imposed by it on its own citizens, is imposing a *personal duty* on the foreign corporation. This requirement violates the basic rule of jurisprudence that no state by legislation may project its powers and authority beyond its own borders. (*Department of Financial Institutions v. General Finance Corp.*, 227 Ind. 373, 86 N.E. 2d 444, 449)

This was the theory of the Supreme Court of Michigan in its well reasoned by oddly enough little-noted decision in *J. B. Simpson, Inc. v. State Board,* 297 Mich. 403, 407, 298 N.W. 81 (*Cert. Den.* 314 U.S. 674). The Michigan Court there held that the Michigan use tax act could not be interpreted to require the collection of that tax by an Illinois corporation which took orders in Michigan and filled and shipped them from Chicago. The Court reasoned that: "Sanction of the claim made by a state would make the plaintiff a collector of a tax, on behalf of the state, and such cannot be done, for the law-making arm of the legislature, and much less that of mere administration officials, *cannot reach into another state and mandate persons there to so serve.*"

The states have imposed the duty of tax collection on persons not within their jurisdiction simply as a matter of expediency—because that is the easiest way to cause collection to be made. If the states could collect from their own citizens the same amount of revenue would be realized from the use tax. The states, then, are imposing a restraint upon interstate commerce in the name of expediency alone, with no other justification.

Confusion and consternation is not confined to interstate retailers, but permeates all levels of industry. It is hard to imagine a more severe burden on interstate commerce than that which is now imposed by the activities of the various states and local subdivisions.

Another matter of great concern to manufacturers and wholesalers is the requirement of many states that they pay directly (as opposed to merely collecting) a use tax on the advertising and give away material which they send into the state as sales aids.

The requirement that a use tax be paid on advertising material is particularly harsh when, as in the automotive parts industry, the material is absolutely necessary not only as a sales aid but also for the education of the users of the products. There are over 15,000 parts in each automobile, and any number of makes and models of automobiles. Technical information describing the various parts and their uses is an indispensable part of distribution in this industry.

Since the actual value of the advertising or give-away material is minimal, the revenue to the states from a use tax on it would be very small. On the other hand, the nuisance of arriving at a value, keeping track of different state requirements, and filing returns, adds up to a great deal of time and effort, if not money, for interstate sellers. That time and effort, and the resulting burden on interstate commerce, are out of all proportion to the possible returns to the states.

A.S.I.A. urges the adoption of the S. 1245, the interstate taxation bill as it is now being considered by this subcommittee.

We feel that the time has come when the burden on interstate commerce has reached such proportions that congressional action is all that will prevent a severe restriction on that commerce. Unless some certainty is restored to this area, the economic implications for the economy of the entire nation may be unfortunate.

Your subcommittee can fairly conclude that there is a real possibility that many smaller firms will remove themselves from interstate commerce so long as the present uncertainties and costly burdens remain. If this happens, local businesses will be deprived of important sources of goods and of income.

We not only strongly recommend this action, but add our hopes that it will not be long delayed. The time for remedial action in interstate taxation is now.

Senator MONDALE. Thank you very much. I have asked Senator Packwood to Chair the remainder of this hearing.

Senator PACKWOOD. Mr. McKenzie.

STATEMENT OF SYDNEY H. McKENZIE III, ASSISTANT ATTORNEY GENERAL OF STATE OF FLORIDA, IN BEHALF OF FLORIDA DEPARTMENT OF REVENUE

Mr. McKENZIE. Senator, my name is Sydney H. McKenzie. I am assistant attorney general of the State of Florida, and I appear before you today for Attorney General Robert L. Shevin, of the State of Florida, and on behalf of the cabinet of the State of Florida, acting as the Department of Revenue. I have submitted a written statement and a resolution of the Florida cabinet and an extensive report of the attorney general of the State of Florida.[1]

These documents set out in detail our position, and I would request that they be placed in the record.

Senator PACKWOOD. They will be placed in the record.

Mr. McKENZIE. Thank you, sir. I appear before you now, to urge this subcommittee to provide in a manner which respects the discretionary privilege of the States to tax interstate businesses, while at the same time reducing compliance burdens allegedly imposed by the State and local jurisdictions.

On August 21, 1973, the Florida cabinet approved a resolution. That resolution firstly requested Congress to support the constitutional right of the sovereign States to tax interstate businesses, to respect local and State fiscal policy decisions; secondly, the resolution considered the creation of regulatory agencies to administer Federal regulations to be detrimental to the ability of the State public officers to act in public trust, and detrimental to concepts of our federalism; and thirdly, supported the basic policy position of the National Association of Tax Administrators. The preferred solution to compliance problems in interstate business, in our opinion, is support of State-established uniform laws.

In 1959 Congress passed Public Law 86–272 after 6 months of limited consideration as a "stopgap" measure. The minority of the Senate Committee on Finance at that time criticized the bill as premature and not properly coping with the real issues of the situation. The same consideration is a real concern to us today.

In 1965 the House Committee on the Judiciary concluded an exhaustive study on State taxation of interstate commerce. However, in our opinion, it is questionable whether that study is still timely when one considers the posture of Congress, the States, and business today. Various interstate taxation bills have been introduced annually in Congress since 1965, but there has been no legislation-oriented congressional study since that time.

[1] The report of the attorney general of the State of Florida was made a part of the official files of the committee.

And in 1969 a group of businessmen and State officials formed the "ad hoc committee" to achieve uniformity by a merger of the Multistate Tax Commission and Federal legislation. The basic concept of that approach, as you know, is embodied in S. 2902 by Senator Magnuson.

Early in 1973 the National Association of Tax Administrators formed a special subcommittee on Federal legislation, to prepare the interstate taxation bill that could best represent, if possible, a State consensus. While we have not had the opportunity to analyze the final draft of that proposal due to the contraints of the subcommittee, it is Florida's intent to support that proposal if possible.

To the extent that today's situation might resemble the Public Law 86–272 situation, we would observe a similar time constraint, and Florida is concerned. To enact legislation in this complex area without timely and thorough study only compounds the problem in the name of expediency and is not a resolution to the problems.

The most apparent resolution to the issues in interstate taxation, in our opinion, is to the gathering of consent, and consent only, to the multistate tax compact, with provisions for review of the situation in 5 years by the House Committee on the Judiciary or the Senate Committee on Finance. If the commission and the States, together with business interests, have not resolved the issues now before this subcommittee at the end of that period, the respective committee or subcommittee could then propose such measures as are determined to be in the national interest. This time period would, in addition, provide a mandate for voluntary State uniformity.

If, however, the subcommittee determines that enactment of Federal legislation is essential now, enacted legislation should provide an umbrella of uniformity under which a State could obtain adequate discretion over its taxing power. Thus, if the State determines that legislation is necessary, it retains the discretion to tax that aspect of business operation, but in a uniform manner. This umbrella concept, of course, should be embelished with provisions of State discretionary use of consolidation, and, in our opinion, absolutely no provisions for compulsory regulatory agencies.

In summary, we sincerely believe a 5-year mandated study period and consent to the multistate tax compact, or minimum umbrella regulation is the most appropriate Federal resolution to the interstate taxation issue.

Senator PACKWOOD. Thank you very much, Mr. McKenzie. I have no questions.

[The documents referred to previously follow:]

WRITTEN STATEMENT OF ATTORNEY GENERAL ROBERT L. SHEVIN, PREPARED BY SYDNEY H. MCKENZIE, III, ASSISTANT ATTORNEY GENERAL, STATE OF FLORIDA, TALLAHASSEE, FLORIDA, ON BEHALF OF THE STATE OF FLORIDA,

SUMMARY

1. The State of Florida respectfully requests that the Florida Cabinet Resolution, and the Florida Attorney General's report be incorporated as part of this statement, and included in the printed record of the hearings.

2. Florida does not seek federal legislation in the area of state taxation of interstate commerce, and opposes H.R. 977, S. 1245, and S. 2092 as drafted.

3. It is the intent and expectation of the State of Florida to support the proposal of the National Association of Tax Administrators.

4. The proper federal resolution is to provide Congressional consent to the Multistate Tax Compact, to pass an amended form of H.R. 6822, and provide a five-year period for states and business to create uniform legislation. If state uniform legislation is not enacted, Congress could propose legislation in the national interest.

5. If there is substantive federal legislation it should be "umbrella" legislation permitting state discretion: a) corporate income tax—no distinction between business and non-business income, full apportionment, apportionment of dividends except intercorporate dividends with 80% controlled ownership, equally weighted three-factor formula, sales factor with sales destination test and throwback rule [income that is taxed, not subject to tax], separate jurisdictional rules for corporate income tax, and sales and use taxes; b) sales and use taxes—state imposition [no local imposition] and vendor collection of all sales and use taxes, adoption of uniform exemption certificates, recording periods, reporting forms, and bond requirements; c) federal administrative agency—no federal regulatory agency; d) court of claims—litigation should be presented to the respective state and federal courts.

STATE OF FLORIDA RESOLUTION

A Resolution to the Congress of the United States requesting Congress to support the constitutional right of the sovereign states to tax interstate businesses, and to defeat S. 1245, introduced on March 15, 1973, and other similar proposed legislation unduly restricting the right of the State of Florida to tax interstate businesses.

Whereas the House of Representatives of the Congress of the United States has on two occasions (H.R. 2158 on May 22, 1968, and H.R. 7906 on June 26, 1969) officially passed legislation similar to S. 1245, and

Whereas H.R. 977, introduced January 3, 1973, is pending before the House Committee on the Judiciary, and

Whereas the National Association of Manufacturers, Council of State Chambers of Commerce and National Association of Whole salers-Distributors have assisted in drafting S. 1245 and have urged its passage, and

Whereas the United States Senate created the Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance on February 20, 1973, and

Whereas the referenced Congressional bills, if enacted, would significantly affect Florida's revenue effort in an adverse manner, and particularly defeat the effectiveness of the Florida corporate income tax and sales and use taxes, and

Whereas the proposed Congressional interestate taxation bills do not serve proper federal or state uniformity interests, or the proper role of states in our participatory federalism, and

Whereas the creation of a regulatory agency to administer federal legislation limiting the right of the State of Florida to tax interstate businesses would strike at the State of Florida's sovereign powers and the duty of its public officers to act in public trust, and

Whereas the State of Florida has been in the forefront of National developments relative to state taxation, and has consistently strived for uniformity in taxation of interstate businesses, and

Whereas the Attorney General of Florida presented the Cabinet of the State of Florida with a report critical of the proposed Congressional interstate tax bills on August 21, 1973, and

Whereas the Subcommittee on State Taxation of Interstate Commerce of the United States Senate Committee on Finance provided a forum for discussion of the interstate taxation bills on August 9 and 10, 1973, and

Whereas the Subcommittee on State Taxation of Interstate Commerce of the United States Senate Committee on Finance will hold hearings on the interstate taxation bills on September 18 and 19, 1973, and

Whereas immediate action is urgently needed to affirm the State of Florida's right to levy and collect taxes from interstate businesses: Now, therefore, be it

Resolved, By the Governor and the Cabinet of the State of Florida, That the Congress of the United States is hereby requested to accept this Resolution as an endorsement and supplement to the policy position of these issues to be presented to the Subcommittee on State Taxation of Interstate Commerce by a special committee of the National Association of Tax Administrators, to the full extent it is consistent with the objectives herein stated; be it further

Resolved, That the Congress of the United States is hereby requested to adopt a posture respecting the right of the State of Florida to fully exercise its legislative discretion to tax interstate businesses; be it further

Resolved, That as elected constitutional officers of the State of Florida, comprising the Department of Revenue, we hereby authorize J. Ed Straughn, Executive Director of the Department of Revenue, or his designated representative to appear and testify before the United States Senate Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance on September 18 and 19, 1973, or at any other hearings on proposals affecting interstate taxation of businesses; be it further

Resolved, That copies of this Resolution be dispatched to the President of the United States Senate, the Speaker of the United States House of Representatives, and each member of the Florida Delegation to the United States Congress.

In testimony whereof, the Governor and Cabinet of the State of Florida have hereunto subscribed their names and have caused the official seal of the said State of Florida to be hereunto affixed, in the City of Tallahassee, Florida, on this 21st Day of August, A.D. 1973.

[SEAL]

REUBIN O'D. ASKEW,
Governor.
RICHARD (DICK) STONE,
Secretary of State.
ROBERT L. SHAW,
Attorney General.
FRED O. DICKINSON, JR.,
Comptroller.
THOMAS D. O'MALLEY,
Treasurer.
FLOYD T. CHRISTIAN,
Commissioner of Education.
DOYLE CONNER,
Commissioner of Agriculture.

STATEMENT

On August 21, 1973, the Cabinet of the State of Florida signed a resolution requesting the United States Congress to support the constitutional right of the sovereign states to tax interstate businesses. The Attorney General of Florida, at that time, presented to the Florida Cabinet a report critical of the proposed interstate taxation bills. Copies of that report have been made available to the Senators on the Subcommittee and appropriate staff members. I respectfully request that this statement, the Florida Cabinet resolution, and the Florida Attorney General's report be included in the printed record of the hearings and that the Florida Cabinet resolution and Attorney General's report be incorporated as a part of this statement.

I have prepared this statement to supplement that of the National Association of Tax Administrators, and to specifically delineate certain issues of interest to the State of Florida. It is the posture of the State of Florida that federal legislation in this area, historically reserved to state prerogative, is neither desirable nor proper under present concepts of our federalism.

In development of its corporate income tax, Florida had as its principal objectives to simplify taxpayer compliance and state administration in addition to acting as a catalyst for more progressive uniform state legislation. It is sincerely believed that federal intrusion into independent state fiscal operations will produce considerable economic disruption for the states.

Prior to discussing particular substantive aspects of pertinent bills, I would like to set forth certain characteristics of the federal corporate income tax that I seriously doubt any state wishes to be applicable in its jurisdiction. I bring these facts, and others as the pertinent topics arise, to your attention only to illsutrate that federal preemption is no guaranteed solution to a problem that may not exist as contended.

On August 1, 1973, Congressman Charles A. Vanik (Ohio) released a report entitled "Corporate Federal Tax Payments and Subsidies to Corporations in 1972" [119 Cong. Rec. 7165-7188.]. Congressman Vanik concluded the report by noting 1) that his study "significantly illustrate(s) the propensity of the [federal] tax code to cause market distortions", and 2) that "the present laws [federal] are designed to *insure* that the large American corporations will pay less and less in the future support of our government."

According to pertinent sections of the Internal Revenue Code the federal corporate tax rate is twenty-two (22) percent on the first $25,000 and forty-eight (48) percent on amounts exceeding $25,000. In fact, however, the average *effective*

federal corporate income tax rate was twenty-nine and six-tenths (29.6) percent in 1971, and twenty-nine (29) percent in 1972. That rate is nineteen (19) percent *below* the statutory rate. [119 Cong. Rec. 7166]

A large number of corporations in supporting federal regulation suggest that non-compliance and partial compliance are the normal state corporate income tax reporting procedures. Congressman Vanik interestingly has repeatedly found this situation to be the case with reqard to *federal* corporate taxes.

Noteworthy is the fact that the federal Revenue Act of 1924 provided for corporate returns to be public but that the publicity clause was repealed after one year of existence. The results of this federal public disclosure provision are very interesting:

One year after the 1924 Revenue Act, with the publicity clause in effect, corporations paid at least $100,000,000 more into the Treasury, with business actually lighter in volume than in the previous year. . . . The secrecy that has surrounded corporate income taxes serves only to protect against the tax collector. [119 Cong. Rec. 7179]

Mr. Johnnie Walters, former Commissioner of the Internal Revenue Service, Congressman Vanik reports, suggests that federal "corporate tax *evasion* is becoming widespread."

The exact posture to assume before this Subcommittee is somewhat perplexing since Florida merely desires to retain the inherent sovereign right to make state and local policy decisions. To maintain a functioning federalism it is necessary that the respective Congressional delegations respect the fiscal policies of the states. I strongly submit for your consideration that the true need for federal legislation only pertains to Congressional consent to the Multistate Tax Compact, and approval of a form of common audit bill [H.R. 6822]. In essence, these are Congressional actions that would strengthen state action toward uniform state laws.

The National Association of Tax Administrators' Committee on Taxation of Interstate Commerce is in the final stages of preparation of its alternative to industry-sponsored bills. It is the State of Florida's intent to support this proposal. but I respectfully request the opportunity to submit a written supplement to this statement delineating any provisions which may not be consonant with the State's position.

Six basic bills, H.R. 977, S. 282, S. 1245, S. 2092, a National Association of Tax Administrators Committee bill, and a Multistate Tax Commission bill, will be before Congress. To the extent that these bills are an attempt to thrust immediate, stop-gap federal legislation in an area not susceptible to such a resolution, they only compound problems in the name of expediency and are not resolutions of the problem.

The most apparent resolution to the issues of interstate taxation is the granting of consent (only) to the Multistate Tax Compact with provisions for review of the situation in five years by the House Committee on the Judiciary or the Senate Committee on Finance. If the Commission, the states and business interests have not resolved the issues now before this Subcommittee at the end of five years, the respective committee or subcommittee could then propose such measures as are determined to be in the national interest. This time period would provide a mandate for voluntary state uniformity.

If it is the sense of Congress to inject the federal government into areas previously left for state fiscal policy, the State of Florida recommends the following proposals to provide conciliation to business interests, and minimum state fiscal disturbances.

A. CORPORATE INCOME TAX

The effort in this area must be directed to obtain "full accountability" of all corporate income, and to provide means for "full taxation" by market states on an apportioned basis subject to a circuit breaker for small businesses, and minimal sales in the state [$300,000]. The exact purpose of the legislation should also be clarified—is it based on a method of doing business or the ability to pay.

All distinctions between business and non-business income should be eliminated. A corporation or business is in operation to derive income or profit and the form of income it selects to derive cannot rationally determine its tax status. Rent, interest. royalties, and portfolio dividends are pecuniary benefit to the business and should be fully apportioned. Allocation of such income factors to states of commercial domicile is a matter of corporate convenience and deprives the invested state, where the income was earned, of legitimate corporate taxes.

Dividend taxation demands close scrutiny but it is reasonable to apportion two types of dividend income: (1) portfolio dividends; and (2) dividends if the taxpayer owns less than 80 percent of the voting stock.

It must be recognized that a dollar of income to a corporation is a dollar of income subject to taxation, whether that income is derived from the sale of a product from interest on a note, or a dividend on an investment. [119 Cong. Rec. 7180. Report of Congressman Vanik.]

If the taxpayer maintains more than 80 percent of common ownership, the dividends may be considered as intercorporate dividends.

All pending proposals, except H.R. 977, support the equally weighted three-factor—payroll, property, sales—apportionment formula. Differences, however, appear in defining compensation and sales. I believe there is a general consensus that Section 303 of S. 2092 represents the preferred, prevailing compensation definition rather than Section 203 of S. 1245 which adopts a $4,200 limitation of the federal Unemployment Act.

A sales factor assigning sales to a state by the sales destination test with application of the throwback rule would prevent the statutory creation of two particular tax-havens: (1) sales into low tax rate states; and (2) non-taxed sales into states lacking jurisdiction due to Public Law 86-272. If these tax-havens are not eliminated, grave problems arise regarding the competitive advantage the interstate corporation achieves over the intrastate, and often, small corporations. Many state objections could probably be dissolved if state tax jurisdiction were to follow sales, and if the dividend issue were resolved by full apportionment and consolidation.

The inherent substantive differences between the corporate income tax and sales and use taxes demand that separate jurisdictional standards be provided for each tax. The business location test provided in §§101 and 513 of S. 1245 fails to provide for full accountability of corporate income derived from market states. Corporate income must be fully apportioned to market and industrial states having jurisdiction to tax. The referenced business location prevents this accountability and should be excluded from all proposals.

B. SALES AND USE TAXES

The area of greatest concern with the sales and use taxes imposition has been the large number of local taxing jurisdictions. There are approximately 8,919 jurisdictions but 8,559 of the jurisdictional impositions are collected at the state level. The most expedient resolution that preserves the fiscal policies of all taxing jurisdictions and minimizes the business compliance burdens is to propose state collection of all sales and use taxes at a rate to permit local tax distribution if desired by the state.

To insure state fiscal protection, a rebuttable presumption should be established providing that tangible personal property used in another state for six months was not purchased for use in the state the property is transferred to. A shorter time period of ninety days is both administratively inefficient and assists taxpayer avoidance of tax imposition. In addition, a state should credit the amount of the sales or use tax paid in another state against its own. Uniformity may be given another boost with the adoption of uniform exemption certificates, recording periods, reporting forms, and bond requirements.

With the reduction of compliance burdens to fifty-one jurisdictions the vendor should be required to collect and remit the tax on mail order sales. The above recommendations with the specific authorization of discretionary reciprocal collection agreements between all states illustrate the significant areas of uniformity readily attainable.

C. FEDERAL ADMINISTRATIVE AGENCY

Two bills, H.R. 977 and S. 2092, confer binding regulatory powers on the Multistate Tax Commission. This agency's rulings and regulations are to be binding upon each state which does not affirmatively "repeal" the item within one hundred and eighty days. The gist of this issue is who is the proper party to make state and local tax policy decisions. Strong opposition to this measure was presented during this subcommittee's August 9 and 10 roundtable discussions. The most reasonable approach would be to grant consent to the Multistate Tax Compact and support to a five-year state tax uniformity development program.

D. COURT OF CLAIMS

Section 401 of S. 1245 grants the United States Court of Claims de novo jurisdiction of litigation arising under an interstate taxation act and Public Law 86-272. At this Subcommittee's roundtable discussions it was reported that this Court's workload has increased forty percent while its federal tax cases had decreased seventeen percent.

The net effect of this general jurisdiction recommendation appears to ensure diversity. This change effectively renders a state administrative decision unenforceable and affirmatively seeks a heavy judicial docket. The rationale for the *de novo* review and for not adhering to the presumptions inherent in an administrative decision is not clear. State administrative participation would be of minimal usefulness and demands the pointless creation of a statutorily complying state administrative agency and supplementary legislation. Other provisions of S. 1245 require every state to be represented in each case since all states are bound by each case as if a party defendant.

Undue state compliance and financial burdens are created by these sections that do not respect the decisions of state and federal courts.

E. CONCLUSION

The complex issues of state taxation of interstate commerce are issues that are not susceptible to stop-gap legislation and rushed consideration. The five-year mandated period to permit the states and business to support state legislation is the most desirable approach. Undue federal intervention is then unnecessary.

If the Congress determines federal legislation to be an appropriate solution, such legislation should provide an umbrella of uniformity under which a state could use its discretion to tax. Thus, if a state determines that legislation is necessary, it retains the discretion to tax that aspect of business operation but in a uniform manner with minimal restrictions.

Senator PACKWOOD. Ted de Looze.

STATEMENT OF THEODORE W. de LOOZE, CHIEF TAX COUNSEL, OREGON STATE DEPARTMENT OF JUSTICE

Mr. DE LOOZE. Senator, I am Ted de Looze, chief tax counsel for the Oregon State Department of Justice, and am a person who has participated for a number of years in various activities connected with the problems of taxation in interstate commerce, including the formation of the multistate tax compact, the ad hoc committee and the subcommittee of the NATA. Being the last speaker, I will try to be very brief and try to hit some of the points that I think need stressing or clarification.

First of all, it must be realized that Congress did consider a bill which would provide for what I would call uniformity when they considered H.R. 11798, or the original Willis bill. Now, the proposals that have been given to you by the subcommittee, Mr. Chairman, Mr. Clark and others, are not mandatory uniformity. I do not think anybody here has requested mandatory uniformity. But, I suggest if that is a consideration, that you reexamine H.R. 11798 which not only was for total uniformity, but for total accountability of tax liability.

Oregon is not a State that has a sales and use tax. I listened to the panel here, I listened to the gentleman from Oregon, and I would suggest perhaps if there had been a show of hands of those gentlemen who are now protected by the U.S. Supreme Court decision in the *National Bellas Hess* case from taxation by other States, I think there

would have been a large show of hands. I think the problems there will be considered as this committee considers the suggestion of the Louisiana tax collector.

Now, if the committee wants the same kind of consideration on the income tax side, I suggest that they seriously examine the concepts of the subcommittee of NATA and that is that the States want the opportunity to decide their own tax policy with respect to the businesses of intrastate and interstate that come into their States. As I have said in my statement, I think the fact that there is not uniformity is not an unnatural thing, because every State tax program is based basically upon historical development of what has been acceptable to the people in that State with respect to the location of the State and the resources of the State and other factors. So, what the States really want is to be permitted to utilize their State taxing power and then give preferential treatment wherever they decide within their own policy it should be given. And they have the opportunity to do that by such things as credits, changing the rate of taxation, allowing certain exemptions. They do not need the kind of provisions that we find in S. 1245.

S. 1245 I think very definitely would harm the State of Oregon. Oregon for some 20 years has been following the combined method of treating multistate business, and it has found that the combined method is the best answer to any problems of multiple taxation or double taxation.

The unitary method of reporting basically does this. It says that we will not try to segregate out to any particular dollar investment of a company how much that particular dollar of investment earns. In other words, when you take all of the net income of all of the corporations in the affiliated group, and combine it, and then apportion it to the particular States, you are saying that every dollar of property, payroll and sales of that State, in that State, is entitled to the same rate of return.

And there is also one thing that has not been stressed here, and that is the fact that when you have combination reporting you do get rid of, to a large extent, the problem of taxation of dividends as intercorporate dividends are eliminated.

I do hope that the committee will not put us in the position that has happened with respect to financial institutions, where, for example, in Oregon we have a moratorium on the taxation of the Bank of California which has a 22 story building in the State of Oregon. It advertises in the Wall Street Journal that it gives complete banking service, has a picture of the whole Pacific coast, and yet because of the technical reason that it does not have its principal office in the State of Oregon there is a moratorium on its taxation under the income tax and this is the kind of situation we are fighting. If you look at the definition of employee in Senate 1245, and you apply it to Oregon, with the neighbor to the north, the State of Washington, which has no income tax, and the way of doing business of a corporation, it can locate in the State of Washington, and it can send its employees back and forth and can completely exploit the Oregon marketplace and at the same time incur no tax liability.

I wish to stress that if this committee is going to look at the tax situation that it take a good look at Public Law 86-272. Oregon is in

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the position of having litigated more cases under that statute than any other State and we find that the State of New Jersey and the State of Oregon do not entirely agree upon the interpretation of Public Law 86-272. And I am sure if there is any extensive statutory action by this committee we will have the same situation arising, many problems to be litigated, and voluminous additions over the course of the years to the Federal law.

But, let me just say that if the Olympic Brewing Co. which has recently been held taxable by the Oregon Supreme Court because they have an inventory of kegs in the State of Oregon, if that company could invent somehow an instantaneously disappearing keg, their liability would also instantaneously disappear.

And is that the test that the Congress wants to apply as to tax liability under Public Law 87-272? As has been stated here before, it exempts corporations whether they are large or small, and we suggest the addition of a standard which would really give the protection to small businesses. In other words, the standard of the size of business and the amounts of sales that are occurring in the State.

I want to wholeheartedly endorse the Multistate Tax Commission and the concept of a consent bill. It is badly needed. I do not think that the hearings today or yesterday have stressed the advantages that have been given to the States by the Multistate Tax Commission.

In summary, the eyes of the States have been opened up by the activities of the Multistate Tax Commission to the possibility of full disclosure of tax facts, to the possibility of joint audits, to the possibility of exchanges of information between States, to the possibility of fairer taxation and to the adoption of combined or unitary methods of reporting. I sincerely hope this committee will give extremely careful consideration to the adoption, if nothing else, of a multistate tax compact consent bill.

I think, Mr. Chairman, I would like to add one more thing, and that has to do with the activities of the Multistate Tax Commission in connection with uniform regulations that have been mentioned in these hearings. And one of the problems, of course, or the biggest problem under the Uniform Division of Income for Tax Purposes Act, which is a part of the Multistate Tax Compact and is now a part of the 27 jurisdictions, is the distinction that must be made between business and nonbusiness income. Our MTC committee labored for some 4 years to come up with a set of uniform proposed regulations, which also the NATA Committee on Uniform Regulations has recommended that the NATA adopt. Both committees worked on this. The new uniform regulations have been adopted, to the best of my knowledge, by Oregon, North Dakota, Nebraska. They are in the process of adoption by Indiana, New Mexico, Montana, and Michigan. They are under study in Hawaii and Alaska. And virtually the same regulations are now in effect in Florida and Idaho. The Illinois regulations are very similar, and the uniform regulations are in the process of consideration in Indiana.

Now, I think that is a good record and I think that the Multistate Tax Commission will give the opportunity to the States to develop greater and greater uniformity.

I would also, Mr. Chairman, or Senator Packwood, like to put into the record not only my statement which I have filed, but also a pamph-

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let entitled Guide for Corporations Filing a Combined Report, which is put out by the Franchise Tax Board of California, and I think will give the committee and its staff an excellent explanation of the combined report method that Oregon and California have followed respectively for 20 and 35 years.

Senator PACKWOOD. Ted, thank you very much. I can recall when you and I first met 15 years ago. Even then you were talking about this subject or something akin to it. You were working with Carlisle Roberts as I recall.

Mr. DE LOOZE. That is right, and in my paper I have cited several cases, including one decided by Judge Roberts which supports the full apportionment concept, which I think is the way to go. I think the trend today, Senator, is toward full apportionment for the unitary method and for full disclosure, the joint audit, and I think this is the way we will point more and more toward greater uniformity and accountability, and solve corporate problems as far as corporate income cases are concerned.

Senator PACKWOOD. You must be familiar with the Louisiana proposal on uniform sales and use tax reporting procedures?

Mr. DE LOOZE. I am just very vaguely familiar, yes.

Senator PACKWOOD. Are you familiar enough to comment on it?

Mr. DE LOOZE. It sound to me like a very good proposal. I think that it does one thing, and that is that it provides for accountability in accordance with the opportunities, benefits and privileges that are accorded a company regardless of how they sell, regardless of the manner in which they sell and that, of course, is the problem of Public Law 86-272. It sets up one set of corporations as to how they do business, they are taxable, and another set, of course, because they are able to do business a little differently, then they are not taxable. I am sure there are problems to be ironed out with that proposal. It may be that Congress will have to consider the possibility of a minimum amount of sales exemption for the small businesses in connection with that, the enactment of that. One of the very nice features I think of that proposal, is that it leaves to each State the problem of apportioning out the sales taxes that accrue to that State under the system with respect to the local subdivisions within that State. I think that it has great possibility.

Senator PACKWOOD. Ted, do you think if we reopen this question of minimum jurisdictional standards that we will be inviting consideration of many other changes which I know you and probably most State tax officials would oppose reopening?

Mr. DE LOOZE. Well, Senator Packwood, I think it has already been reopened. I think we are indebted to the people who introduced S. 1245 for showing us the extent to which they are asking for exemption. We are indebted for that. They have reopened it now. I think that has given us the opportunity to show, that for example, Public Law 86-272 does exempt corporations that are utilizing the opportunities, benefits, and marketplace of Oregon and getting a complete exemption simply because they are able to do business in a certain way. I do not think they can shut that question out.

Senator PACKWOOD. I have no other questions. Thank you very much.

That will conclude our hearings.

[The statement of Mr. de Looze, and the pamphlet referred to follows:]

Statement of Theodore W. de Looze, Chief Tax Counsel, Tax Division, Oregon Department of Justice

SUMMARY

I

The necessity, if any, for Federal legislation and for uniformity in the field of State taxation in interstate commerce.

II

The need for a consent bill for the multistate tax compact.

III

Required standards of Federal legislation if such legislation is imposed on the States.

(1) Amendment of Public Law 86-272 to apply to small businesses only.

(2) Preservation of state taxing jurisdiction and state tax base.

(3) Combination reporting and apportionment by three factor formula of property, payroll and sales.

(4) Adoption of Multistate Tax Commission as Administrator of federal legislation.

STATEMENT

My name is Theodore W. de Looze, and I serve as Chief Tax Counsel of the Tax Division, Oregon Department of Justice, and Chief Counsel for the Oregon Department of Revenue. As an Assistant Attorney General and Chief Counsel I have been involved in the problems of state taxation of interstate commerce since 1958. During this period of time I assisted in the drafting of the Multistate Tax Compact, have served as Chairman of the Rules and Regulations Committee of the Multistate Tax Commission, member of the Committee on Uniform Rules of the National Association of Tax Administrators, member of the so-called "Ad Hoc" Committee which drafted S. 2092 (93rd Congress, 1st session), and am at the present time serving as a member of a special Subcommittee on State Taxation of Interstate Commerce for the National Association of Tax Administrators.

The ideas expressed in this statement will not be original or startling, and may be repetitious of other speakers, but are intended to reinforce the view that valid state interests in state taxation of interstate commerce must be recognized and protected, as this committee gives thoughtful consideration to the necessity of federal legislation.

The principal points of this statement will focus on:

1. The necessity, if any, for federal legislation and for uniformity in the field of state taxation in interstate commerce.
2. The need for a consent bill for the Multistate Tax Compact.
3. Required standards of federal legislation if such legislation is imposed on the states.

I.

THE NECESSITY, IF ANY, FOR FEDERAL LEGISLATION AND FOR UNIFORMITY IN THE FIELD OF STATE TAXATION IN INTERSTATE COMMERCE

It would be impossible to bring to this Committee a complete, technical discussion of all the various arguments that have been made as to whether federal legislation is or is not necessary. Such arguments are to be found in various speeches introducing proposed federal legislation during the last eight years, in various articles in tax and other law journals, in the staff hearings conducted in August of this year, and in many other sources. It is my position, based upon my experience with the administration of Oregon's taxation of interstate commerce and the cases I have have handled for Oregon in that respect, my experience with the Multistate Tax Commission and the formulation of uniform regulations, my experience on various committees on the drafting of proposed federal legislation, and most important, my observations as to the progress that the states have made towards uniformity, that federal legislation is not necessary. Furthermore, that as time ensues, and providing that the Multistate Tax Commission is able to

fulfill the role it has set out to undertake in the field of taxation of interstate commerce, that consideration of federal legislation will become less and less necessary and less and less inviting.

During these years of my experience in this area, I have observed and concluded that uniformity in state taxation is not a natural sequence of events. Differences in the historical development and even existence of the various states, differences in the developments within states of their revenue needs, differences in state resources, differences in geographical location, and many other factors have lent themselves to the emergence of state tax systems varying between states. Even more important, differences in the controlling interests in state legislative bodies and particularly business interests, have lead quite naturally to different state schemes of taxation. Almost without equivocation, it may be stated that any particular state's scheme of taxation represents a balance of what controlling business interests within the state have been able to achieve legislatively against the background of the totality of all interests within the state itself. Differences in state formulas for apportionment and allocation of income are grounded on state business and revenue requirements.

Nevertheless, progress in achieving uniformity has been continuous, and especially since the adoption in 1957 of the Uniform Division of Income for Tax Purposes Act by the National Conference of Commissioners on Uniform State Laws, and the historic enactment of Public Law 86-272 by Congress in 1959. I cannot overemphasize the catalystic effect that the creation of the Multistate Tax Commission and adoption of the Multistate Compact has had upon such progress. At the same time, state tax administrators' eyes have been opened to the possibilities of uniformity in certain areas of state taxation of interstate commerce, and the cry for uniformity has resulted in a fuller disclosure of the actual facts of tax reporting to the various states, a fuller realization of the necessity for exchanges of information between the states, for joint audits, for acceptance of the combined or unitary method of reporting, and for better training programs within the states. The need for uniformity has concurrently been shaped by certain business interests into a need—not for uniformity leading to full disclosure and full tax accountability—but to uniformity of exemption, or proposed exemption. The pending lawsuit in the United States District Court for the Southern District of New York of leading multinational corporations against the Multistate Tax Commission, seeking its dissolution, together with the blatant request for exemption of income publicly proclaimed in S. 1245 demonstrates how the need for legitimate solution of problems of uniformity of administration by the states has been turned into proposals for uniformity of exemptions.

As chairman of the Multistate Tax Commission Rules and Regulations Committee, and as an attorney who has actively tried many lawsuits under Public Law 86-272, I am convinced that no tax law, no matter how deceivingly uniform it may appear on its surface, is capable of administration without the ironing out and attention to miriad problems that arise because of its application to numerous fact situations. These fact situations naturally occur because of the different forms of business operations that have to be accommodated under the seemingly innocent and simple language of the statutes.

If Congress is pursuaded that there is an overwhelming need for federal legislation, it must face the responsibility of a new federal tax code that over the course of years will grow in depth and complexity as it seeks to legislate on every problem that arises. The existence of the United States Internal Revenue Code is ample evidence of the inevitability of such a future course of action.

Balanced against this prospect, I believe that the results of state action to date significantly show that the states may be trusted to bring order to their own tax situations. From my discussions in various committees as to sales and use tax problems, and taking into consideration that I have had no experience in administering a sales and use tax in Oregon, I have not heard any overriding considerations requiring federal legislation. Sales and use tax jurisdiction is well settled. The arguments that have been made that there are thousands of tax jurisdictions with which a corporation must deal usually fail to cite the overriding number of situations in which state administration is superimposed upon local jurisdictions to provide uniformity and certainty.

In the corporation income and excise tax field, the adoption of the Uniform Division of Income for Tax Purposes Act in 27 jurisdictions is a gigantic step forward towards uniformity. The development of the Multistate Tax Commission revised proposed uniform regulations under this act, after some four years of study, is another gigantic step forward towards uniformity. These revised regulations, finally adopted by the Multistate Tax Commission in January of this

year, already have been adopted by Oregon and several other states, and are under the process of adoption in many more. The development and acceptance of the concept of uniform apportionment of all corporate income, including dividends, is a move toward greater uniformity and protection of the state tax basis. The continued development of programs for the exchange of income tax information between the states, and the development of corporate joint audits, both through the auspices of the Multistate Tax Commission, can do nothing but serve the cause of uniformity in the reporting and disclosure of income to the states. The Multistate Tax Commission has taken a dominant and active role in the preparation and giving of training seminars in auditing and in corporate tax law generally, as well as its activities with respect to uniform regulations.

I suggest to you that there is no overriding case for federal legislation.

II

THE NEED FOR A CONSENT BILL FOR THE MULTISTATE TAX COMPACT

In my opinion, the most significant federal action that could be made would be in the adoption of a consent bill consenting to the Multistate Tax Compact. The Multistate Tax Commission believes that it has a strong case for the proposition that Congressional consent is not necessary, since the activities of the Multistate Tax Commission do not impinge upon the power and authority of Congress, but merely carry out what the states already have authority to do under constitutional state law. Nevertheless, it is a fact that the New York litigation referred to is a financial drain upon the Commission and is seriously diverting such resources from the Commission's audit program. Adoption of a consent bill would free the Multistate Tax Commission from future attacks on its legality and let it put its full resources to work in the achievement of greater uniformity and better tax administration by the states.

III

REQUIRED STANDARDS OF FEDERAL LEGISLATION IF SUCH LEGISLATION IS IMPOSED ON THE STATES

If Congress should insist on federal legislation, it can only be on the grounds of the "something must be done" syndrome. And it must not fall into the error of accepting the fallacy that uniformity means uniformity of exemption. Nor should it accept the fallacy that federal tax policy in the Internal Revenue Code constitutes a necessary guideline for a state tax policy and state revenue needs. More specifically, and in connection with corporation and income excise tax law only (Oregon does not have a sales and use tax), I call your attention to the following points:

(1) Public Law 86-272 should be modified to provide for the exemption and protection of small businesses only, and not the protection of the major national corporations which have no need for such exemption. At present, Public Law 86-272 applies regardless of the size of the corporation. The only question raised by Public Law 86-272 is the manner of doing business. Can the corporation "get by" in a particular state by utilizing the systematic solicitation by salesmen or detailmen without creating further nexus with the state? If the manner of doing business lends itself to such solicitation, the corporation is exempt regardless of its ability to pay taxes to such state, regardless of whether compliance is simple or complex, and regardless of the corporation's being nevertheless afforded the protection, benefits and opportunities of that state to earn income in that state. I strongly urge that Public Law 86-272 be modified as suggested by the Multistate Tax Commission "Plan" and by the drafting Subcommittee of the National Association of Tax Administrators to provide exemption only if a corporation has a minimum sales activity in the state and is of a minimum size. The proposal is that the total gross receipts of the corporation or the affiliated group to which it belongs must average more than two million dollars for the tax year and the three last preceding taxable years, and the corporation or its affiliated group must have derived more than three hundred thousand dollars in gross receipts from the sales of property in that state, before tax jurisdiction would obtain.

(2) Aside from Public Law 86-272, no jurisdictional limitation should be imposed upon the states which would reduce a state's share of taxable net income to figure less than that determined by utilization of a uniform apportionment formula utilizing property, payroll and sales. Such utilization necessarily constitutes an adherence to the "source" concept of taxation rather than treating the

corporation as an individual citizen of a state, taxable upon all of its income in the same way that a state now taxes either source income or personal income of an individual regardless of where earned. The three-factor formula is widely accepted and widely used and should in no event be reduced to two factors. The application of the formula should be permitted either against the net income of the single corporation over which the state has jurisdiction or against the combined corporate net income of the affiliated group to which the corporation belongs. The apportionment formula should be applicable against all net income of the corporation of the affiliated group, regardless of whether it is classifiable as "business" or "intangible" income. Federal legislation should leave no vestages of the problem of determining what is business or nonbusiness income such as is not extant under the Uniform Act.

At the same time, full accountablity as to tax liability for taxable income should be recognized by adoption of the concept that if a state has no jurisdiction to tax a corporation, the corporation has earned no taxable income in that state. The corporation's income is then apportionable among the states having jurisdiction over the corporation.

(3) The concept of combination, developed by California and followed wherever possible by Oregon and other states, provides the best and easiest solution to the problems of apportionment and allocation of the net income of a multistate corporation. The three-factor formula, in itself, says that each of the factors produces income. Use of the combined method, which combines affiliated corporations by either the unitary test or by a test of ownership alone, further states that each dollar of investment by the corporation in property and payroll and each dollar of sales, has the right to have attributed to it the same amount of earned income. It allows no discrimination, distinction or allocation by a corporation to any one of these dollars of more income than that eanred by another of such dollars.

(4) Administration of federal legislation should be by the Multistate Tax Commission. The adoption of a Multistate Tax Compact consent bill should if other federal legislation is adopted, carry with it provisions for permitting the Multistate Tax Commission to act as a state body for the working out of those details of state taxation which must accompany such federal legislation. California has, for example, identified some 30 areas where different types of business other than the usual manufacturing and sales corporation have need for special formula consideration as to apportionment. The states should be free to work out these details with their own input into a state governed and state regulated administrative agency.

CONCLUSION

The State of Oregon has had a corporation excise tax since 1929 and a corporation income tax since 1955. It has followed the concept of combined reporting of income of corporations engaging in a unitary business for a number of years, beginning the application of this concept in the early 1950's and consistently following it regardless of whether the tax consequences have created greater or lesser tax liability for the particular corporate group. Oregon was one of the pioneer states in the development and activation of the Multistate Tax Commission, and its state administrators have played prominent roles in the administration and leadership of that organization. Oregon is one of the few states maintaining out-of-state offices in New York, Chicago and Los Angeles. It has encouraged and aided the joint audit program of the Multistate Tax Commission and firmly believes in its principles. Oregon opposes any attempt to limit its jurisdiction under the guise of false aid for uniformity. It believes that it should be free to pursue its revenue needs within the corporation excise and income tax framework, applying its own state tax policy within its constitutional and statutory jurisdictional limitations by means of particular exemptions or deductions where necessary, and by adjustment of tax rates.

Oregon is fully aware of the adverse effects such litigation as S. 1245 would have in its tax practices and policies. A failure to duplicate in this statement the analyses made elsewhere of S. 1245 does not mean that Oregon does not oppose the exemption of dividends under S. 208 of that bill, or the administratively impossible task that would be imposed under § 209 of that bill. The 1973 Oregon Legislative Assembly has just enacted chapter 233, Oregon Laws 1973 (HB 2195) which returns dividends to taxable corporate income, except for dividends paid out of income already included in the measure of the tax paid by the paying or receiving corporation. Section 209 would wipe out the administrative practice

of combined unitary reporting developed in Oregon during the last 20 years, and approved by the Oregon Tax Court [1] and Oregon Supreme Court.[2]

The states have made significant progress in working out their problems during the last decade. Congress must be conscious of the burden it assumes if it insists on federal legislation. We ask that Congress desist from imposing such legislation upon the states and that it give full consent to the Multistate Tax Compact so that further state progress towards uniformity might be encouraged and speeded. And such is sufficient unto the day.

(Whereupon at 1:10 p.m. the hearing was concluded.)

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[1] *Humble Oil and Refining Co. v. Department of Revenue*, 4 Oregon Tax Court 284 (1971).
[2] *Donald M. Drake Co. v. Department of Revenue*, 95 Or. Adv. Sheets 850 (September 8, 1972).

Appendix A

Communications Received by the Subcommittee Expressing an Interest in the Subject of State Taxation of Interstate Commerce

21-350—74——26

Statement of Hon. Warren Magnuson, a U.S. Senator From the State of Washington

INTRODUCTION

My deep interest in the general subject matter of the legislation presently pending before the Subcommittee stems from two sources. First, although the various bills now under consideration have been referred to the Committee on Finance—and properly so—any bills which can be truly said to "regulate and foster commerce among the states" still remain of interest to me in my capacity as Chairman of the Committee on Interstate and Foreign Commerce.

The second source of my interest is more local in nature. Since 1965, when the report of the "Willis Subcommittee" was issued pursuant to Public Law 86-272, the State of Washington has been at the forefront of those states attempting to find satisfactory solutions to the problems now before the Subcommittee. I have been working closely with our state officials in this effort, and will continue to do so.

These two sources of my interest also give rise to the two overall goals which I feel should be attained by any legislation which may be recommended by the Subcommittee. The first goal may be expressed in terms of the language quoted above which appears in the title of S.2092, i.e., the goal of fostering commerce among the states. It is my strong belief that much of the diversity existing among the states in their taxation of multistate businesses is the result of historical accident rather than carefully considered policy decisions. Further, I also believe that this lack of uniformity may be, in some instances, an impediment to the free flow of commerce among the states.

This first goal, however, must not be achieved to the detriment of a second goal. Any federal legislation in this area must assure the states that multistate businesses will receive no preferential immunities from state taxation, and must pay their fair share of state tax burdens along with local businesses. The theme of any federal legislation must be uniformity, not preferential immunity.

To illustrate this point with the most extreme possible example: It would certainly "foster commerce among the states" if all businesses operating in two or more states were made completely immune from state taxing jurisdiction. The obvious problem here, however, is that while the first general goal would be attained, it would be attained only by completely disregarding the second goal, with the result that there would be not only an intolerable discrimination against local businesses, but a crippling of the states' taxing systems. This would be preferential immunity for multistate businesses with a vengeance. But so long as the first goal is conceived of in terms of uniformity, rather than preferential immunity, the two goals are perfectly compatible.

BACKGROUND OF S. 2092

I turn next to S. 2092. S. 2092 represents, I believe, a large step forward in the right direction towards solving those problems with which the Subcommittee is presently concerned, and achieving the two goals described previously.

Among the various proposals presently pending before the Subcommittee, S. 2092 is unique in that it contains not only substantive provisions, setting forth federal standards regulating state taxation of multistate businesses, but also contains administrative provisions designed to implement, on a continuing basis, the uniform application of those standards. Both aspects of the bill are, in my opinion, equally important and can best be understood in the light of the history of the bill.

This bill is familiar to state tax administrators and business representatives alike as the "Ad Hoc" proposal. The Ad Hoc Committee, as originally constituted and later expanded, has no official status. It is a volunteer and self-appointed group of state tax administrators and business representatives.

The original Ad Hoc Committee grew out of conversations early in 1969 between the Co-Chairmen, George Kinnear, Director, Department of Revenue, State of Washington, and then Chairman of the Multistate Tax Commission, and Leonard E. Kust, a partner in the New York firm of Cadwalader, Wickersham & Taft, and then Vice President and General Tax Counsel, Westinghouse Electric Corporation. These conversations were concerned with the seemingly unbridgeable gap between the view of state tax administrators and business, and the stultifying effect of the conflicts involved on the prospects for reasonable solutions for the problems of taxation of interstate business. The conversations culminated in agreement to strive jointly to organize a committee which would seek to bridge the gap in views by identifying the areas of agreement and of disagreement and working out some reasonable accord in the areas of disagreement.

After a year's exposure of the original Ad Hoc proposal and its consideration by various interested groups, an expanded Ad Hoc Committee met in Seattle, Washington, on June 8 and 9, 1971. The purpose of this meeting was to reconcile differences of viewpoint and to develop necessary changes in those provisions of the original proposal which, despite the effort of the original Ad Hoc Committee, remained unacceptably controversial. In addition to the twelve-month exposure of the original proposal, the expanded Committee also had the benefit of the Plan developed by the Multistate Tax Commission as a guide in its deliberations.

The new expanded Ad Hoc Committee did not purport to represent any viewpoint other than that of its individual members. While the revised Ad Hoc Bill purports to be a result of a consensus of opinion expressed at the Seattle meeting, it has been aptly referred to as representing an "uneasy consensus." There was no formal vote taken or record made of the proceedings. It was recognized at the meeting that those in attendance were completely free to voice later objection to any provision of the draft.

The general conception of the proposals to which the original Ad Hoc Committee was committed from its beginning in 1969, is that the solutions to the problems of multistate taxation of interstate business should be implemented through a merger of the Multistate Tax Compact approach and the federal legislation approach. The objective of such a merger of approaches is to preserve as far as possible administrative authority in the States by requiring the States to act, in certain areas, through the machinery of an interstate tax compact consented to by the Congress and serving as the agency to implement uniform standards established under federal legislation.

Such a structure would provide flexibility for adjustment and evolution to improve the system for taxation of interstate business. With the Multistate Tax Commission under the Compact acting as the administrative agency it could implement and modify, within the limits of permissible administrative interpretation, the legislative standards under federal law, and when the need for changes exceeded the bounds of permissible administrative interpretation the Commission could seek amendments to the federal legislation. Moreover, any proposal for amendment of the federal legislation will have been preceded by extensive discussions between state administrators and business representatives and will presumably, therefore, be presented to the Congress with a substantial consensus of support.

The Ad Hoc Committee recognized—and correctly so—that its proposals with respect to federal substantive legislation addresses itself to problems for which there are no final, perfect solutions. Thus, the Subcommittee may well decide that any proposals such as it may make will differ in certain specifics.

In this regard, I have been informed that a committee of the National Association of Tax Administrators, under the chairmanship of Mr. Owen Clarke, Deputy Commissioner of Taxation for the State of Massachusetts, is developing proposed substantive legislation which, in certain particulars, will differ from S.2092. The Subcommittee may well decide that the proposal of Mr. Clarke's committee represents improvements in certain areas over the substantive provisions of S.2092. Even though I am the sponsor of S.2092, I would urge the committee to consider carefully not only the substantive provisions of S.2092, but also the proposals which will be forthcoming from Mr. Clarke's committee.

THE PROCEDURAL PROVISIONS OF S.2092

As already noted, S.2092 is unique among all of the proposals presently pending before the Subcommittee in that it establishes an administrative mechanism for implementation of any federal substantive provisions. This administrative mechanism is embodied in Title I of S.2092, and it is to this unique feature of S.2092 that the balance of this discussion will be addressed.

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In the report of the Willis Subcommittee, issued in 1965 (see Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 89th Congress, 1st Session, Volume 4, page 1161–1162), it was recognized that any federal substantive legislation would require a single agency to issue regulations and rulings to implement the statutory substantive provisions. In Title I of S.2092, this same need is recognized. The Willis Subcommittee, however, recommended that this agency be the U.S. Treasury Department. The states objected to this, and rightfully so. Title I recognizes the validity of this objection, and provides that the rule-making agency will be a state-controlled agency rather than a federal agency such as the Treasury Department.

There is in existence such a state agency upon which Title I would confer this rule-making authority. That agency is the Multistate Tax Commission, established under the Multistate Tax Compact which has been enacted by the legislatures of twenty-two states. Enactment of the Compact, and the work of the Commission has resulted in great progress having been made toward the goal of greater uniformity in state taxation of multistate businesses. It is upon this progress that Title I is building.

Sections 101 and 102 provide for Congressional consent to and identification of the Multistate Tax Compact. The position of the Multistate Tax Compact has been from the very beginning — and remains — that Congressional consent is not technically necessary for the validity of the Compact. Nevertheless, Congressional consent would serve at least two very useful functions. First, it would constitute Congressional recognition of the desirability, policy-wise, of the Compact approach discussed above. Secondly, it would have the practical effect of freeing Commission resources, including financial resources, now being diverted to contest the action in Federal District Court in New York City brought by certain giant corporations challenging the validity of the Compact.

As already noted, the basic assumption behind section 104 is that implementation of federal substantive provisions will require uniformity of regulation as well as uniformity of statutory provisions. It is also based on the conviction that the rule-making agency should not be a federal agency such as the Internal Revenue Service, but rather should be composed of state tax administrators acting collectively. Thus both sides of the "federalism" coin would be utilized. Congress would act to establish substantive rules to provide national uniformity but would support the autonomy of state governments in administering and implementing their state revenue programs.

In the drafting of section 104, two principal problems presented themselves. First, it was recognized that participation in the rule-making process should not be limited to regular member states, i.e., those states whose legislatures have enacted the Multistate Tax Compact, and that accordingly there should be a device whereby even those states whose legislatures have not enacted the Compact can easily be put on equal footing with regular member states in participating in the rule-making process. This goal is attained through the use of associate member status, which can be obtained under the bylaws of the Compact by action of the governor of a state. Thus, simply action by the governor, rather than action by a state legislature, will result in a state being placed on an equal footing with regular member states for purposes of exercising the powers conferred under section 104.

The second problem to which section 104 addresses itself is the degree to which the regulations issued by the Multistate Tax Commission should be binding on all states, i.e., the degree to which the decisions of state tax administrators acting collectively would bind those administrators individually. Section 104 incorporates the principle that if a state tax administrator does not want to be bound by the regulations issued under section 104, he doesn't have to be. In this sense, the regulations are advisory rather than mandatory. However, section 104 also incorporates another important principle, which is simply this: The state tax administrator who does not wish to be bound by the regulations issued under section 104 cannot make the decision to reject the regulations by simply tossing them into the wastebasket. Instead, the decision to reject the regulations must be processed through that particular state's administrative procedure act or equivalent statutory provisions, i.e., through public hearings and whatever other statutory requirements there are for the adoption of rules and regulations in that particular state.

What is really at stake here is not the advisory nature of the regulations, but rather the accountability of the tax administrator for his decision to reject the regulations. To the extent that a state tax administrator must, under state law, justify to the public the adoption of any rule or regulation in the field of taxation,

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so too that administrator must, in rejecting any rule or regulation issued under section 104, present a similar justification.

Thus, section 104 is designed on the one hand to preserve the advisory nature of any rules and regulations issued by the enlarged Multistate Tax Commission; at the same time it incorporates a principle whose necessity is being recognized more and more in all fields of government, i.e., the principle of accountability to the public for governmental decisions. It should also be noticed that, by reason of section 104's adoption by reference of the procedures of each individual state for promulgation of rules and regulations, the precise degree of accountability imposed upon the tax administrator is the same degree of accountability which the individual state, through its administrative procedure act or equivalent law, imposes upon that administrator generally.

Finally, since each state will know that it cannot avoid the impact of the regulations by just ignoring them, the procedures in section 104 will, in practical operation, provide a strong incentive for each state to participate fully in the formulation of the regulations at the very outset. This, in turn, will provide assurance that the best possible job is done in the drafting of the regulations in the first instance.

Almost fifty years ago, in their landmark article on the Compact Clause, Felix Frankfurter and James M. Landis stated:

> ". . . in view of the growing burden upon time and feelings, as well as the cost in money due to the conflicts and confusion arising from the administration of independent systems of State taxation, the possibilities of amelioration and economy realizable through an alert use of the Compact Clause call for more intensive study, as part of a disciplined attack upon the entire tax problem."
>
> (The Compact Clause of the Constitution—A Study in Interstate Adjustments, 34 Yale Law Journal 685 at 704)

Title I of S. 2092 is an attempt to meet that challenge.

Statement of Hon. William A. Egan, Governor, State of Alaska

Comments on S. 1245, S. 2092, H.R. 977 and S. 282

Dear Senator Gravel: This is further to your letter received here on September 14th, with which you enclosed several bills related to the question of State Taxation of Interstate Commerce.

I have examined these bills from the point of view of the specific interests of the State of Alaska, as well as the broader interests of general state-level taxation and revenue policy. Alaska, along with approximately 20 other States has subscribed to the Uniform Multi-State Tax Compact. This Act, and its adoption by other jurisdictions will, in our view, provide uniform and equitable results in inter-state taxation without the necessity for Federal legislation in this area. The Multi-State Compact recognizes the importance of equitable apportionment of taxation among the separate jurisdictions based upon the three factor formula, and utilizes guidelines enumerated by the U.S. Supreme Court in establishing a "nexus" for taxation purposes. I feel that legislation of the type proposed is unnecessary, and I would even suggest that with respect to some of the proposed Bills they may have been drafted in such a manner as to prevent the States from realizing their fair share of tax revenue.

Accordingly, I can summarize our position with respect to the various bills which you have forwarded by saying that the single most acceptable Bill is S. 1918 which was not included, and which has been prepared by the Multi-State Tax Commission authorizing Congressional approval of the Multi-State Compact.

Inter-state taxation is a particularly important area of concern for the State of Alaska. A large share of our natural resources and fisheries are exploited by non-residents. The major issue is whether or not Alaska can, consistant with the Federal interstate commerce power, realize its share of taxes on income earned within this Jurisdiction. Shortly after the initial approval of Alaska's State Income Tax, our law was subjected to challenge in the courts on grounds of constituting a burden on interstate commerce. In *Alaska Steamship Company* v. *Mullaney*, 12 Alaska 433, 84 F. Supp. 561 aff'd 12 Alaska 594, 180 F2d 805 (9th Cir. 1950) the Alaska law was upheld. In *Alaska* v. *Petronia*, 69 Wash. 2d 460, 418 P2d 755 the State's right to levy a tax on the net income of seamen where the tax was levied on that portion of the seamen's net income attributed to their activity within Alaska was sus-

tained. However those two court actions produced a short-lived result and in 1970, Congress enacted PL 91-569 which precluded any State from requiring the withholding of taxes on the income of seamen or other persons engaged in interstate commerce unless they were residents of the particular state levying the tax. This public law was partially intended to relieve resident Washington fisherman from withholding tax liability on their incomes derived within the State of Alaska. It has significantly reduced tax collections from nonresident fishermen. A recent study of the Alaska fishing industry conducted in conjunction with the implementation of our "limited entry" legislation has shown that only a very small percentage of non-resident fishermen who derive income from within Alaska, regularly submit tax returns or pay taxes to the Department of Revenue.

For these reasons, and for others which will become apparent in the analysis of certain of the measures proposed, the State of Alaska has a very vital interest in any legislation which attempts to limit the State's taxing powers under the guise of reducing burdens on interstate commerce. I might also point out that we have some very grave doubts on the constitutionality of legislation which apparently seeks to limit the taxing powers of the States on income which is derived from within the State's boundries.

S. 1245 introduced by Mr. Mathias

Perhaps of all the Bills which you have forwarded for our comments, S. 1245 is the most objectionable. I will attempt to analyze the features which we would consider to be unworkable or predjucial to Alaska's interests.

Jurisdictional Standard.—This bill attempts to establish a jurisdictional standard relative to the imposition of state income taxes and gross receipts taxes. It limits the State's jurisdiction to tax a corporation on the basis of whether or not the corporation has a business location within the State.

Sec. 513 of the bill defines *Business Location* and is limited to a number of factors which are unduly restrictive. Under this definition, a foreign corporation in the business of providing oil field rigs and equipment could do a huge volume of selling within Alaska and not be subject to any tax because it would not have established a business location in Alaska under this section. The section is also misleading in a sense because it apparently attempts to define a business location as being established if the corporation has one or more employees located within the State (Sec. 513(2)). However, Sec. 515(c)(3) which defines *Location of Employee* exempts any employees who are involved in the installation or repair of property which is the subject of an interstate sale by the employer. Thus, although the section purportedly would establish a "nexus" for taxing purposes based on the assignment of corporate employees within Alaska, if these same employees are merely involved in the installation or repair of the equipment, the required Business Location of the corporation for taxing purposes, does not exist.

Three Factor Formula.—This Bill purports to adopt the three factor formula for apportionment of taxes between jurisdictions. Sec. 202 defines the *Property Factor*, and Sec. 202 (b)(1) provides that the property owned by the corporation would be valued at its original cost. For corporations dealing primarily with natural resources, this is not the best value which should be assigned for tax purposes. Such a formula would be acceptable for almost any commodity other than a natural resource which should be valued after its initial processing or as in the case of oil, any refining which may be accomplished before it is exported from the State.

Sec. 203 defines the *Payroll Factor*, but Sec. 515(c)(3) provides that an employee would not be considered to be located within the State if his only business activities are the installation and repairing of property which is the subject of an interstate sale. Thus any salary paid to these employees would not be included in the apportionment to determine tax liability of the corporation in Alaska.

It should also be noted that the definition of "wages" provided in Sec. 203(c) includes only those wages as defined for purposes of Federal Unemployment Tax in Sec. 3306(b) or the Internal Revenue Code. This means that no more than $4,200.00 of the salary of each employee could be included in the payroll factor in determining the corporate tax liability. In Alaska, and particularly in the petroleum industry, relatively high wages are not at all uncommon. To limit the amount that can be included, as this section attempts to do, results in a gross distortion, and omits a significant amount of income from the computation of the payroll factor.

Sec. 204 defines the *Sales Factor* and adopts the straight "destination rule". Only sales of property received within the State by the purchaser are considered in arriving at the Sales Factor in this part of the formula. This is not objectionable in

itself, but with the additional limitations imposed on taxing jurisdiction in this bill, it is inevitable that a significant amount of sales will be destined for delivery in Alaska and yet there will be no jurisdiction to impose a tax. If it cannot be established that the Corporation has a *Business Location* within Alaska, no amount of equipment or other products destined for delivery within the State would be included within the Sales Factor formula for tax purposes.

Under this Bill, in these circumstances, the sales could not be apportioned to any State. The Multi-State Compact has recognized this problem and has incorporated the "throwback rule", wherein if there is no nexus established for tax purposes in the destination State, then the tax would be attributed to the origin of the sale.

Sec. 205 also provides that if the denominator of any factor is zero, then this factor would be disregarded. This too, would result in distortionment, and it would be relatively easy for a corporation to manipulate its figures to establish a zero denominator for one or more factors. It would be much more advisable to provide a negligible denominator in these circumstances of 10–15%.

Apportionable Income as defined in Sec. 207 is perhaps the most objectionable section of all. The section is replete with hidden ramifications which directly effect Alaska's interests in its natural resources. Sec. 207(a)(1) excludes *foreign income* from any tax that can be imposed by a State. It also excludes all income from off-shore oil exploration and mining on the Outer Continental Shelf. In this respect, reference must be made to Sec. 502 which defines income from sources without the United States, and specifically excludes income defined in Sec. 638 of the Internal Revenue Code. Sec. 638 IRC deals with the Continental Shelf areas and brings these resources within the term "United States" for tax purposes. The effect of this section is to exclude income derived from the OCS as being "foreign income" which cannot be taxed by the States.

The *Outer Continental Shelf Act* 43 U.S.C.A. Sec. 1333 places exclusive jurisdiction of these areas in the Federal Government. The section prohibits taxation by States in a contiguous relationship to the shelf area. However, although the States may not tax the shelf or exploration and production activities thereon, it has generally been conceded that this income can be included in any overall apportionment formula to determine tax liability. The effect of this bill would eliminate this apportionment and prevent any allocation of this revenue to any State. It would be the best of all possible worlds for the oil industry.

Sections 207 and 208 even go further to provide that any dividend income to the corporation either received from (1) a controlled affiliate or as (2) portfolio dividends from other corporations is not considered as income to the corporation for apportionment purposes, but is allocated to the State of the corporations commercial domicile. The effect is that the large commercial States would inevitably reap the benefits from such a provision. There are no large corporations which would consider themselves domiciled in Alaska, yet particularly with the oil industry, they have significant and perhaps predominant commercial interests here. The Multi-State Tax Compact has always taken the position that dividends of whatever nature, to the extent that they are business income should be apporttioned. The provisions of Mr. Mathias Bill would not even look to see if the dividends were business or non-business in nature, but would allocate all to the State of the corporations commercial domicile.

Sec. 207(a) also prohibits the State from disallowing deductions connected with this exempt income. If the corporation incurs expenses in capturing dividend income allocated to the commercial domicile, the State couldn't disallow these expenses. Under current Alaska Law, AS 43.20.010(c)(2)(B), expense deductions are allowed only to the extent they are associated with income arising from sources within Alaska. The effect of the provision would permit the corporation to deduct expenses from any tax liability it may have to the State of Alaska, but none of the income associated with the expense deduction would be included within the taxable income subject to tax liability in this State.

The theory of the Multi-State Tax Compact is to use the medium of consolidated or combined returns to review a company's entire operations. In particular this would apply to a parent company and all controlled subsidiaries engaged in the unitary business and require apportionment of the entire income between taxing jurisdictions. In S. 1245, Sec. 209 purports to allow this same procedure, but it would do so *only* if the State can show that the parent company and the subsidiary were engaged in *non-arms length transactions*. This places a heavy burden on proof upon the States and effectively precludes them from the most effective instrument of determining overall tax liability. In the hedge-row of inter-corporate relationships which is so characteristic of the modern business community a provision of this type is unworkable and unreasonable. A large

corporation can easily set up a losing subsidiary in one State and incur no tax liability although the overall corporate operations may be profitable. To limit the provisions for requiring consolidated or combined returns to those instances in which the State can show non-arms length transactions effectively emasculates the Multi-State Tax Compact.

Even if the State could show that there were non-arms length transactions involved, it still could not combine the income of the subsidiary with the parent corporation if the corporation derived 50% of its income from outside the United States, see Sec. 209(b)(2) and Sec. 207(a)(1). As I have previously indicated under Sec. 522 the entire Outer Continental Shelf would be considered *outside* the United States. An oil exploration firm could very profitably organize a corporate subsidiary exclusively for the purpose of developing the Continental Shelf and the subsidiary would not be subject to tax, nor would the overall corporate profits be taxable on that portion derived from the OCS.

Sales and Use Tax Provisions.—As you know, Alaska does not have a State-wide Sales and Use Tax. These taxes, unlike most other jurisdictions which levy a State tax, are imposed in Alaska, by local subdivisions of Government. We would suspect that a very limited amount of Use Taxes are presently being collected by the borough and city tax assessors.

It is possible that at some future date, the Alaksa Legislature may consider that it would be more efficient to impose a uniform Sales and Use Tax which could be administered by the State with the revenues returnable to the local communities. In the event that the State of Alaska were to enact Sales and Use Taxes in the future, there are certain provisions of S. 1245 which are objectionable to us.

Sec. 301 provides that a State or political subdivision may impose a sales or use tax or require a seller to collect taxes on interstate sales only if the property is destined for a *contiguous state*. There are no other contiguous States to Alaska, and an argument might well be made that Alaska would be precluded from entering into any reciprocal agreements with Washington State or any other West Coast State for the collection of taxes on goods destined for shipment to Alaska.

Sec. 306 relating to *Local Sales and Use Taxes* also provides that no seller can be required to collect a sales or use tax for an interstate sale unless the property is destined for delivery in the local subdivision of government and the seller has his business location there or makes his own deliveries. For sales involving delivery by mail or common carrier, the local borough or city would not be able to levy a sales or use tax. Considering the great quantities and varieties of products which are purchased out of state and delivered to Alaska, this provision might seriously jeopardize local businesses which are subject to local taxes, and prevent collection of taxes on the out-of-state sales.

The Bill also purports to give jurisdiction to the United States Court of Claims for a trail de novo on any issue relating to a dispute arising under the Act (See Sec. 401 et. seq.) I am at loss to know why the Court of Claims should be selected. At the very least such authority should be vested in a court with tax expertise and we would prefer to have our own courts determine our taxing jurisdiction. I also find it objectionable that the Court of Claims would be vested with de novo authority. A taxpayer contesting any State tax measure could resort to the Court of Claims for a de novo review on any issue, and the State would be bound by the Federal ruling. The litigation in these matters would unquestionably proliferate at an inordinate rate because each State would be required to become a party when any other State was in the process of contesting against the same taxpayer. Considering the many large oil corporations which presently have interests in Alaska, as well as in many other parts of the Nation, a large expenditure of public funds and personnel would be required to safeguard Alaska's interests.

S. 2092 Introduced by Mr. Magnuson

Of the several bills submitted for consideration this is the most acceptable for the reason that it gives congressional recognition to the Compact and its enforcement by the Multi-State Commission. The States which have thus far adopted the Compact have developed increasing expertise in the area of interstate taxation and apportionment of revenues. The existing system is based upon voluntary State compliance and cooperative effort. We would strongly recommend that this system be continued.

As I have previously indicated however, we would naturally prefer S. 1918 as incorporating the desirable features of the Multi-State Compact. In Senator Magnuson's Bill, as proposed, there are still some objectionable features from the point of view of the State's taxing authority.

Sec. 201, *Jurisdictional Standards,* again seeks to limit the State's power to tax corporations engaged in interstate commerce on the basis of whether or not the corporation has established a *business location* within the jurisdiction. Sections 302, 303 and 304 also provide that if a State doesn't have jurisdiction to impose a tax, then the factor involved (property, payroll or sales) would be excluded from the denominator in determining the particular State's portion of taxable income.

This Bill does not have the specific provisions relating to the Outer Continental Shelf question, and does allow for combined reporting based upon an equitable three factor formula. S. 2092 also contains provision for the "throwback rule" thus precluding the assignment of income to the State of "Nowhere". In determining tax liability for operations and production on the Outer Continental Shelf, the three factors of property, payroll and sales would be included in the denominator formula, but would not be included in any State's numerator.

Sec. 306 which provides for the exclusion of dividends from apportionable income is objectionable for the reason that it eliminates dividends received from controlled subsidiaries and provides that dividends are taxable only in the State of the taxpayer's commercial domicile. The Multi-State Compact embraces the position that dividends should be apportioned and not allocated.

The *Sales and Use Tax* provisions of Sec. 401 and Sec. 406 also contain the same reference to "contiguous State" which would place Alaska in a very difficult position for inter-state revenue collection purposes. This phraseology could easily be subjected to challenge on the basis that there are no States which are contiguous and therefore no State could assist in collecting taxes on sales of goods destined for transshipment to Alaska.

Sec. 405, *Local Sales and Use Taxes* also provides that no seller is required to classify sales according to geographic areas of the State, other than for those areas in which the seller has a *business location.* Alaska's Sales and Use Taxes are primarily local taxes. Anchorage, which is the largest commercial center in the State has no local sales tax, but a majority of Alaska business firms have their principal locations in that area. Food items, and other commodities purchased in Anchorage or Seattle and destined for transshipment to another area of the State would thus be exempted from any local Sales or Use Tax at their destination by reason of this provision.

H.R. 977 Introduced by Mr. Rodino

This Bill imposes the same objectionable jurisdictional limitations on State or local Income Taxes, Gross Receipts Taxes or Sales and Use Taxes. Instead of the three factor formula provided in the other bills, it proposes to utilize only two factors (property and payroll). This is contrary to the experience of most jurisdictions which have found the three factor formula to be the most equitable and reasonable method of apportioning income.

This Bill does not have any of the objectionable features relative to Outer Continental Shelf taxation, but it does contain a similar limitation on the requirement for the collection of sales and use taxes on any property destined for delivery to a political subdivision in which the seller does not maintain a *business location.*

S. 282 Introduced by Mr. Cranston

This Bill is more limited in its scope and relates only to Sales and Use Taxes. In effect it sets a jurisdictional standard which is much closer to the holdings of the U.S. Supreme Court. Other than the elimination of the "contiguous state" terminology contained in Sec. 201(a)(2), and the general discussion of some of the unique problems in the administration of these taxes in Alaska, we have no other detailed observations to make with respect to this proposal.

I regret that this answer has to be such a lengthy document, however, I think the issues involved justify very careful consideration. Almost every item entering this State can be considered in interstate commerce, and therefore the issues are of very real concern to us. Not least important is the fact that we anticipate very active interest in the further exploration of Alaska's Outer Continental Shelf for oil and other minerals exploitation. Natural resources will provide the basic source of tax revenues to the State of Alaska for many years to come. It is no secret that major industries and particularly the petroleum industry have historically contested the right of the State to tax their operations. Of all the major oil industries with interests in Alaska at the present time, only a small portion of them pay *any* corporate taxes. It is for this reason that the Department of Revenue intends to undertake a joint audit of several of the major oil companies in conjunction with other State revenue agencies and the Multi-State Tax Commission, in 1974.

For these reasons we would be most concerned that any legislation being considered by Congress be in full harmony with the concept of the Multi-State Tax Compact, and consistent with the rulings of the U.S. Supreme Court which have established the jurisdiction of the States to tax income produced within their borders.

STATE OF UTAH,
OFFICE OF THE GOVERNOR,
Salt Lake City, January 8, 1974.

Senator WALTER F. MONDALE,
Senate Subcommittee on State Taxation of Interstate Business, Senate Office Building, Washington, D.C.

DEAR SENATOR MONDALE: As Chairman of the Committee on Executive Management and Fiscal Affairs of the National Governor's Conference, I appreciate the opportunity to comment for the record on legislation before your subcommittee affecting the power of states to tax income of corporations doing business in interstate commerce. I recognize that this is a sensitive and recurring problem, but I am convinced that it is an appropriate area for state initiative and that an equitable solution can be achieved by the states or their compacts and associations without recourse to Federal legislation.

To this end, I am directing the staff of the committee on Executive Management and Fiscal Affairs of the National Governor's Conference to develop a comprehensive policy position on this issue to present to the assembled governors at the June meeting of the National Governor's Conference. In this assignment they will be proceeding in concert with the National Association of Tax Administrators, the Multi-State Tax Compact and key officials representing the array of state concerns on this issue.

Again, I appreciate your invitation to express a position on this issue and assure you of my willingness, nay, eagerness, to demonstrate the ability of the National Governor's Conference to devise a reasonable and equitable solution to this problem.

Sincerely,

CALVIN L. RAMPTON,
Governor.

STATEMENT SUBMITTED BY JOHN M. HAZELETT, CHAIRMAN, ARIZONA STATE TAX COMMISSION

Mr. Chairman and members of this subcommittee:

My name is John M. Hazelett and I am currently chairman of the three member Arizona State Tax Commission as well as being a member of the executive committee of the National Association of Tax Administrators. My testimony is being submitted to acquaint you with my views on the various interstate taxation measures now before your subcommittee.

For over 30 years I have been concerned with this problem. First, as the World War II head of the tax department of one of America's largest aircraft manufacturers, followed by over 20 years as a part owner and general manager of one of Arizona's largest construction equipment firms dealing with hundreds of manufacturers and suppliers throughout the United States and for the last 9 years as a member of the Arizona State Tax Commission.

I am a CPA and was apparently the only state tax administrator who testified in basic support of the Interstate Taxation Act proposed in 1966 by Congressman Edwin Willis (H.R. 11798).

VIEWS CHANGED VERY LITTLE

My views since 1966 have changed very little but they have been considerably refined. The problem, as I see it, hinges on states' rights which a properly worded measure could actually strengthen rather than weaken. It is in this direction that I feel you should focus your attention.

Modern science, radio and TV, faster and faster airplanes, trips to the moon, devaluation of the dollar, etc. have caused our problems in interstate and international commerce to grow by leaps and bounds. I now feel that action by the Congress is the main link necessary to properly speed us on our way to greater national achievements.

Because you have so many bills before you and will no doubt be receiving so many statements detailing specific change recommendations, I am not going into

this type of detail but instead want to give you the basic concepts I feel you should follow in the adoption of proper legislation.

First, I am a long way from being sure that there is a need in this legislation for any administrative agency such as the Multistate Tax Commission, a special department of the Treasury Department, a division of the Commerce Department, a branch of Internal Revenue Service or any other agency. Currently, I feel your legislation should not provide for any such agency, but should allow all disputes to flow through state and federal courts as they do now or at least until a greater need is shown for such an agency than is now apparent.

Second, as Public Law 86-272 was the first legislation enacted by the Congress in this field and it has since had numerous court interpretations, I feel this law and court decisions should now be codified into one new law.

Third, in the income tax field, I feel the Uniform Division of Income for Tax Purposes Act (UDITPA) formula is the best approach to be followed in solving the bulk of the income tax allocation and apportionment problems. However, this formula should be updated and made mandatory in all 50 states rather than optional as now being followed by many states and proposed under the Multistate Tax Compact concept.

Fourth, in the sales tax field, I feel interstate sellers must collect sales taxes on all interstate sales unless they have been given valid resale certificates by their customers. Under this plan states would be able to reduce their expensive out-of-state audit crews, taxpayers would be forced to pay increased use taxes and/or be subject to greater use tax audits by home state tax authorities.

MOST DIFFICULT CONCEPT

The most difficult field that I feel you should legislate in is the income tax field quoted above as my *third basic concept.* This is where I feel the most give and take will be required between tax administrators and industry before a proper solution to these problems will be achieved.

So far most plans seem to have been directed toward simplicity. My basic concept is that, if you strive towards simplicity, it is not going to be equitable and, if not equitable, the courts are going to be filled with cases testing what is equitable under states' right principles and what is not.

I feel the best discussion of this problem was covered in a report of the Committee on Interstate Taxation of the New York State Bar Association dated December, 1971 prepared by Mr. Peter Miller. Page 27 of this report is quoted in part as follows:

> "Although our Committee recognizes that formula apportionment of the taxpayer's entire net income could greatly simplify the division of its income among the several states, we believe that such simplification should be rejected because it would cause significant amounts of income to be assigned to States other than those to which the income should fairly and reasonably be attributed, thereby resulting in an inequitable and inappropriate division of income detrimental to one or more States (and frequently also to the taxpayer), which could, in turn, raise serious Constitutional issues."

Our Arizona law on this point is currently as follows:

> "A.R.S. 43-135(g) Allocation formula. When the income of a corporation subject to the tax imposed under this title is derived from or attributable to sources both within and without this state, the tax shall be measured by the net income derived from or attributable to sources within this state . . . and the income attributable to sources within this state shall then be determined by (1) separate accounting thereof when requested by the taxpayer or required by the tax commission to more clearly reflect the income of the taxpayer or, (2) an allocation (*this should have been apportion*) upon the basis . . . provided that in no case shall the tax be less than would result from the use of the allocation (*this should have been apportion*) method." *Underlined* words added.

We now have lawsuits against us in our local courts involving some $10,000,000 that would apportion recent income of our larger copper mines rather than using the Arizona Tax Commission's stated requirement for a separate accounting basis. If the wording of many of the bills now being reviewed by your subcommittee were in the law that our tax commission is now administering, we would lose these cases or have to go to court claiming that it was an infringement on the rights of the State of Arizona to tax that income to which we have a meritorious claim superior to any other taxing jurisdiction. As reported by the New York Bar Association, this would raise serious Constitutional issues which we want to avoid

if at all possible. In my opinion, therefore, our state would not approve of most apportionment formulas now being studied.

It is believed that other states have situations similar to ours whether it be copper mining, iron mining, coal mining, oil wells, architectural firms, construction contracting, timbering, etc. In the end a Congressman will usually vote the way his constituents want him to vote and, if they want their states' rights protected, this is the way he is going to vote.

As I see it, then, the alternative to an apportionment formula is to establish some plan that will gain the support of all states by retaining states' rights in this field.

On page 33 of the New York Bar Association report it is stated:

> "In our view, formula apportionment should not be permitted to take the place of specific rules for assigning each of the more common types of allocable income to the State having the most meritorious claim to tax that particular type of income . . ."

On page 34 they go on to say:

> ". . . the growing misuse of the Uniform Act reinforces the desirability of Federal legislation to provide improved standards for allocation and apportionment of the income of multistate enterprises among the states."

Using this report as my basic philosophy, I have prepared the attached "Preliminary draft of basic concepts to be included in an updated UDITPA formula proposed for inclusion in the Interstate Taxation Act".

In this draft I have gone a step beyond what the New York Bar Association has proposed in that I would allow what I feel would be a concession by tax administrators to industry to allow "any group of controlled corporations to have a parent company without operating activities to be taxed only by the state or country of its commercial domicile; providing that it had no income other than dividends or capital gains on security transaction".

To me this concession would go a long way towards solving the dividend taxation problem so prevelant today between states and would also set up a plan for the solving of many multinational corporation tax and dividend problems in this field.

I wish to thank you for the chance to file this report with you and hope it will be of value. Should I be of any additional help in explaining these thoughts, I would be glad to go into them as you may request.

Preliminary Draft of Basic Concepts To Be Included in an Updated UDITPA Formula Proposed for Inclusion in the Interstate Taxation Act

1. Any state should be able to impose its income tax on all allocable income to which it has a more meritorious claim than any other state or country.

2. Any group of controlled corporations with 50% or more ownership by a parent should be permitted to have one parent holding or investment company taxable only by the state or country of its commercial domicile. As long as that parent company had no operating activities in any state or country, it would be taxed on its dividend and net security transaction gains only.

3. The lending of money by such a parent to a subsidiary or the receipt of royalties by a parent from any source would constitute an operating activity subjecting all its income to apportionment during the period of such a loan or royalty agreement.

4. There is to be no such thing as "nowhere income".

5. Restriction of income taxable by the states is not to include a restriction similar to IRS Section 482 (as required under Federal law) but is to cover all worldwide income of a corporate organization allocated or apportioned under the updated UDITPA formula.

6. Income derived principally from manufacturing, processing and sales activities is to be considered as income apportionable under the optional three factor formula.

7. Income derived principally from mining, petroleum productions, etc. is to be considered as allocable to the state or country from which the ore, oil, etc. was extracted.

8. Income derived principally from construction contracting is to be considered as allocable to the state or country where the work was performed with a reasonable allowance for distribution of head office expenses.

9. Income from dividends and capital gains and losses from security transactions (not taxable to the non-operating parent company), interest, royalties and

gains and losses on capital assets other than securities are to be considered as apportionable income inless it can be proved that a single state or country has a more meritorious claim on this income than any other, in which case the income would be considered allocable to that state.

10. The only expenses to be allowed a non-operating parent company would be directors fees and expenses, dividends paid and expense of keeping corporate records. Salaries of officers holding operating division jobs would be chargeable to those divisions.

11. Research and development expenses may be capitalized or considered to be operating expenses and either allocated or apportioned at the election of taxpayers. Income resulting from such expenses must be allocated or apportioned on the same basis as original expenses were handled unless it is clearly evident that such a basis would not be reasonable.

12. All corporations would be required to report to each state the allocation and apportionment factors being reported to all other states or countries in which there was jurisdiction to tax. This report would be due within 6 months of the date required for filing the original return.

13. Corporations controlling 50% or more of the voting stock of a subsidiary or affiliate must include such corporation's allocation and apportionment factors in their reports of activities to each state or foreign country so requesting this information.

14. Corporate organizations divided into distinct groups or divisions based upon specific activities such as transportation, mining, manufacturing, etc. (all responsible to one non-operating parent company) may elect to file division reports only to those states in which they are liable to tax. However, this option would be available only as long as all relationships with other divisions were carried on as arm's length transactions.

15. Once adopted it would be mandatory that each state use this revised UDITPA formula for allocation and/or apportionment of income taxable in its state.

16. Any disputed items would be appealed from state tax administration decisions to (1) state courts and then (2) to the Federal courts on the basis of what is or is not equitable.

STATEMENT BY JOHN H. HECKERS, EXECUTIVE DIRECTOR, DEPARTMENT OF REVENUE, STATE OF COLORADO

We realize the millions of dollars that have been spent on lobbying over the past few years for restrictive federal legislation that would carve out large areas of preferential exemption for interstate businesses.

Those of us in charge of the tax departments of each of the states have a duty under the laws to represent the interests of *all* the people of the state—without prejudice to the local businesses or the interstate operators. Many of the people appearing before this committee spoke eloquently for the special interests they represent. I hope that my 2.3 million clients will receive equal attention.

The State of Colorado is no different from all the other states—we have a few large operators who by carefully arranging their affairs stand to benefit a great deal if S.1245 passes. We have a couple of mail order houses who want to exploit the markets of the other 49 states without being accountable to anyone. Their "fair share" of taxes adds up to "no share" of the taxes under the protective guise of interstate commerce.

At every congressional hearing on the subject of state taxation of interstate commerce, assertions have been made that some businesses *might be* taxed on more than 100% of their net income. The tax administrators have been looking for a taxpayer's case like that. If there is such a case, the tax administrators would certainly like to correct it. I think it is significant that despite broad allegations of duplicative taxation no evidence has ever been presented to this committee, or previous committees, to prove its existence. It would be a simple matter for a taxpayer who can show his tax return to whomever he chooses, to show you his tax return to give some substance to the vague claim of unfair taxation. If there is such a case, the proponents of federal legislation would have presented it as evidence before this committee.

Over and over again the taxation of interstate commerce by the states has been described as "chaotic". In this country, uncertainty and undefined legal areas result in litigation. Tax disputes result in litigation because the pocketbook is the tenderest spot of the human anatomy. To illustrate the fact that chaos is not

rampant in this area of taxation, I invite your inspection of the docket of the United States Supreme Court, both past and present, as to the number of state tax cases considered. Seven or eight state tax cases before the Supreme Court indicate that the amount of "chaos" in the state tax field is infinitesimal when compared to the scores of school cases before the Court.

Can standards be legislated by the Congress to define exactly what taxes are a "burden on interstate commerce?" In all the proposed federal legislation of recent years, the proposed answer has been: "If Congress will exempt wide areas of interstate operations from any state taxation there will be no burden on interstate commerce". This is not a logical answer.

The courts over a period of many years have set out a series of rigid guidelines concerning state taxation of interstate commerce.

If such an unfortunate occurrence as this bill (S. 1245) passing should happen, taxpayers and states will still be approaching the courts as to the constitutionality and applicability of the standards of S. 1245.

In my opinion, the current cries for uniformity and ease of compliance are somewhat misplaced. Considerations of equity and justice are much more important elements to be considered in the tax systems.

Congress can achieve simplicity and uniformity in the federal and state tax systems by passing a bill. But taxing the blind seventy-year-old pensioner the same as the affluent business executive is not the American way.

For several years now, advocates of federal legislation to restrict the states have said to the states: "You can't stand up before Congress and oppose Federal legislation. You've got to offer some alternatives. You can't always be *negative.*"

Coming through the wires into this building are both positive and negative currents. Without the negative charges, we would be sitting here in darkness. Eight out of the ten commandments are negative. We don't think that it is a sin to be against a bill.

We do suggest one alternative to passing out this bill—kill it! That's the most positive thing you could do. The most negative thing we can do for the states is to be positive about this bill.

Lest you think that the State of Colorado is mired down in the status quo and sees nothing correctable in our state taxing systems, let me hurriedly say that we are not dwelling in the past.

In 1964, we hanged our state income tax to follow the Federal income tax. Administratively, we made many changes while trying to alleviate the corporate taxpayer's irritants. We abolished the outstate audit charge. We adopted the Uniform Division of Income for Tax Purposes Act so that interstate business could get uniformity. We adopted the Multistate Tax Compact because we believe in voluntary, cooperative, self-help programs for the states. We do not tax household goods of a taxpayer brought into Colorado by a nonresident of this state after first bona fide use in another state.

The Willis Subcommittee report of 1966, once cited as the most authoritative study of state taxation of interstate commerce, is as out of date in 1973 as last year's list of defeated candidates.

The State of Colorado is unalterably opposed to the enactment of federal legislation such as S. 1245 which is now before you. This bill nationalizes the state and local tax system.

The federal system is a fragile and delicate system. It requires infinite wisdom to know when and where to juggle with this balance. This decision is in your hands. Thank you.

STATEMENT OF THE IDAHO STATE TAX COMMISSION SUBMITTED BY EWING H. LITTLE, COMMISSIONER

The State of Idaho, like other states who have testified before the Subcommittee on State Taxation of Interstate Commerce, has a vital interest in the pending bills on taxation of interstate commerce. Like other states who have testified before the Subcommittee, Idaho is keenly interested in any legislation that might either impair Idaho's ability to fairly tax interstate commerce, or increase Idaho's ability to fairly administer its revenue laws and collect taxes from businesses involved in interstate commerce now unlawfully evading those taxes.

In accordance with the previous expressions from the Subcommittee indicating a desire that states, where possible, present joint statements, the State of Idaho has joined in and concurs with the expression of views presented by Mr. Eugene

Corrigan, Executive Director of the Multistate Tax Commission. We trust the Subcommittee will understand that our support of the views expressed by Mr. Corrigan is complete and we have refrained from presenting a complete statement of those views because of the Subcommittee's desire to consolidate views where possible.

Several bills already presented to Congress would make far-reaching changes designed to ease the burden of state taxation of corporations engaging wholly or in part in interstate commerce. Idaho does not oppose the easing of the burden of unnecessary record keeping by multistate corporations; it does strenuously oppose legislation that will give large multistate or multinational corporations an exemption from state taxation not enjoyed by all commercial enterprises. We feel the approach embodied in S. 1245 has this undesirable effect.

Idaho believes that any bill that is to provide a workable solution to current problems in state taxation of interstate commerce should emphasize the key problem in state income taxation of interstate commerce; the lack of full accountability on the part of large multistate or multinational corporations. Practical experience in the revenue laws of this state has fully demonstrated that the overwhelming single source of conflicts and expense for both taxpayers and revenue officers comes from the lack of a concept of full accountability for all income. Large multistate and multinational corporations have repeatedly been shown to pay taxes on only a small segment of corporate income; substantial portions of their income is treated as "earned" in states in which such taxpayers contend they have no nexus and are not doing business.

The solution to the problem of lack of full accountability lies, in large part, in approval and consent to the Multistate Tax Compact which, through its joint auditing program, has the capability of insuring full accountability. We vigorously urge that Congress consent to the Multistate Tax Compact.

Idaho believes that consent to the Multistate Tax Compact would substantially solve problems involved in income and sales taxation of interstate commerce and urges Congress to approve that Compact and allow it a reasonable number of years in which to demonstrate its ability to solve problems in state taxation of interstate commerce.

However, if Congress determines it advisable to enact substantive provisions governing state taxation, we urge Congress to carefully consider the following considerations:

(*a*) No federal act should grant multistate or multinational businesses a blanket exemption of dividends nor an unrealistic allocation of such dividends to a state based upon the fiction of commercial domicile.

(*b*) The technique of combination or consolidation should not be restricted; state taxation cannot hinge on the fiction of separate corporate entities for businesses that do not operate on a daily basis as separate entities.

(*c*) The "business location" test should not be adopted; Congress should instead carefully consider repeal of PL 86-272, insofar as it pertains to large multistate or multinational corporations having a sophisticated financial record keeping capability.

(*d*) To insure full accountability, Congress should not mandate against the so-called sales "throwback" rule; Congress should not place its stamp of approval on the argument of multistate and multinational businesses that they earn substantial portions of their income in states in which they do not do business or have nexus.

(*e*) The jurisdiction of federal courts should not be expanded to include litigation involving state tax revenues. If federal court jurisdiction is to be permitted, it should be patterned after the federal Interpleader Act and authorize jurisdiction of federal courts only upon an actual showing by a multistate corporation that it is in fact being taxed upon more than one hundred per cent (100%) of its income.

Statement of Donald H. Clark, Commissioner, Indiana Department of Revenue

I appreciate this opportunity to present my views on S. 1245 and the principles it encompasses.

As the Commissioner of the Indiana Department of Revenue I oppose any federal legislation which would limit the states' ability to tax multi-state businesses. There is no necessity for Federal intervention in the area of substantive standards regulating the state taxation of interstate commerce. Co-ordination and

co-operation of the states, individually, and through the Multistate Tax Commission, serve to fairly apportion corporate income for state taxation purposes.

I would not propose that any corporation be taxed on the same income by multiple states. Likewise I would not propose that vast segments of corporate income be "untouchable" where state income tax liability is concerned.

Rather than Federal intervention in this area, I would postulate that effective state tax administration with respect to multi-state business might best be served by the services of a state-operated, state-controlled, and state-oriented agency. Such an agency working within the present framework, could promote uniformity in tax administration practices, share information among the states, and participate in a multiple audit program. Such a single, co-ordinated approach would eliminate the "shot gun" multiple audit technique necessitated when the states individually audit a multi-state corporation.

Such a state-operated, state-controlled, and state-oriented agency exists today in the form of the Multistate Tax Commission, which Indiana joined in 1971. Twenty-one states have moved into full membership by adopting the Multistate Tax Compact. An additional 15 states have joined in the commission as associate members. Thus, the Multistate Tax Commission already exists as the logical agency through which problems of interstate taxation be resolved.

Rather than discouraging and impeding the efforts of the Multistate Tax Commission, I would suggest that you lend further support to its operation—namely by encouraging and consenting to its activities.

In the few years of operation of the Multistate Tax Commission, the states have been making steady progress toward reduction and resolution of interstate taxation problems. As the states' levels of efficiency in this area have increased, we've repeatedly realized that non-uniformity in such matters has worked to the detriment of the states, and, thus, not surprisingly to the advantage of multistate business.

It is completely understandable then, in light of this, why the multi-state businesses would strongly favor the adoption of S. 1245 and the limitations it will place on the tax collection jurisdictions of the states. Likewise, one can readily see why the states would oppose federal legislation which would further limit their authority to levy and collect taxes, and in so doing place a heavier burden on the small taxpayer.

The taxpaying public, ever conscious and resentful of tax "loop holes", will doubtlessly look upon legislation such as this as a "gate" through which the multi-state corporate taxpayer can walk, untouched in many cases.

Broad exemptions such as those proposed in S. 1245 should not be enacted in the name of uniformity.

Uniformity can be obtained through the efforts of the states working in concert and with the multi-state business community to solve the problems of multistate taxation which do exist.

The solutions to these problems undoubtedly are not instantaneous. But reason, experience, and knowledge applied in good faith to the problems will provide resolution. The states, through the unified entity which is the Multistate Tax Commission, can accomplish this end. In my judgement Federal legislation along the lines of S. 1245 provides further fragmentation rather than the unification it proposes to seek.

Statement Filed on Behalf of the Finance Administration of the City of New York

The history of the recent past underlines more clearly than ever before the frequently colliding interests of business and government in the field of state and local taxation.

Quite clearly, business will not flourish in an atmosphere laden with restrictive and onerous taxation. Similarly, government cannot provide the healthy and progressive conditions essential to the well-being of business, and indeed to all of its inhabitants, unless public revenues are available to provide the services and facilities which an enterprising and forward-looking community deems itself entitled to enjoy today.

The accommodation of the respective interests of taxpayers and government, where such interests conflict with each other, is one of the most difficult arts in government. Indeed, it is to that end that your Subcommittee and those of us who seek to contribute to its information, address ourselves.

Where interstate business rather than only "local" business, is involved, the problem is an even more complex one, for bound up in it is the desirability for the states and localities, as part of a nation-wide scheme, to follow rules of taxation that are reasonably uniform and so to minimize the effort and cost of compliance on the part of taxpayers. In this context, if the economic and social interests of all states and localities were identical, the solution—although not easy—would certainly be within fair grasp. But since our nation has ever been composed of many diverse parts, with varying concerns, the efforts to achieve an accommodation between taxpayer and government have thus far been labored and prolonged. Ample evidence of this fact is found in the history of the past 15 years, ever since the Supreme Court rendered its historic decision in *Northwestern Cement*, a period in which the Congress, the states and localities, as well as the business community, have sought, thus far in vain, to achieve a workable solution to the problem of establishing a fair framework within which state and local taxation of interstate business can operate.

In New York City we are seriously concerned over the handling of this problem in the bills presently under consideration by your Subcommittee. The City levies corporate income taxes on domestic and foreign companies doing business in the City, and in 1969 the City's taxing jurisdiction was expanded to include, in addition to corporations doing business in the City, any corporation which maintains an office, or employs capital, or owns or leases property, in the City. In addition, the City imposes a 3% sales and use tax which is collected for it by the New York State tax authorities.

Since the revenues produced by these taxes are vital in meeting the City's ever-increasing need for funds for essential public services and facilities, we feel it is incumbent on us to express to you our views regarding the measures now before you.

With these preliminary observations, we turn to a consideration of the major provisions of the bills insofar as they affect the City of New York.

JURISDICTION TO TAX

We conceive the basic aim of federal legislation in this field to be neither the limitation nor the enlargement of the states' and cities' taxing powers, although manifestly such a result will follow in some cases—we trust without major effect—in the wake of legislation.

Rather, the prime purpose of legislation, in view of the background and history of the problem, should be the minimization for business of the burdensome effort and cost of complying with varying state laws, while conserving for the several taxing jurisdictions the revenues needed to render their essential public services. In this connection, we recall particularly the words of Mr. Justice Frankfurter, dissenting in *Northwestern Cement*, that the decision in that case would impose on small and moderate size businesses "large increases in bookkeeping, accounting, and legal paraphernalia to meet these new demands. 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 * * *."

Viewed this way, the establishment of a uniform jurisdictional standard based on a "business location" seems to us to impinge needlessly on the revenues of the states and cities. Although the provisions of both bills appear at first blush merely to codify the jurisdictional standards already prescribed by Congress and the Supreme Court (for example, Public Law 86-272, the *Northwestern Cement* and companion cases [income tax], and the *Scripto* and *Bellas Hess* cases [sales and use taxes]), in fact the provisions go beyond established rules insofar as they may restrict and right to levy an income tax where the tax, under the *Roadway Express* case, is imposed, as it is in the case of New York City, for the privilege of employing capital in a state, or where property is regularly installed or repaired in a taxing jurisdiction, or even perhaps where there is regular and persistent solicitation.

Fully mindful that uniformity of taxation is desirable from the standpoint of interstate business, we nevertheless question its essentiality or desirability where the matter of jurisdiction is involved. A "business location" test, in our judgment, unduly restricts the ability of states and localities to require some recompense from the corporations which may have a substantial nexus with the state, although falling short of a "business location" as defined in the bills. The variety of factual situations that can arise in the context of a multi-state enterprise requires a flexible approach that would be unavailable under the proposed standard. The business activities pursued by a corporation in a particular jurisdiction may or may not be extensive; such activities, in any case, however, are well-known

to it and pose no need for uniformity. Where it is held that a sales office in a taxing jurisdiction staffed by but one secretary and one salesman subjects the corporation to taxing jurisdiction (see *Northwestern Cement*), and the bills under consideration also so provide, does it not violate basic notions of fairness to say that unless a corporation maintains such a "business location" it is not open to taxation regardless of its other far-flung activities in the state producing a substantial volume of business?

To the extent that a "safe harbor" for corporate activity would be useful, it is my belief that the minimum jurisdictional standard contained in Public Law 86-272 more nearly safeguards the interests of the states and cities, while giving recognition to legitimate concerns of interstate businesses.

Further, we note that the "business location" test appears to make no distinction between domestic corporations and foreign corporations. Insofar as the bills would permit a corporation to escape taxation in the state of its incorporation, we believe the bills needlessly interfere with the traditional prerogatives of the states in this area.

Additionally, the bills would apparently deny a political subdivision of a state the power to levy a tax on corporations without a business location within its boundaries, although a business location may exist elsewhere in the state. Again, this would permit a corporation to conduct substantial operations in a particular locality from a base in an outlying area, thereby avoiding its fair share of taxes in that locality.

In our view, corporations which choose to avail themselves of a state's markets and derive benefits from the governmental services, as indeed is their right, owe a correlative duty to contribute to the cost of those services. In light of economic conditions today, and absent effective revenue sharing formulas, we believe that great care should be taken to avoid unduly restrictive Federal limitations on state and local taxation, which would hamper the ability of the states and localities to fashion laws which will not only meet their revenue needs for the benefit of local business and inhabitants, but also establish a climate in which interstate business can thrive.

APPORTIONMENT

Although a case might reasonably be made for the position that a distortion of the sales factor can result if sales destined for states in which a corporation is not taxable are included in the denominator of this factor, hence such sales should be attributed to the originating state, as is provided in S. 2092, it seems to us that such a rule not only enlarges the tax obligations of business but also imposes a substantial administrative burden on taxpayers to make determinations as to liability that are open to reversal upon review, thereby altering the amount of tax liability in all other taxing jurisdictions to which the taxpayer reports.

Accordingly, we prefer the position on this score taken in S. 1245, which indeed is the course followed by the New York City corporation tax law. On the whole, it works well, and it is simpler both for taxpayers and tax-gatherers.

APPORTIONABLE INCOME

(1) Under the bills, dividends are excluded from apportionable income, nonsubsidiary dividends being specifically allocated to the taxpayer's state of commercial domicile (S. 1245, §§ 207, 208; S. 2092, § 306). Such an allocation, in our view, may not accurately reflect the source of the income. New York City presently allocates nonsubsidiary dividends in accordance with the apportionment percentage in the City of the issuing corporation, a rule which has worked well in practice, and which, in our judgment, results in a fair attribution of dividend income.

(2) Excluded from apportionable income under both bills is income from sources outside the United States, subject to proper attribution of expenses allocable thereto (S. 1245, § 207; S. 2092, § 306). Consistently with the views I hold on apportionment, discussed above, we perceive no valid reason for excising foreign-source income from a corporation's total business operations, for purposes of arriving at a determination of its apportioned liability in a particular state or locality.

New York City's present taxing statute includes income from foreign sources in entire net income subject to apportionment. We believe that this approach produces an equitable attribution of corporate income to the taxing jurisdiction, and avoids the difficult apportionment problems inherent in the proposals now under consideration.

(3) For purposes of the exclusions mandated by both bills, it is provided that no state may make any offsetting adjustment of an otherwise allowable deduction (S. 1245, § 207; S. 2092, § 306). This provision appears to us to be an unwarranted and needless departure from the well-established and thoroughly fair principle that no deduction should be allowed for expenses incurred in the production of tax-exempt income.

LOCAL SALES AND USE TAXES

We vigorously oppose the provision in both bills (S. 1245, § 306; S. 2092, § 405) which would exonerate sellers, except in certain instances, from collecting *municipal* sales and use taxes otherwise collectible by them for states, unless a state-administered tax program at "the same combined" state-local tax rate exists.

Worthy as may be the purpose to lighten the tax collection obligations of vendors, such obligations weigh lightly compared to the fiscal needs of our cities today. We do not believe that the burdens on vendors in this instance are so onerous as to justify depriving localities of a significant source of vitally-needed revenues. In this instance the bills clearly undo for the cities the unequivocal Supreme Court holdings in *General Trading* and *Scripto*, which are retained for the states. In our judgment, it is simply unfair to enact such a substantive change in the interests of convenience.

New York State does administer a combined state-city sales and use tax, but at rates that vary for different localities. Accordingly, if this provision were to be enacted, the City of New York, which provides a huge market for nonresident sellers acting through salesmen and independent sales representatives, would suffer material revenue losses.

LIABILITY FOR UNASSESSED TAXES

Under each bill (S. 1245, § 529; S. 2092, § 522), states and cities would be denied the power to assess, after the date of the bill's enactment, any taxes for prior periods, if such jurisdictions would not have had the power to make an assessment had the bill's jurisdictional standards been in effect during such earlier periods prior to enactment. Such a provision, in effect, grants an amnesty to taxpayers who violated existing tax statutes. We can see no reason for such forgiveness of delinquent taxpayers, who indeed, by reason of failure to file returns, may have been guilty of criminal offenses. Such a provision may well encourage noncompliance in anticipation of enactment of a bill. Further, it could propel some jurisdictions to make hasty assessments in order to avoid this deadline. The several states and the localities should retain, it seems to us, the power to assess taxes due and payable for periods prior to the effective date of a Federal statute.

CONCLUSION

We wish to express my appreciation to the Subcommittee for this opportunity to present for its consideration, in the context of S. 1245 and S. 2092, our views on the proper scope of Federal regulation of the states and cities in their tax treatment of interstate business. The problem is an enormous one; just and satisfactory solutions are difficult to construct. Not only must we give heed to the co-existing federal-state powers under the Constitution—the power to regulate interstate commerce on the one hand, the reserved power to tax on the other—but we must also consider the need to balance and reconcile with each other the convenience of taxpayers and the taxing powers of the states. With this in mind, it must still be said that no solution that fails to substantially meet the needs of all interested elements will, in the long run, work out satisfactorily.

STATEMENT ON BEHALF OF THE ROCHESTER TAX COUNCIL

The Rochester Tax Council was formed in 1969 as a volunatry group of companies located in the Rochester, New York, area. Membership in the Council presently includes the following corporations: Bausch & Lomb, Inc., Champion Products Inc., Corning Glass Works, Eastman Kodak Company, R. T. French Company, Gannett Company, Inc., Garlock, Inc., Gleason Works, The Schlegel Manufacturing Company, Security New York State Corporation, Sybron Corporation, and Xerox Corporation.

The members of the Council collectively manufacture a wide variety of high technology products that are sold in national and international markets. They therefore favor the prompt enactment of federal legislation that would result in some measure of uniformity in the jurisdictional standards to be applied by states and local governments in the taxation of corporations doing business in interstate commerce and that would establish maximum limitations with respect to the bases for income and capital stock taxes and the apportionment formulae applied thereto. It is the opinion of the members of the Council that the Interstate Taxation Act of 1973 (S. 1245), which is presently being considered by the Finance Subcommittee on Interstate Taxation, would provide such uniform standards and limitations and thus enable businesses operating in interstate commerce to be more certain of their tax liabilities in the various states.

The "business location" jurisdictional standard contained in S. 1245 for the imposition of a corporate net income, gross receipts or capital stock tax would provide a uniform minimum jurisdictional test not presently existing under the various state laws and would free an out-of-state business with few economic contracts in a state from the administrative burdens resulting from its being required to comply with such state's income tax laws.

The basic sales and use tax jurisdictional standards proposed in S. 1245 would represent a codification of existing restrictive jurisdictional standards established by the Supreme Court. The Council believes that a "business location" jurisdictional test should also be applied in the sales and use tax area. If the proposed jurisdictional base for sales and use taxes is retained, however, the registration number procedure contained in S. 1245 is essential to enable small and medium-sized businesses to compete in states in which they do not have a business location. Another provision in S. 1245 that would provide a major benefit to interstate sellers is the provision that would prohibit the thousands of political subdivisions that impose sales and use taxes from requiring a seller to collect a sales or use tax on an interstate sale unless the seller has a business location in or makes regular deliveries into the subdivision or unless the local tax is imposed in all geographic areas of the state at the same combined and local rate, is administered by the state, and is uniformly applied.

The optional three-factor formula contained in S. 1245 would establish a uniform maximum formula for the division of capital and income among the states, beyond which the states could not tax. Such a maximum formula is essential to provide an equitable apportionment of income among the states and to provide a uniform method of apportionment that would ease the compliance burdens of businesses operating in interstate commerce. In addition, the straight destination test for assigning sales to a particular state would result in greater equity to and fewer administrative problems for multistate businesses.

The above provisions would halt the growing trend toward "Balkanization" of the interstate market: One state, Iowa, recently adopted an income apportionment formula based solely on sales on a destination basis; two states, Florida and Wisconsin, recently adopted three-factor income apportionment formulae that give double weighting to the destination basis sales factor. All three formulae result in a substantial element of double taxation for interstate taxpayers delivering goods into the state from a state that has adopted the standard three-factor formula.

Further consideration should be given to the definition of wages in section 203(c) of S. 1245. Total wages paid in a state for unemployment compensation tax purposes, rather than taxable wages subject to unemployment compensation tax, would more accurately reflect company activity in a particular state.

The Council strongly supports the provisions of S. 1245 which would exclude from both apportionable and allocable income intercorporate dividends and dividends from foreign sources. Such provisions, which are similar to the provisions of the Internal Revenue Code relating to the federal taxation of dividends received from domestic affiliates and from foreign corporations, are essential to prevent double taxation.

S. 1245 contains the additional favorable feature of excluding from apportionable income all net income from sources outside the United States, as that term is defined for federal income tax purposes. Such a provision would prohibit the present practice of a few states that attempt to tax foreign source income by utilizing the so-called "unitary business" concept of taxation to include the income of both domestic and foreign affiliates in the apportionment formula of a corporation having a business location in the state. It is apparent that the draftsmen of S. 1245 intended that "Subpart F income" be included in the definition of foreign

source income; however, section 862 of the Internal Revenue Code does not expressly define Subpart F income as income from sources without the United States. Therefore, S. 1245 should be amended to expressly provide that Subpart F income be excluded from both apportionable and allocable income.

The Council also supports the consolidation provisions contained in S. 1245, which would permit a state to require consolidation of the apportionable income of related domestic corporations only if they are found to be engaging in non-arm's length transactions and which would prohibit a state from requiring consolidation with foreign corporations or corporations that derive 50 percent or more of their gross income from sources without the United States.

Further consideration might be given to prohibiting consolidation in all events and including a provision in the bill, similar to the last sentence of section 209(b), that would allow states to make section 482 type adjustments when domestic corporations are found to engage in non-arm's length transactions. The bill as drafted, however, would alleviate the serious inequity resulting from the current practices of those few states that require the income of so-called unitary businesses to be consolidated or combined at a time when most states forbid such consolidation or combination. In addition, S. 1245 would prohibit the current grossly inequitable and constitutionally questionable practices of a few states, such as California, that attempt to tax the foreign income of the foreign affiliates of a corporation doing business in the state. For example, California has further enlarged the unitary business concept in an effort to include in the apportionable tax base of a corporation subject to its taxing jurisdiction the worldwide income of such corporation and its foreign affiliates. Federal legislation is urgently needed to prohibit such a practice, which clearly conflicts directly with the international tax policies of the federal government.

S. 1245 would provide uniform rules and maximum limitations so that multistate businesses could be more certain of their liability for income, sales, use and other taxes imposed by the various states and thousands of local political subdivisions. The Rochester Tax Council urges prompt Senate action on this bill.

Statement of William D. Dexter, Assistant Attorney General, State of Washington

SUMMARY OF PRINCIPAL POINTS

1. The stated objective and legitimate purpose of any federal legislation in the area of state taxation of interstate commerce is embodied in the report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on Judiciary, House of Representatives. These basic objectives should not be lost sight of by this Subcommittee in considering the various proposals presented.

2. The states without the aid of any congressional legislation have sought to implement these objectives by the adoption of uniform legislation, promulgation of uniform rules and regulations and the creation of the Multistate Tax Commission. Federal legislation in the field of state taxation of interstate commerce should further and be supportive of the unilateral effort of the states by the Multistate Tax Commission and other state representative organizations such as the National Association of Tax Administrators, the Governors' Conference, the National Association of Attorneys General and Council of State Governments to meet these objectives and purposes.

3. Proposed federal legislation such as S. 1245 does not implement the objectives of the Special Subcommittee on State Taxation of Interstate Commerce and the Multistate Tax Commission, which is to produce a more equitable tax system and to alleviate undue administration and compliance burdens. Rather, S. 1245 is primarily designed to carve out vast areas of state and local tax immunity and preference for selected multistate businesses at the expense of state and local revenues and the remainder of the business community. Illustrations of this are the assignment of income by the optional three-factor apportionment formula to states which are denied jurisdiction pursuant to its provisions to impose an income tax and the exemption of major sources of corporate income from any taxation whatsoever.

4. Congress should not legislate in the area of state and local substantive tax law except where absolutely necessary (i) to strengthen the state's ability to require multistate businesses and "interstate commerce" to pay their fair share

of state and local taxes; (ii) to prevent the states from exposing multistate taxpayers to tax burdens not imposed on intrastate businesses and (iii) to alleviate unnecessary and costly compliance and administrative costs. In no event, should Congress substitute its judgment for that of the states in the absence of a clearly known, defined and overriding federal policy.

DISCUSSION OF PRINCIPAL POINTS

1. *Any federal legislation in the area of state taxation of interstate commerce should not violate any of the basic principles set forth in the report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives.*

Following authority granted in Public Law 86-272, Congress created the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives. After extensive hearings and considerable research by a competent staff, this Special Subcommittee issued a report in four volumes covering in depth all aspects of state and local taxation of interstate commerce and submitted to the 89th Congress HR 11798. While HR 11798 was a subject of attack by many of the states and their representative organizations and large multistate and multinational business organizations, HR 11798 did embody the basic principles which are well documented by the report of the Subcommittee which should not be lost sight of here because of controversy over the implementation of those principles by HR 11798.

The Subcommittee report and its implementation by HR 11798 embodies the following basic principles:

(a) There is provision for "full accountability" by multistate corporations to the states collectively of any state and local taxes covered by the report and the bill. This simply means that multistate businesses are required to pay the same state and local tax burden as required of locally based businesses. The Special Subcommittee report and HR 11798 did not contemplate carving out areas of immunity and exemption from state and local taxes of multistate and multinational corporations. Thus, if jurisdiction were denied one state to impose a tax on particular income or a particular transaction or receipt, this jurisdiction was affirmatively granted some other state. As will be indicated below, this has not been the case with legislation such as S. 1245.

(b) In implementing the principle of "full accountability", the Subcommittee report and HR 11798, there was congruence between the jurisdictional rules and apportionment rules. This simply means that if a state is denied jurisdiction to impose a particular tax, no part of such tax base will be attributable to the state denied jurisdiction to tax. Furthermore, the states which have jurisdiction to tax are given the power to reach 100% of the tax base. As will be demonstrated, this principle is also violated by S. 1245.

(c) All income of a taxpayer was subject to apportionment. The apportionment of all income of a multistate or multinational corporation simply gives recognition to the principle that a corporation's income is business income and it is all attributable to the jurisdictions in which a corporation carries on its activities. In essence, the apportionment of all income adopts the principle that the intangible properties and income derived from these properties is utilized in furtherance of the general business of the corporation. As will be indicated below, this principle is not incorporated in S. 1245 as pertains to dividend income which has not been exempt.

(d) In order to achieve uniformity, the Subcommittee report and HR 11798 provided for mandatory apportionment rules (not optional rules as contained in S. 1245 and other proposed federal legislation) and centralized administration and adjudication of any federally prescribed apportionment rules. While representatives of the states and the business community both oppose mandatory apportionment rules and central administration by a federal agency, there is a recognized need of providing for some centralized administration and interpretation of any congressionally prescribed substantive standards. Currently, this function is being discharged on an advisory basis by the Multistate Tax Commission. While the strengthening of the role of the Multistate Tax Commission and congressional support of the Multistate Tax Compact would not go as far as contemplated by the Subcommittee report in reference to centralized administration it is a minimal step that Congress should take if the basic principle of the subcommittee report is accepted concerning the need of centralized administration.

The above is not intended to be an exhaustive analysis of the ideas or principles set forth in the Special Subcommittee report or HR 11798. They are made here

with the intent of placing any suggested federal legislation in the context of the basic report and initial implementation legislation (HR 11798). In its summary of recommendations the principles are stated as (1) ease of compliance, (2) no loss of state revenues, (3) a single jurisdictional standard, (4) uniform attribution rules and (5) congruence between jurisdiction and the attribution of tax bases. (Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, Volume 4, pages 1133–34.)

Inasmuch as the Special Subcommittee recommendation and study have constituted the foundation for any proposed federal legislation, Congress should enact only federal legislation that is compatible with the basic principles of the Subcommittee report. If proposed federal legislation does not produce greater uniformity, does not ease compliance burdens, or has serious effect on a state's revenue by violating the principles full accountability and congruence between apportionment and jurisdictional rules, such federal legislation is completely incompatible with the Subcommittee Report and does not constitute a proper subject matter of congressional legislation.

Since the cooperative efforts of the states by the compact and Multistate Tax Commission approach have made substantial progress in alleviating the major difficulties envisioned by the Subcommittee in its report,.there is a serious question of the need for any substantive federal legislation at this time. Congressional support for this cooperative state effort may well be all that is needed at this time.

2. *Federal legislation in the field of state taxation of interstate commerce should further and be supportive of the unilateral effort of the state to meet the objectives and purposes of the Special Subcommittee report.*

One of the basic assumptions of the Subcommittee report was that the states would not or could not cooperate in solving the administrative and compliance problems found to exist by the Subcommittee concerning state and local taxation of multistate businesses. A majority of the states did not accept this premise of the Special Subcommittee. They thus sought to prove that cooperative efforts of the states could make a significant contribution in alleviating the problems of non-uniformity, undue compliance and administrative burdens and the elimination of discriminatory practices because of lack of proper enforcement which the Special Subcommittee found to exist in the area of state or local taxation of multistate businesses. This resulted in the creation of the Multistate Tax Compact and the Multistate Tax Commission.

Other testimony has indicated to this Subcommittee the objectives, efforts and accomplishments to date of the Multistate Tax Commission. Irrespective of the shape, form or extent of any federal legislation, Congress should give its consent to the Multistate Tax Compact and strengthen the role of the Multistate Tax Commission as an administrative agency to work for uniformity and alleviate unnecessary compliance and administrative burdens as pertains to state and local taxation of multistate businesses. An indication of what such an agency can accomplish should be examined in light of its accomplishments to date against belittling and strong opposition of the most powerful business interests in this country, which envision any accomplishment of such a commission as a serious threat to their effort to obtain from Congress tax preferences and exemptions such as that contained in S. 1245.

3. *Proposed federal legislation such as S. 1245 does not implement the objectives of the Special Subcommittee and the Multistate Tax Commission which is to produce a more equitable tax system and to alleviate undue administration and compliance burdens.*

The current business proposal for federal legislation is contained in S. 1245. This bill and its explanation beginning on page 4848 of the Senate Congressional Record of March 15, 1973, was drafted and is being promoted by the Committee on State Taxation of the national organization of the states' Chambers of Commerce. By and large, this committee represents the interests of large multistate and international corporations. The explanation of the bill is inaccurate and misleading and does not indicate the true purport and effect of S. 1245. It is interesting to note that the group that : ipport its enactment by the Congress constituted the group that was created to defeat congressional passage of HR 11798. This alone indicates the difference between the substance of legislation such as S. 1245 and the Special Subcommittee's justification and purpose of any federal legislation at all, such as that embodied in HR 11798.

As heretofore indicated, the study of the Willis Subcommittee, its recommendations and the statutory implementation of those recommendations in HR 11798 of the 81st Congress did not violate the principle of "full accountability." The states, within the framework of HR 11798, collectively retained the power, subject to some federal administration and interpretation, to require corporations to fully account for all of their income, gross receipts, sales and use tax, and franchise and capital stock taxes to the states which had jurisdiction to tax.

Unlike S. 1245, HR 11798 provided for full accountability of the income tax and franchise tax bases by permitting the states, including the District of Columbia, to tax 100% of the income of all corporations carrying on activities within the United States to the extent that income is not excluded from the federal income tax base.

The two-factor (property and payroll) apportionment formula of HR 11798 was *mandatory* and was subject to uniform administration by the Treasury Department. In addition, there was general congruence between the apportionment formula and the jurisdictional rules, that is, no tax was assigned to a state which did not have jurisdiction to tax.

S. 1245 eliminates many of the "full accountability" provisions of HR 11798. It creates "nowhere" income (income not attributable to any state) by (1) the lack of any congruence between the apportionment and allocation rules and jurisdiction to tax, (2) prohibiting a group of corporations conducting a unitary business from being taxed on a combined or consolidated basis, (3) eliminating from the tax base various sources of income, and (4) superimposing a congressional restriction on existing state limitations, rather than requiring the federally prescribed standards to be used by the states and the business community to produce the presumptively sought-for uniformity.

The S. 1245 three-factor apportionment formula with the elimination of the throw-back rules, its base limitations, its restriction on combination or consolidation, and its jurisdictional rules, is superimposed on existing rules as limitations. S. 1245 does not eliminate the classification of income for allocation and apportionment purposes; it permits some income to be specifically allocated and some income to be apportioned in accordance with individual state laws, so long as the allocation and apportionment result does not attribute to a state any income in excess of what would be attributable to the state by the three-factor apportionment formula applied to a corporation's entire apportionable and allocable income as defined in S. 1245. It thus not only leaves the states free to use different apportionment formulas, but also permits some income to be allocated and some income to be apportioned under these different rules, so long as the maximum provided in Title II of S. 1245 is not exceeded.

In addition, S. 1245 does not give the states jurisdiction to tax where a state's existing jurisdictional standards are arrived at by the use of different criteria than that employed in S. 1245. The superimposing of different income tax base requirements, allocation and apportionment rules, combination and consolidation rules and jurisdictional limitations on the existing state tax standards in these areas via congressional prescribed limitations does not create uniformity or simplify compliance burdens. It is incompatible with the "full accountability" rule adhered to in the Willis Report and generally embodied in HR 11798.

It can thus readily be seen that S. 1245 represents an unprecedented and unwarranted effort to restrict the power and the jurisdiction of the states to effectively and fairly reach the tax bases attributable to them under present constitutional guidelines. It constitutes limitations placed upon limitations. The bill prescribes no uniformity and confounds and compounds compliance problems. It uses apportionment factors which prevent the states collectively from reaching the tax base of multistate and multinational corporations, and then limits those factors' application to so-called apportionable income, and further riddles those factors with loopholes by assigning the income to jursidictions which have no jurisdiction to tax, by excluding from the tax base various sources of income, and by prohibiting inter-related dependent corporations from being treated as economic units.

S. 1245 must be considered as legislation primarily motivated by economic consideration; namely, the saving of substantial state and local tax dollars by preferential immunity and exemption granted large national and international corporations. Thus it is evident that the effect of S. 1245 is to carve out vast areas of preferential immunity and exemption to selected businesses at the expense of State and local governments and the remainder of the business community. This inevitably results in tax discrimination and the loss of state and local tax revenues.

There is no justification for giving multistate business this further competitive edge over local businesses—authorizing them by law to escape State taxation upon income and sales taxed to their local competitors does not promote uniformity or equity.

It cannot be too strongly emphasized that the combination of apportionment restrictions, base restrictions, restrictions on combination or consolidation and restrictions on jurisdiction, taken together, mean (1) further complication in state and local tax administration, and (2) substantial inter-related loopholes, the true significance of which will not be felt, if this bill were to be enacted by Congress, for a number of years. It clearly is not the type of legislation that Congress should in any way attempt to justify or support.

The following examples illustrate how S. 1245 violates the full accountability rule and creates unwarranted exemptions and preferential immunity:

Example 1

Facts.—Corporation A is a Michigan manufacturer located in Detroit and all property and payroll are in Michigan. All sales are to customers located outside Michigan and Ohio in which it does not maintain a "business location." At this point, Corporation A is not covered by S. 1245 and is taxed 100% by Michigan. Corporation A then establishes a sales office in Toledo, Ohio. A new sales manager is hired, who is a resident in Toledo. The Toledo office consists of the sales manager and his secretary. Corporation A is now covered by S. 1245. Corporation A's apportionment factor is 66% in Michigan. Ohio's apportionment factor is less than 1%.

Results.—One-third of Corporation A's net income has now escaped from state taxation because all sales are assigned to states which do not have jurisdiction to impose an income tax. This example illustrates the effect of attributing sales under the sales factor of the apportionment formula under S. 1245 to states which do not have jurisdiction to tax. It provides a tax-free loophole up to one-third of the tax base. The higher the jurisdictional standard (in S. 1245 the "business location" test), the greater the loophole.

Additional apportionment loopholes are created in the property and payroll factors to the extent property and payroll are attributable to states which do not have jurisdiction to tax, including property which is in transit.

Example 2

Facts.—Corporation A is a Michigan manufacturer located in Detroit and all property, payroll and sales of manufactured products are in Michigan. Corporation A does have $1 million per year income from licensing agreements with common market manufacturers located in Germany, France and England. At this point, Corporation A is not covered by S. 1245 and is taxed 100% by Michigan.

Corporation A organizes Subsidiary B and turns over licensing agreements in exchange for stock. Subsidiary B maintains an office in New York and is organized under the laws of New Jersey. Subsidiary B remits $1 million to Parent A each year as a dividend.

Result.—Parent A is now covered by S. 1245 as well as Subsidiary B. The $1 million escapes all state taxation either as to Parent A or Subsidiary B. The dividend income is exempt to Parent A under S. 1245 and the income from foreign sources is exempt as to Subsidiary B. This illustrates the effect of exempting foreign source and dividend income.

Example 3

Facts.—Corporation A, located in Chicago, Illinois, owns all of the stock of Corporations B and C. It conducts an integrated retail business with Corporations B and C. Corporation B conducted retailing in California and made a profit of $5 million. Corporation C conducted retailing in Oregon and suffered a $5 million loss. Corporation A made a profit of $10 million which it derived solely from the advantages of centralized purchasing and other centralized services for Corporations B and C. Corporations B and C paid Corporation A the same amount for goods and services furnished them by Corporation A as they would have paid for such goods and services on the open market. Both California and Oregon by case law permit taxable income to be determined by combined reporting.

Result.—In computing its California income tax liability, Corporation B could report on a combined basis and offset the loss of Corporation C in computing combined income. Oregon, however, could not consider the income of either Corporation A or Corporation B in computing the income tax liability of Corporation C.

Corporation A, by engaging in some non-arm's length transactions with Corporation C, could offset the $5 million loss against its $10 million profit if these transactions result in a "material distortion of income."

This example illustrates the potential results of combined or consolidated reporting pursuant to the standards of section 209 and applicable local law.

Example 4

Facts.—Corporation A conducted an integrated oil business with its affiliates. It acquired off-shore oil interests and formed subsidiary Corporation B for the purpose of owning and conducting some off-shore operations, and Corporation C for the purpose of owning and conducting other off-shore operations. Corporation B has a profit of $10 million and Corporation C has a loss of $10 million. Corporation A does not deal at arm's length with Corporations B or C.

Result.—Corporation A can elect to offset the loss of Corporation C for the tax year if state law requires or permits combined reporting. However, Corporation A could not be required to report its income on a combined or consolidated basis with either Corporation B or Corporation C. The result follows from the fact that section 209(b) leaves a corporation free under local law to determine combined or consolidated income with a corporation deriving its income from off-shore operations, but prevents the state from requiring this result.

Inasmuch as Congress will be urged by substantial and influential business interests to enact S. 1245, there is appended hereto as Addendum A to this statement, specific comments on the various provisions of S. 1245.

4. *Congress should not legislate in the area of state and local substantive tax law in the absence of a clearly defined and overriding federal policy.*

One of the principal problems that any proposed federal legislation in the field of state and local taxation of multi-state businesses is the gap between the purported justification for such legislation and the true effects and results of the proposed legislation. As this Subcommittee is aware, there has been much activity concerning the extent, if any, and the nature of Congressional involvement in the field of state and local taxation of multistate businesses. There are, of course, divergent views. The basic conflict between the states and certain business interests result from the desire of some business spokesmen to use Congressional involvement as a source for preferential immunity and exemption from the burden of state and local taxes; the desire of some states to independently pursue their own policy; and the desire of other states (the vast majority of the states) through their own cooperative efforts with the aid of Congress where necessary, to provide needed uniformity, simplification and predictability in the area of state and local taxation of multistate businesses. Cooperative state effort supported by Congressional legislation to the extent necessary to make this effort effective is a constructive middle-of-the-road position. It is based on the premise that state and local taxation, even as to multistate business and interstate commerce, is primarily a state concern; and that any federal legislation should be consistent with this principle. This does not mean that Congress should not legislate in the field of state and local taxation of multistate businesses in furtherance of some overriding federal policy. Any federal policy, however, should be clearly defined and the proposed legislation should specifically implement and only implement this policy. Congress should not be placed in the position of attempting to solve all the purported problems associated with state and local taxation of multistate businesses. The basic federal policy involved in any legislation of this nature is relatively simple—namely to require interstate businesses to be taxed on a parity with intrastate businesses and in the process not be burdened with unnecessary and excessive compliance burdens. Recognition of the states' primary interest, congressional policy should permit this objective to be accomplished by the collective efforts of the states to the fullest extent possible.

In determining the problem areas in state and local taxation which may require solution in part by federal legislation, Congress should give substantial weight to the position of agencies such as the Advisory Commission on Intergovernmental Relations, the Governors' Conference, the National Association of Attorneys General, the Council of State Governments, and the Multistate Tax Commission. Each one of these agencies is concerned with both state and federal tax policy in the area of state and local taxation of multistate businesses. Each have made specific recommendations and taken positions on this subject matter on several occasions since the enactment of Public Law 86-272 and the creation of the Special Subcommittee on State Taxation of Interstate Commerce. These organizations have generally taken the position that very limited federal legislation

is needed at this time. All agree that Congress should give its consent to the multistate tax compact. None support the proposition that there should be any base or jurisdictional restrictions placed on state taxing power in addition to existing constitutional standards and PL 86–272.

Addendum "A" to statement of William D. Dexter, Assistant Attorney General, State of Washington.

SPECIFIC COMMENTS ON S. 1245 (3RD CONGRESS, FIRST SESSION)

The purpose of this analysis is to examine the most important features of the current interstate taxation act (S. 1245) introduced by Senator Mathias, which is comparable to the COST proposal of June 28, 1972, introduced in the 92nd Congress as S. 4080, and to indicate why it is wholly unacceptable to the states.

It is no more and no less than a collection of preferential immunities and restrictions designed primarily to benefit large multistate and multinational corporations at the expense of state and local governments and the rest of the business community.

S. 1245 includes jurisdictional restrictions in Title I (section 101); income and capital stock tax base and apportionment and allocation restrictions in Title II (sections 201–209); sales and use tax limitations in Title III (sections 301–305); jurisdiction of federal courts in Title IV (sections 401–402); and definitions and miscellaneous provisions in Title V (sections 501–531).

TITLE I—JURISDICTION TO TAX

Title I prohibits a state or political subdivision of a state to impose an income tax, a capital stock tax, or a gross receipts tax with respect to sales of tangible personal property unless the corporation has a "business location" in the state or political subdivision during the taxable year. In addition, it limits the circumstances under which a state can require a person to collect and remit a sales and use tax with respect to an interstate sale of tangible personal property. These limitations are contained in section 101.

"Business location," as used in section 101, is defined in section 513, which in turn uses the term "location of an employee" which is defined in section 515. Thus, in order to determine the scope of the jurisdictional limitations imposed by section 101, the definitions contained in sections 513 and 515 must be taken into consideration. By reference to the definition of business location, as used in section 101 and defined in section 513, it is clear that a state has no jurisdiction to impose an income tax, a capital stock tax or a gross receipts tax, unless the corporation (1) owns or leases real property within the state, (2) has one or more employees located in the state, (3) regularly maintains a stock of tangible personal property in the state for sale in the ordinary course of business (excluding property on consignment), or (4) regularly leases to others tangible personal property for use in the state. If a corporation is present in the state by the leasing of tangible personal property, the corporation shall be considered to have a business location in the state only with respect to such leased property.

Applying test (2), that is, whether a corporation has one or more employees located in the state, section 515 must be examined to determine when an employee is located in a state. Section 515 provides in substance that an employee shall not be considered to be located in a state if he performs services in more than one state that are not incidental to his service within the state *unless* he has a base of operations within the state, or the place from which his services are directed or controlled is within the state; or *unless* he has no base of operations or place from which his services are controlled in any state, or he is a resident in the state. In addition, section 515 provides that an employee shall not be considered to be located in a state if he carries on only business activities consisting of solicitation of orders which are subject to approval or rejection outside the state and are filled by shipment or delivery from a point outside the state. This encompasses the PL 86–272 income tax jurisdictional standards. In addition, an employee is not to be considered to be located in a state if he installs or repairs tangible personal property which is the subject of interstate sale by the employer if such installing or repairing is incidental to the sale.

While the term "base of operations," as used in section 515, is nowhere defined as used in section 515, section 514 (pertaining to the location of property) does define base of operations with respect to a corporation's moving property, and states 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.

The jurisdictional standards pertaining to collection of sales and use taxes employ the "business location" test as well as the regular household delivery other than by common carrier and U.S. mail test and the solicitation of orders test. In addition, section 101, as cross-referenced to section 306, prohibits seller collection liability for sales and use taxes of political subdivisions in which the seller does not have a "business location" or regularly makes delivery other than by common carrier or U.S. postal service. An exception to this rule is where the local taxes are collected and administered by the state on a uniform basis.

Also immunized are any sales to a sales or use tax registrant purchaser. These sales and use tax jurisdictional standards relieve the large corporations from any collection responsibility if they do not have a business location in the state. To impose use tax liability on numerous in-state purchasers complicates state enforcement problems.

Inasmuch as interstate sales for sales or use tax purposes generally remain taxable to either the out-of-state seller or the in-state purchaser and in general codify existing law, there is no serious objection to the sales and use tax jurisdictional standards. The language employed may need some clarification. There are no problems in this area; thus, the advisability of extensive federal legislation on the subject is highly questionable. The same, however, is not applicable to the jurisdictional standards pertaining to net income taxes, capital stock taxes and gross receipts taxes.

As to income taxes, gross receipts taxes and capital stock taxes, the bringing together of the business location test, the UDIPTA test for assignment of payrolls to a state for payroll factor purposes, and the PL 86–272 jurisdictional limitation as a practical matter would eliminate state jurisdiction unless the corporation in its own name owns or leases real property within the state or regularly maintains a stock of tangible personal property other than property on consignment in the state for sale in the ordinary course of business. A corporation is thus free to carry on a multitude of activities within a state through national advertising, affiliates and employees without incurring any gross receipts, income or capital stock tax liability. These activities are directly related to the conduct of its principal business within a state.

Contrary to the statement of the COST group appearing in the Congressional Record, the jurisdiction of the states to impose an income tax, a gross receipts tax, or a capital stock tax on large, complex, multistate or international corporations would be greatly limited without justification. These corporations do not have "business locations" in their own corporate names in all of the states in which they sell their products. Their ability to use affiliated corporations, agents and employees not located in the state within the "business location" test to carry on exempt activities is limited only by the ingenuity of the corporate tax planner.

Of particular interest to the State of Washington is the detrimental effect of S. 1245's jurisdictional restrictions on the states' present jurisdiction to impose and enforce their business and occupation taxes measured by gross receipts. The gross receipts jurisdictional restriction would overrule existing law established by *General Motors Corp. v. State of Washington*, 377 U.S. 436, 12 L.Ed. 430, 84 S.Ct. 1264(1964).

It should be further pointed out that the detrimental effect of these jurisdictional limitations must be viewed in light of the income and capital stock *base* restrictions, the denial to the states of the right to *combine* the income and apportionment factors of corporations conducting an integrated business to determine corporate income tax liability, and the *existing* limitations under various state laws.

Contrary to the assertions of the COST group, these limitations do not preserve the legitimate interests of the states in collecting all taxes to which they are entitled. The COST group argument pertaining to the elimination of the throw back rule from the sales factor considered *infra* is predicted on the argument that the assignment of income, gross receipts or capital stock of corporations to states which do not have a "business location" is justified on the basis of market considerations.

It should also be noted that the assertion that the jurisdictional restrictions provide a uniform standard is fallacious. These are only in the form of *limitations* or *restrictions*. They are superimposed on existing jurisdictional limitations now contained in various state laws as interpreted and applied by state courts. In fact, section 527 in Title IV of S. 1245 explicitly preserves existing limitations. Furthermore, how the restrictions in S. 1245 are to be integrated with existing state limitations is not known. For example, if State A by judicial decision or statute does not impose a capital stock tax as the result of passive investments in

real property or treats income from property as non-business income, how does this restriction tie in with the jurisdictional restrictions of S. 1245?

Consider the following example: The law of State X provides that the passive ownership of real property is an insufficient jurisdictional nexus for the imposition of a capital stock (corporate privilege) tax, whereas the presence of salesmen regularly soliciting orders does constitute sufficient nexus for imposing this tax. Under S. 1245 the regular solicitation of orders would not trigger jurisdiction while the ownership of real property would trigger jurisdiction. Assuming that S. 1245 is law, does State X have jurisdiction to impose its capital stock tax?

TITLE II—MAXIMUM INCOME OR CAPITAL ATTRIBUTABLE TO TAXING JURISDICTIONS

Section 201 contains income tax and capital stock tax base limitations for the imposition of a net income or capital stock tax as well as apportionment limitations. It provides for an *optional* apportionment formula as a limitation, in addition to the apportional formulae otherwise provided by applicable state law.

Capital Stock Tax Base Limitation

Section 201 prohibits a state from including in a capital stock tax base a corporation's investments in and advances to affiliated corporations. This capital stock tax base limitation is of great economic importance to those states imposing significant capital stock taxes. Large multistate and international corporations have substantial investments in affiliated corporations and make substantial loans to these affiliated corporations. These advances and loans constitute assets of the parent corporation. The proscription of such a limitation on a state taxing power is arbitrary and capricious. It is intended to help only those large corporations which have substantial investments and advances of this kind. Stock investments in and loans receivable from affiliated corporations are just as much a part of the net worth of a corporation as any of its other assets. This base restriction is specifically designed to overrule case law which establishes this principle of corporate worth. Furthermore, the capital stock base reduction has no multistate or interstate implications. It is a subject matter peculiar to local state law.

Income Tax Base and Apportionment Limitations

The maximum income tax liability that can be imposed by a state under S. 1245 is that portion of a corporation's apportionable income as defined in the bill, apportioned by the property, payroll and sales factors as set out in sections 201, 203 and 204 of the bill and income allocable to the state as defined in section 209.

The only serious objection to the apportionment factors is the elimination of the so-called "throw back" rule in the sales factor and including in the denominator of the property and payroll factors the property and payroll assigned to states which are denied tax jurisdiction under the "business location" test.

The elimination of the "throw back" rule is justified in the COST explanation of the bill by the argument that it simplifies the sales factor and gives proper significance to the market states. However, this argument is inconsistent with the COST arguments that states in which a corporation does not have a "business location" do not have sufficient nexus or connection with the income producing activity to trigger jurisdiction to tax. It, of course, also conflicts with the principle of "full accountability" of the income tax base to the states collectively which have jurisdiction to tax. It introduces incongruity between jurisdictional limitations and apportionment limitations contrary to the recommendations of the Willis Subcommittee. If a state is not considered to have sufficient connection with the corporation to justify jurisdiction to impose an income tax or capital stock tax, there is no reason to attribute any income or capital to that state for apportionment purposes. Furthermore, the compliance problems depicted by the Willis Subcommittee report in reference to the sales factor does not exist where you have a uniform destination rule and a uniform throw back rule such as that contained in UDIPTA.

Apportionable income is defined in section 207 as taxable income as determined under state law *except* (1) dividends other than dealers in securities, and (2) income from sources without the United States as defined by the Internal Revenue Code of 1954 as amended.

The policy questions pertaining to the taxation of dividend income and foreign source income of corporations should be left up to the states. The income tax base restrictions in S. 1245 is no more justified than the capital stock base restrictions. Any income of a corporation from "foreign sources" should be subject to the same apportionment rules as pertains to determining income assignable to each of the

states. In other words, if Corporation A conducts business activities both in the United States and in foreign countries, the income tax base should include all of the income of the corporation and the apportionment factors should include the entire property, payroll and sales of the corporation. There is no need to employ a different attribution rule for foreign source income than the attribution rule used in determining what portion of income earned within the United States is assignable to one particular state. There is no need or justification to superimpose on the optional three-factor formula contained in S. 1245 the "foreign source" attribution rules contained in the Internal Revenue Code.

The exclusion of dividend income of affiliated corporations from the income tax base is premised on the fallacious assumption that dividend income is not the income of the corporation receiving the dividends if the payor corporation is an affiliated corporation. Dividend income from an affiliated corporation is just as much a part of a corporation's income as "portfolio" dividend income received from a non-affiliated corporation. Furthermore, the dividend income of a corporation is no different than the dividend income received by any other class of taxpayer. The so-called "double taxation" argument in the corporate setting is no different than the same argument as applied to non-corporate taxpayers. Furthermore, dividend income is no different than income from a bond or other investment. The only reason it is of major concern in S. 1245 is that dividend income from affiliated corporations amounts to a substantial portion of the income of large multinational and multistate corporations.

There is no reason why state policy concerning foreign source and dividend income should not parallel federal policy. Thus, all dividend income should be includable in the tax base of a corporation subject to any special deduction therefrom which states, by implementation of their own policy, wish to allow. Currently, all dividend income of corporations is subject to federal taxation, subject to a special deduction for certain domestic dividends.

The argument of the COST group that the inclusion is apportionable income of all income except dividends "constitutes a major concession" by the business community to those states that have been advocating this approach is completely unjustified. The whole argument between the states and the COST group concerns the taxation of dividends and foreign source income and the apportionment of dividends. The states' position is that the states collectively should retain the power to tax all income of a corporation and that all income be subject to apportionment. There is much more reason for allocating to situs income derived from an investment in real estate which is not integrated with the trade or business of the corporation than specifically allocating dividends to the situs of commercial domicile of a corporation.

Since section 209 exempts in substance all the dividends of large multistate and international corporations, any argument concerning this subject matter is resolved in favor of total exemption. However, it would seem that, in principle, the dividends left taxable should be thrown in to the tax base and apportioned along with all other sources of income. There is no reason to sort out this one type of income and to treat it differently than all other types of intangible income such as interest, patents, copyrights, royalties and so forth. As a pragmatic matter, dividend income in the tax base of corporations.

In reference to the question of allocation or apportionment of income, the following problems should be noted. If state law (as in the case of UDITPA) allocates income other than dividends, how are the apportionment and base limitations to be applied? The corporation apparently would have to compute its income tax liability under state law and under the S. 1245 restrictions, and then be permitted to deduct any excess tax liability computed under state law over that permitted by S. 1245. Since taxable income is an abstract concept, how can particular sources of income be traced and deducted? This is but one example of how S. 1245 complicates administration and compliance problems by superimposing additional limitations on existing limitations concerning state and local taxation powers.

Combination or consolidation limitations

Section 209 permits the state or the taxpayer at its election to determine apportionable income by reference to the consolidated apportionable income and apportionment factors of all affiliated corporations engaged in non-arm's length transactions. "Consolidated apportionable income" does not include the income of an affiliated corporation which is incorporated outside of the United States or any corporation which receives 50% or more of its ordinary gross income from

sources without the United States. The term "income from sources without the United States" is defined in section 522 as income from sources without the United States as defined by the Internal Revenue Code of 1954 as amended, except for section 638 simply means that the states are prohibited from making any non-arm's length adjustments with regard to income from mining, fishing, shipping and other activities carried on offshore and within the continental limits of the United States. This illustrates the narrow and preferential applicability of S. 1245.

A "non-arm's length" transaction, as defined in section 507, must cause a "material distortion of income apportioned to the state" before the provisions of section 209 are triggered. Section 507 in turn defines a "non-arm's length transaction" as a transaction between two or more unrelated corporations under similar circumstances, considering all relevant facts. "Affiliated corporations" other than "excluded corporations" are corporations with a common parent with 50% or more common ownership.

It can readily be seen that section 209 is addressed to hypothetical transactions "considering all relevant facts" which result in a "material distortion of income."

The feasibility of using this test has been the subject of much discussion and debate between members of the COST group and various state representatives. The states have unanimously rejected this test as impractical. It is apparently intended to parallel the Internal Revenue Code, section 482 income adjustment problem, which is implemented by the most complicated regulations and procedures under the Internal Revenue Code. For example, if Corporation A manufactures a patented product and sells it to a subsidiary Corporation B, how is it possible to determine what profit Corporation A should realize from this patented product? On final disposition of this product, what percentage of income can be attributable to the patent and manufacturing effort and to the sales effort? To substitute this adjustment to apportionment income in place of "combined reporting" is an effort to change something into its opposite. The reason for "combined reporting" is that the true income of the member of an affiliated group cannot be ascertained with any certainty when two or more corporations conduct a unitary or integrated business. If this is a sound premise on which to predicate combined or consolidated reporting, it is readily apparent that the "non-arm's length" test is a meaningless, hypothetical test.

Furthermore, because the relevant facts are all under control of the corporate taxpayers, it is more readily available to corporations for tax relief than to the states for the imposition of additional tax burdens.

In sum, it is inconceivable that the states, either alone or collectively, could effectively use this test to require a combined report. It is based upon economic detail of a hypothetical nature of insurmountable magnitude and on the idea that the transactions between members of an affiliated group do not involve unique situations or products which cannot be related to like independent transactions. Furthermore, if a non-arm's length test is to be applied for combination or consolidation purposes, language should parallel a comparable test provided for in section 482 of the Internal Revenue Code. Section 482 does not give the taxpayer any election; it includes all businesses controlled by the same interests and pertains to all items of gross income, deductions, credits and allowances between or among such businesses. Its provisions are triggered if the Secretary or his delegate determines adjustments are necessary to clearly reflect the income of any businesses within a controlled group.

Section 209 in (c) permits the state, by statute or otherwise, to allow affiliated corporations to elect to file a return based on consolidated income. If this election is to be allowed a taxpayer if permitted by state law, there seems to be no justification for not permitting the state under similar circumstances to require a return based on consolidated income. What is the justification for permitting a taxpayer this election and not likewise permitting its use by the states? This is but another illustration of the preferential direction of S. 1245.

TITLE III—SALES AND USE TAX

Inasmuch as this title, in substance purports to incorporate existing jurisdictional standards and base restrictions followed by the states, it does not merit the subject of Congressionl legislation. The only exceptions are broad exemptions pertaining to liability of sellers and the exclusion from the sales or use tax base of any transportation charges.

Section 305, which releases sellers of liability, poses some difficult administrative problems. It necessitates the auditing of a large number of smaller taxpayer

purchasers, rather than a fewer number of large interstate sellers. These administrative problems may well mean the loss of revenue by the states from sales and use taxes.

Section 303 exempts transportation charges with respect to interstate sales. In many instances, the freight charges are a substantial portion of the total consideration being paid for the taxable personal property. By exempting interstate sales freight charges, it places an intrastate seller at a disadvantage, since freight charges for interstate shipments are a part of his cost prior to any sale. The simpler and more equitable rule would be to require that all freight or transportation charges be included in the tax base of states for sales and use tax purposes with respect to interstate sales, which is, of course, true with respect to intrastate sales. This would put interstate sales on a basis comparable with intrastate sales and eliminate any uncertainty and discrimination.

TITLE IV—JURISDICTION OF FEDERAL COURTS

This title (sections 401 and 402) gives the U.S. Court of Claims jurisdiction to review *de novo* any issues relating to a dispute arising under the act or under Public Law 86-272, as amended. Justification for this federal court jurisdiction is claimed on the ground of uniformity. It is a novel proposition, indeed, to place tax matters in a court which is not familiar with tax matters. The fact that the Court of Claims does not have a crowded docket is no excuse for utilization of that court for the adjudication of complex state tax issues.

While such an arrangement may well produce uniformity as concerns certain large multistate taxpayers, it could hardly be said to produce uniformity within a state tax structure, inasmuch as all other taxpayer actions on state and local tax matters will have to be adjudicated through the state courts. This problem must be examined in great depth before any decision is made concerning the same. Of significance also is the fact that any state given notice may be joined in any litigation and bound by its results. This is an unprecedented and unwarranted extension of court jurisdiction.

TITLE V—DEFINITIONS AND MISCELLANEOUS PROVISIONS

Some of the provisions of Title V have been commented on elsewhere in analyzing the significance of the definitions as used elsewhere in the act.

It should be noted, however, that section 508, which defines affiliated corporations, may not include the parent as part of an affiliated group. More specifically, the question is whether or not the "common owner" is part of the affiliated group.

STATEMENT OF THE NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS, INC.

The National Association of Tobacco Distributors Inc., representing the WHOLESALE TOBACCO INDUSTRY which is responsible for the distribution of more than 10 billion dollars in consumer goods to approximately 1,425,000 retail outlets throughout the United States, wishes to go on record in support of legislative uniformity in the taxation imposed by the several states upon merchants whose business requires them to engage in interstate commerce. In particular, this Association endorses the bill introduced by Senators Mathias and Ribicoff and cosponsored by Senator Humphrey, which is entitled S 1245 and which Your Honorable committee is considering in conjunction with similar legislation before you.

Our Association is composed of a great number of distributors of consumer goods such as cigarettes, candy, stationery supplies, cosmetics, smokers' accessories, cigars, pipes, pipe tobacco and similar items, much of which is involved in interstate commerce. The present hodge-podge of State Taxes, in particular State Sales and Use Taxes, imposes a substantial burden on businessmen who sell, as most of our members must perforce do, across state boundary lines. As the law now stands a wholesale tobacco distributor engages in interstate sales at his peril if he has misconstrued the appropriate jurisdictional requirements established in the State where the merchandise is delivered. The wholesale distributor has imposed on him, obligations to collect sales taxes established by a foreign State without proper appreciation of the standard established by that State and at the mercy of the whim of legislators who may revoke, revise or modify rules under which he has operated in the past.

The great virtue of S 1245 is that it codifies minimal jurisdictional rules for the collection of State sales and use taxes. The increasing proliferation of State and

even municipal or local taxes and use taxes has created a bewildering economic climate which severely cripples normal business operation and imposes an intolerable burden on interstate commerce.

As far back as 1960 the Supreme Court in the Scripto Case (*Scripto Inc.* v. *Carson*, 362 U.S. 107) validated the right of the State to require an out-of-state business to collect and remit use taxes on sales within the taxing state, even though the business subjected to this obligation had no facilities witin the taxing state and even though the out of state businessman conducted the sales operations in the taxing state through an independent contractor.

The authorization thus given by the Supreme Court to arbitrary state taxing standards, which might be adopted by the 50 states and the thousands of local tax authorities, demands control through the auspices of our Federal Government. S 1245 is the most progmatic resolution of this difficulty and will, at least, set guidelines under which modest business enterprises, such as those of a wholesale distributor, may operate with a reasonable degree of security.

As projected in S 1245, a Seller having no business location in the taxing state will not be obliged to collect a sales or use tax in behalf of that state if he obtains, in writing, the registration number of the buyer located in that State. The State would then look to the buyer for the payment of the sales and use tax, and this makes pre-eminent good sense. It is in line with the procedure developed in 1950 in the Jenkins Act, which went far toward curbing excesses in the mail-order sale of cigarettes which were depriving numerous states of substantial tax revenues. It insured proper payment of proper taxes by the person truly liable for the tax, and substantially simplified business operations of major and reputable mail order houses engaged in cigarette sales. What the Jenkins Act did, in microcosm, S 1245 will do for distributors of all products, in macrocosm. It will assure that all purchasers of out-of-state products pay, to their respective state and local governments, the proper taxes imposed upon them by state and local authorization, and it will remove from reputable businessmen selling across state boundaries the fear of arbitrary and unexpected liability for taxes in a foreign jurisdiction because of failure to comply with unknown requirements of an unfamiliar law. It establishes a simple procedure with which all businessmen can comply, and thus makes more reasonable the legal requirements to which they must adhere.

The other provisions of S 1245 having to do with the imposition of sales taxes are equally salubrious. It limits the power of a state, or a locality within that state, to impose a sales or use tax except on merchandise actually received in the state in question or in a contiguous state with which it has a reciprocal collection agreement. It provides for a credit on the use tax where a tax was previously paid to another state or locality on the same property, and it precludes a state from levying a sales or use tax on household goods or automobiles brought into the state by a person establishing his residence in the jurisdiction and who had acquired those goods in another state more than 90 days before his becoming a resident of the taxing state. All of these provisions are benefical, equitable and much needed in the interests of uniform law uniformly applied throughout our entire nation.

S 1245 is of further benefit in establishing uniformity in the apportionment of income and capital between the various states for tax purposes. It will ensure that all competing businessmen have equal obligations irrespective of which side of a state boundary their principal place of business is found. It conforms state rules with respect to taxation of dividend and foreign source income to the rules currently applied under the Federal Internal Revenue Code, and establishes a single Federal Court with exclusive jurisdiction to review disputes arising out of the taxation by states of interstate commerce.

All of the foregoing long-awaited reforms may be found in S 1245 now pending before Your Honorable committee. All of them are heartily endorsed by this Association, and it is respectfully requested that S 1245 be given speedy consideration and approval by your committee.

Statement of Sidney B. Hutton, Jr., on Behalf of the American Association of Nurserymen

INTRODUCTION

Mr. Chairman and Members of the Committee: My name is Sidney B. Hutton, Jr. and I am here today to express strong and unequivocal support of S. 1245 on behalf of the American Association of Nurserymen, of which I am a

Past President, and the Mailorder Association of Nurserymen, in which my firm holds membership. Together these organizations represent some 2,000 nursery firms who grow 90 percent of the nursery stock produced in the United States today. They also represent the vast majority of gross volume shipped by mailorder nurserymen. These are small businesses by any yard-stick, the majority with gross sales less than $1 million per year.

Apart from these trade association responsibilities, I speak also on behalf of the Conard-Pyle Company of West Grove, Pennsylvania, of which I am President. Specializing in rose bushes, we grow and distribute a complete line of nursery products through wholesale sales to garden centers and other retailers, retail sales through our own garden center, and mailorder sales. Like other nursery firms, we have a highly seasonal business with most of it occurring during a few months in the Spring.

Seven years ago, I appeared here on the Hill before the House Special Subcommittee on State Taxation of Interstate Commerce. On that occasion, I expressed support for H.R. 11798, the original Willis bill. Since that time, we have followed the evolution of this legislation into its present form. I am pleased to be able to say that while we would like to see the present bill go even farther, in the direction of requiring greater uniformity of state tax laws, procedures, forms and interpretations, we think that S. 1245 as now before you, represents legislation that has been greatly improved in detail as a result of seven years of intensive review by interested governmental and industry representatives. We strongly urge you to support favorable action on this legislation in this session of Congress.

NATIONAL DISTRIBUTION OF NURSERY STOCK

Although the plants we sell are widely distributed in all states, they can be produced most efficiently only in certain areas of the country. For instance, there are only four relatively small areas in the country where rose bushes for the home garden may be best produced even though they may be grown by the home owner with great success in any state. These four would be: California, Arizona, Texas and Pennsylvania. Tennessee has become famous for its production of dogwood trees because the soil and climate there are particularly suitable. For the same reason, New York State is noted for quality production of apples and other fruit trees. Some kinds of trees are found to grow best in Oregon; certain kinds grow best in Pennsylvania and some of these are quite different from those produced best in Ohio. While these trees are best *produced* in limited areas of the country, they grow well and live for *consumers* all over the country. It is obviously beneficial for the home owner in Pennsylvania to be able to buy easily and readily the dogwood produced in Tennessee, the weeping cherry produced best in Oregon, or the azaleas produced best in New Jersey, Alabama and Louisiana. Nonuniform and burdensome state taxation of interstate commerce can seriously restrict the free flow of these commodities in interstate commerce, without any greater revenue to the states than could be achieved from a uniform, easy-to-comply-with system.

HEAVIEST BURDEN ON SMALL BUSINESS

The increase in the burden of keeping records and filing forms is becoming tremendous. It falls most heavily on the small business, which cannot afford a staff of accountants and lawyers to cope with a multiplicity of differing state laws. The very thought of a small business such as my own, which does business in 46 of 50 states, finding itself required to take on additional tax collecting and paying burdens each year, sometimes gives us nightmares. Small as we are, we have to study thoroughly the specific requirements and differences that exist between the various state tax systems. To comply with these laws fully, we would have to assign one person in our firm full-time for a year or two to study the different regulations and install procedures that would make accurate compliance possible. Of course, for the small sums at stake and on a small profit margin, we cannot afford to do this so we simply do the best we can by guess-work and "rough justice"—and take our chances. Our firm's situation is duplicated many times throughout the country. As a matter of fact, as mailorder nursery firms go, we are larger than most. The smaller a firm is, the more expensive it is to comply per dollar of sales, because most mailorder nursery firms do business in a great many states. Thus, the small firm is penalized by the present multiplicity of different systems and the large firm realizes an "economy of scale" that has nothing to do with efficiency or quality of production or service to the consumer.

EXAMPLES OF BURDEN ON SMALL BUSINESS

At the present time, the small business that I am personally associated with computes and pays separately a great many different taxes. I would like to quickly list them:

United States Income Tax.
United States Unemployment Compensation Tax.
Social Security Taxes on Agricultural Employees.
Social Security Taxes on Non-agricultural Employees.
United States Income Tax Withholding on Employees.
Withholding Tax on Foreign Payments.
Township Road Taxes—2 separate.
School Taxes—2 separate.
County Real Estate.
Pennsylvania Capital Stock Tax.
Pennsylvania Corporate Income Tax.
Pennsylvania Corporate Loans Tax.
Pennsylvania Unemployment Compensation Tax.
Pennsylvania Sales and Use Taxes.
Real Estate Transfer Tax—2 separate.
Pennsylvania Motor License Taxes.
New York State Truck Mileage Tax.
Delaware Road Sign Tax.
Maryland Road Sign Tax.
Philadelphia Mercantile Tax.
Philadelphia General Business Tax.
Philadelphia School District Tax.
Fertilizer Tax—4 separate states.

Gentlemen, in all, there are presently more than 28 of these different taxes our firm is required to compute and pay without even considering sales and use taxes outside of our own state.

In addition to the above, there are six information returns or sets of records that we are required to keep by State and Federal regulations:

Workmen's Compensation Insurance.
Inspections on All Boilers.
Hospitalization Insurance Information for Department of Labor Reports.
Information Return for Employees Profit Sharing Plan.
Employees Income Tax Withholding Records.
Occupational Safety and Health Records.

Yet in addition to all these local, state and federal taxes and reports, there are 26 states in which we have to obtain licenses to do business, even though we do not have any property, facilities or agents employed in them.

Now ours is only a small business, but we require two accountants full time. If we had none of the above records to keep or tax computations to figure excepting income tax and our own necessary internal cost accounts, we could do without one of these accountants, a saving of approximately $12,000—a tidy sum in our size of business. It is rather easy to see what will happen to our cost of doing business if we should add only 15 more tax computations to our already heavy burden, let alone 45 more out of the total 46 states in which we now do business. Yet our firm is substantially larger than most nursery firms.

SUPPORT FOR S. 1245

It is the reality of these burdens, which penalize the small businessman that underlies the strong support of the American Association of Nurserymen and the Mailorder Association of Nurserymen for the approach of S. 1245, the Interstate Taxation Act of 1973. We believe that this legislation is desirable from the standpoint of *any* business which operates or sells in more than one state, but especially from the standpoint of small business.

This legislation, if adopted, will increase uniformity in the rules concerning the major areas of taxing jurisdiction, taxability and tax accounting, and, will greatly reduce the burden of tax compliance for both large and small business. The provisions of this bill will be especially helpful to small businessmen who lack the resources to comply with the multiplicity of state tax requirements. At the same time, the resulting increase in compliance will also be in the interests of the several states—an increase which will surely take place because simplification and uniformity of our tax laws will make compliance more practicable.

SPECIFIC BENEFITS FROM S. 1245

Both the sales tax and the income tax aspects of S. 1245 are of special importance to nurserymen, though we have spoken up to now only of sales taxes because they are the more immediate problem. On this sales tax aspect, the establishment of clear rules for sales tax jurisdiction will remove a frequent burden of uncertainty, complexity and nuisance returns on mailorder nurserymen and consumers throughout the country. Mailorder nurseries commonly sell only by catalog, widely mailed, generating a large number of small prepaid orders. Credit is not normally offered. When no sales tax is included in the customer's remittance, the small size of the typical order makes it uneconomical to write back for the tax, yet the alternatives are—disregard of the law or paying the tax out-of-pocket. As a matter of fact, my own firm has a 50 cent minimum charge for orders under $10. This is a charge for handling, postage, etc. We do not widely publicize it but when such an order comes in without the 50 cents, we do not make a strong effort to collect it, *simply* because it would be too expensive to do so. The bill provides that a state cannot collect a sales or use tax from an out-of-state mail order firm with no business location in the state if it makes no household deliveries or personal sales solicitations there, [Section 101(3)] or if it obtains a business buyer's tax registration number (Sections 101(4) and 304]. This will adequately assure the members of our industry against the burden of compliance with dozens of differing state laws.

Let me emphasize here that it is the multiple compliance burden that we object to, not the economic cost of the multiple sales taxes. We have no problem at all with the proposed legislative encouragement in Section 301(a)(2) of the bill of interstate agreements whereby each State would collect the other's sales tax, so long as we know the rules in advance so that we can tell the customer what to remit, and so long as we only have to file returns in our home State or other States where we have a business location. If any State is concerned about the loss of sales tax revenue from incoming retail mail order sales, it can easily obtain this revenue by negotiating reciprocal collection arrangements with its sister States.

Also, Mr. Chairman, the American Association of Nurserymen and the Mail-order Association of Nurserymen strongly favor the permanent retention of *income* tax rules such as those found in the existing Interstate Income Law of 1959 (P.L. 86-272) and continued in sections 101(1) and 514(d) of the bill, protecting a business from income taxation in States where it has no place of business. P.L. 86-272 has surely headed off multiple tax claims against nurserymen who do business in States other than their own, and Section 515(c) will provide further clarity.

These provisions are especially important to the many nurserymen who sell primarily at wholesale for delivery across a State line in a State where they have no place of business. Typically such nurserymen have growing operations in one or more States but may sell through traveling salesmen in distant States in which they maintain no business establishment. We favor the retention and broadening of these rules so that a business can clearly determine its income tax obligations in advance for all States, based on a uniform apportionment formula such as that found in Section 201 of the bill. By requiring a place of business, this bill will eliminate a major cause of uncertainty that would otherwise make it impossible to determine income tax liability in advance.

CONCLUSION

For these reasons, we strongly endorse S. 1245. We urge you to act favorably on this approach to reducing the burden of State taxation of interstate commerce and increasing respect for and compliance with State tax laws, especially as they affect the small business selling across State lines.

ARMSTRONG & BRAY,
New York, N.Y., July 30, 1973.

Re S. 1245, 93d Cong., 1st Sess. (1973) S. 1962, 93d Cong., 1st Sess. (1973).

Senator WALTER F. MONDALE,
Chairman, Subcommittee on State Taxation of Interstate Commerce, Senate Finance Committee, Washington, D.C.

DEAR SENATOR MONDALE: Section 208 of both of the above bills provides that dividends from sources without the United States and dividends from corporations in which the taxpayer owns 50 percent or more of the voting stock shall not be

allocable to any state. This provision should be supported, in my view, for the following reasons.

I. IT IS NOT EQUITABLE OR RATIONAL TO INCLUDE DIVIDEND INCOME FROM SUBSIDIARIES IN THE APPORTIONABLE INCOME OF THE PARENT WITHOUT MODIFICATION OF THE APPORTIONMENT FORMULA

The subcommittee will undoubtedly be presented with the traditional arguments against double taxation of corporate earnings and the constitutional arguments limiting the jurisdiction of a State to tax the earnings of subsidiaries, either directly or indirectly when declared as dividends when such subsidiaries operate entirely outside the taxing state. Assuming, nevertheless, that dividend income from subsidiaries were to be included in the parent's apportionable income I should like to illustrate by a simple example how the apportionment formula would work unfairly and irrationally without modification.

Let us assume that the taxpayer operates in five States, that a Federal return is filed showing taxable income of $5,000,000 from the total operation, that the property, sales, and payroll are equal in each State, and that the tax rate in each State is 10%. Under those facts each State would be entitled to a tax of $100,000 (5,000,000 × 1/5[1] × 10%).

Now let us assume that the taxpayer has identical operations in five foreign countries, that Federal taxable income is now $10,000,000, and that the property, sales, and payroll are still equal in each State and foreign country. Under those facts each State would still be entitled to a tax of $100,000 (10,000,000 × 1/10 × 10%). The apportionment formula has operated as it should: out-of-state expansion has doubled the taxable base, from $5,000,000 to $10,000,000; but the applicable apportionment percentage for each State has been cut in half, from 1/5 to 1/10. The apportionment formula provides a rational and equitable means of allocating the income from goods and services. When such income is converted to dividends, the formula becomes irrational.

Thus, let us now assume that the five foreign operations are incorporated and that Federal taxable income is $10,000,000, consisting of $5,000,000 from the sale of goods and services in the U.S. and $5,000,000 of dividends from the foreign subsidiaries. Under those facts each State would be entitled to a tax of $200,000 (10,000,000 × 1/5 × 10%). The formula has failed to make a proper allocation of Federal taxable income in this instance because the property, sales, and payroll relating to the dividend income has been excluded from the formula. By including the dividend income from taxpayer's foreign subsidiaries but excluding the property, payroll, and sales of those subsidiaries each State has managed in this example to double its tax revenues.

Supposing the formula were modified to include the property, sales, and payroll of the foreign subsidiaries in the proportion that dividends received by the parent bears to the income from which such dividends were derived. Thus, let us suppose that only 60% of the $5,000,000 earned by the foreign subsidiaries is declared as a dividend. Federal taxable income would, therefore, be $8,000,000, consisting of $5,000,000 from the U.S. operations and $3,000,000 of dividends. The apportionment percentage for each State would be 1/8.[3]

Under these facts each State would be entitled to a tax of $100,000 (10,000,000 × 1/8 × 10%). The apportionment formula, when appropriately modified to reflect the factors relating to the dividends, can work in a rational manner.

Without digressing into the merits and mechanics [3] of the modification presented above, it is apparent that absent some modification there is no rational basis for allocating dividends from foreign subsidiaries in proportion that the property, sales, and payroll in a particular State bears to the total property, payroll, and sales in all States.

The inclusion of foreign dividends in the apportionment formula without modification produces the absurd result that the growth of the foreign segment of a company's business will have the effect of increasing the income atrributable to a

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[1] If property, payroll, and sales in each State is y, then total property, payroll, and sales is 5y.

[2] If property, payroll, and sales in each State and country is y, then total property, payroll and sales is under the suggested modification: 5y + .60(5y) = 8y.

[3] The suggested modification simply puts the subsidiaries on a consolidated basis to the extent of income derived from those subsidiaries. If a subsidiary were only 50% owned the includible property, sales, and payroll of that subsidiary would be reduced by 50%. Other adjustments would be necessary for dividends traceable to second and third tier subsidiaries, prior year's earnings, loss years, etc.

State even though the operations in that State as represented by property, sales, and payroll remains static. This is just the opposite of what the formula is intended to accomplish. The modification presented above illustrates why the formula is defective in allocating dividends and how that defect can be cured. (As will be explained in II below, the States will not gain additional revenues from including dividends in apportionable income when the formula is properly modified; therefore, nothing is lost by simply excluding dividends from the tax base at the outset, thus avoiding the complications of modifying the formula.)

The States might take the simplistic position that dividend income belongs to the taxpayer, that such income is an integral part of the business, and that having chosen to operate abroad in the form of subsidiaries no comparison can be made to branch operations. This view overlooks the function of apportionment, namely, to determine what is within a State's jurisdiction. If the States' view is carried to its logical extreme each State could arguably tax the entire Federal taxable income of a taxpayer without apportionment, which is obviously improper. The point is that the expansion of a taxpayer's out-of-State business neither increases nor decreases what is within the State's jurisdiction; therefore, a State's tax should not increase or decrease if the expansion takes the form of a branch or a subsidiary. The apportionment formula must function with this principle in mind.

The purpose of presenting the illustrations above has been to demonstrate how the formula operates irrationally and inequitably when dividends are included in apportionable income and the formula is not modified. It will be left to others to show why the U.S. Constitution requires a modification, at least by States other than the State of commercial domicile of the taxpayer, when this irrationality is demonstrated.

II. WHEN DIVIDENDS FROM SUBSIDIARIES ARE INCLUDED IN APPORTIONABLE INCOME AND THE APPORTIONMENT FORMULA IS PROPERLY MODIFIED, THE STATES WILL DERIVE NO MORE REVENUE THAN IF THE DIVIDENDS WERE EXCLUDED WITHOUT MODIFICATION

In the example above it was assumed that the property, sales, and payroll in each State and foreign country were equal. This assumption was made to illustrate what happens when the taxable base, Federal taxable income, is increased, and the denominators in the apportionment formula, total property, sales, and payroll are increased proportionately or not increased at all. In practice the increase in denominators will not be exactly proportionate to the increase in income. There may in fact be losses. This is true whether the increase in out-of-state operations is by way of branches or subsidiaries.

If the ratio of income from the out-of-State operation to the apportionment factors employed in that operation is greater than the ratio of income to approtionment factors in the taxing State, there will be a greater tax than if there had been no out-of-State operation. Thus, the income apportioned to a particular State will be affected by the "efficiency" or "rate of return" (measured by the ratio of separate accounting income to separate accounting property, sales, and payroll) of the out-of-state operations. This is as it should be, since the out-of-State income is included in apportionable income because it is assumed to be part of one entire unitary business.

To illustrate the foregoing, where the foreign operations are less efficient, let us assume as before that the five U.S. operations produce $5,000,000 income, and the five foreign branch operations produce $5,000,000, for a total of $10,000,000 Federal taxable income. Now let us assume that the apportionment factors in the U.S. amount to y in each State and 3y in each country, for a total of 20y.[4] Under these facts each State would be entitled to a tax of $50,000 (10,000,000 × 1/20 × 10%). Had the factors been equal in all jurisdictions the tax, as we have seen, would have been $100,000.

In contrast, where the foreign operations are more efficient, assume that the apportionment factors in the U.S. amount to y in each State and .6y in each country for a total of 8y.[5] Under these facts each State would be entitled to a tax of $125,000 (10,000,000 × 1/8 × 10%).

The last two examples illustrate that the "efficiency" of the out-of-State operations affects the amount finally apportioned to the taxing State. This arithmetical

[4] $5(y) + 5(3y) = 20y$.
[5] $5(y)+5(.6y)=8y$.

fact applies equally where the out-of-State operations are incorporated and the income from such operations is consolidated directly, or is consolidated indirectly by including the subsidiaries' apportionment factors in proportion to the dividends received from those subsidiaries. See Appendix A hereto annexed.

If one has had the patience thus far to follow the foregoing analysis, which has necessarily been complicated with figures, it will be agreed that the inclusion of foreign dividends in apportionable income gains nothing for the States, unless of course one does not accept the premise that some consolidation of foreign apportionment factors with the parent's is required.[6] They will only gain if the forcing operations are more efficient than the U.S operations.

Over the long run, it is submitted, the foreign operations of all taxpayers will not be more or less efficient than the U.S. operations. Moreover, comparative efficiency should not be a reason for taxing foreign income. Such an approach is short-sighted and fails to take account of the increased complications attending the audit of foreign operations that must necessarily accompany the consolidation of foreign property, sales, and payroll with the domestic apportionment factors.

These complications would apply to a lesser extent to the consolidation of U.S. subsidiary operations. But, if it is assumed that U.S. subsidiaries are operating at arm's length with each other, no State will go in by consolidation, unless it can be shown that operations in a particular State operate less efficiently than in other States; such a State would then gain by consolidation. Whatever the merits for consolidating U.S. operations, which is another topic, there is no merit in consolidating foreign operations. The arm's length problem receives considerable attention by the Internal Revenue Service in foreign transactions and the States will receive the benefit of that attention.

III. CONCLUSION

Considerable effort has been put forth by some States, as manifested by the Multistate Tax Commission Regulations, to define "business income" in a way that it will invariably include the dividends from subsidiaries, the result being an expanded taxable base for apportionment. Of course, in one sense all receipts of a business corporation, as contrasted with a charitable organization, are "business income". Therefore, the distinction between "business income" and "nonbusiness income" seems a fruitless exercise unless it is done in the context of the function of apportionment and the need for describing a taxable base that bears a rational relationship to the standard apportionment formula. Very little effort, however, has been made by the States, in my view, towards the necessity for modifying the standard apportionment formula when the taxable base is expanded to include dividends.

If the latter effort were made it would be seen that when foreign dividends are included in the base for apportionment, foreign property, payroll, and sales must be included in the apportionment fractions. Having made such a modification the States will gain nothing from having included the dividends in the base; an ideal will have been achieved, but only at the expense of considerable complication producing no additional revenue to the States. Therefore, foreign dividends should simply be excluded from the base at the outset as proposed in the bills before your Subcommittee.

Very truly yours,

MICHAEL D. BRAY.

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[6] It is not being suggested that the inclusion of foreign apportionment factors is the only acceptable modification. Other modifications, however, such as the addition of a fourth factor equal to the value of the investment in foreign subsidiaries, are less refined.

APPENDIX A

	Foreign branches	Foreign subsidiaries—Formula modified	Foreign subsidiaries—Formula not modified
I. APPORTIONMENT FACTORS EQUAL[1]			
Income from sales	10,000,000	5,000,000	5,000,000
Dividend (60 percent)		3,000,000	3,000,000
Apportionable income	10,000,000	8,000,000	8,000,000
Total factors each State (numerator)	y	y	y
Total factors (denominator)	10y	8y	5y
Taxable income:			
10,000,000×1/10	1,000,000		
8,000,000×1/8		1,000,000	
8,000,000×1/5			1,600,000
Tax at 10 percent	100,000	[2] 100,000	160,000
II. FOREIGN OPERATIONS LESS EFFICIENT			
Income from sales	10,000,000	5,000,000	5,000,000
Dividend (60 percent)		3,000,000	3,000,000
Apportionable income	10,000,000	8,000,000	8,000,000
Total factors each State (numerator)	y	y	y
Total factors (denominator):			
5(y)+5(3y)	20y		
5(y)+[5(3y)×60 percent]		14y	
5(y)+0			5y
Taxable income:			
10,000,000×1/20	500,000		
8,000,000×1/14		571,428	
8,000,000×1/5			1,600,000
Tax at 10 percent	50,000	[2] 57,143	160,000
III. FOREIGN OPERATIONS MORE EFFICIENT			
Income from sales	10,000,000	5,000,000	5,000,000
Dividend (60 percent)		3,000,000	3,000,000
Apportionable income	10,000,000	8,000,000	8,000,000
Total factors each State (numerator)	y	y	y
Total factors (denominator):			
5(y)+5(0.6y)	8y		
5(y)+[5(0.6y)×60 percent]		6.8y	
5(y)+0			5y
Taxable income:			
10,000,000×1/8	1,250,000		
8,000,000×1/6.8		1,176,470	
8,000,000×1/5			1,600,000
Tax at 10 percent	125,000	[2] 117,647	160,000

[1] The examples follow the text at pp. 2 and 4. Each of the 5 States accounts for $1,000,000 of income and y of apportionment factors. Each of the 5 countries accounts for $1,000,000 of income and y, 3y, and, 0.6y of apportionment factors in Examples I, II, and III respectively.

[2] In all these examples, if the dividends were simply excluded from apportionable income the tax would be $100,000 (5,000,000×1/5×10 percent).

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STATEMENT OF WILLIAMSBURG STEEL PRODUCTS CO., BROOKLYN, N.Y.

OUT OF STATE SALES AND USE TAX FILING PROBLEMS ON INTERSTATE SALES

1. Many states require filing of tax returns within 15 days after the period covered by the return to avoid the imposition of penalites. For instance, for a period ended March 31, the return is due by April 15th.

(a) Due to multi-state business of many firms, they find it impossible to close their books for the third month of each period in time to file their returns by the 15th day after the period covered by the return. In other words, they are only allowed 15 days to classify every invoice by states and type of sale, such as sales for use, sales for resale, and non-taxable sales as hereafter enumerated in paragraph 4. This is actually impossible to do without the use of electronic equipment now used by some giant corporations and which small and moderate sized firms simply cannot afford.

In a number of states filing is required on a *monthly* basis.

As a matter of fact, even with the use of such electronic equipment, many firms cannot afford the expense of the trained personnel needed to complete the closing of their books and the necessary analysis of each invoice in order to file returns within only 15 or 30 days after the close of each period.

In other words, a tremendous administrative and economic burden is imposed on a business concern when it is required to pursue each sale destined for another state and analyse it in terms of the applicability of the tax in the state of destination.

2. In addition to the State requirements for filing tax returns, many cities, counties, and other local government agencies in such states impose sales and use taxes of their own on the same sales.

Some examples of such local agencies which impose sales and use taxes on sales made by a nonresident company where the property of such company is delivered to one of its citizens are:

Illinois, about 1,150 cities and 45 counties.
Alabama, at least 12 counties.
Colorado, at least 3 counties
Louisiana, at least 7 counties.
Mississippi, at least 81 counties.
New York, at least 9 counties.
Utah, at least 8 counties.
California, Virginia and others, at least 50 counties.

3. The sales and use tax laws require the seller to charge and collect the taxes on each shipment of merchandise. In industires which sell to general contractors on a lump sum basis, each individual shipment cannot be billed for the proportionate sales and use tax, but such tax billing can only be accomplished on a finished contract basis because the amount of the final billing is subject to change due to necessary changes in quantities and specifications during construction. Also, as is usual in such business, customers contract to retain percentages of the amount due on the contracts until the final completion and approval of buildings. The states, however, require that sales taxes be billed on each shipment.

It is extremely difficult as a practical business matter to collect sales taxes immediately upon billing, but many states require the seller to advance out of his own funds the taxes billed during any filing period, even though the seller has not yet collected the tax. The financial burden imposed by such a payment requirement on many firms—which are at best acting as tax collectors—is greatly in excess of their entire net worth.

4. Analysis is required to classify sales into taxable and non-taxable sales. Some categories of non-taxable sales are:

1. Sales for resale.
2. Sales of food products.
3. Sales to Federal, State and Municipal agencies.
4. Credits allowed for returned sales, canceled sales and defective merchandise.
5. Sales to exempt institutions.

In the case of some non-taxable sales, the seller is required to secure various certificates from his customer such as resale certificates, exemption certificates, etc.

This frequently requires a great deal of correspondence with customers and a substantial burden is placed on the seller's credit and bookkeeping departments. Disputes also arise with customers as to the taxability of certain transactions necessitating in many instances the services of lawyers and accountants to interpret the laws and regulations of numerous states and municipalities.

5. There are frequent changes in rates by numerous states and municipalities.
6. Where sellers have offered to furnish the states with lists detailing the shipments made to customers in those states, so that the states could collect use taxes directly from their own residents, the states have refused to agree to such an arrangement, but insist on placing the burden of classifying, collecting and remitting the taxes on the shoulders of the seller.
7. The same burden, indeed a greater one, which caused the Congress to pass the Interstate Income Law forbidding the states to levy income taxes on nonresident companies under certain circumstances, exists in the case of sales and use taxes.

Under such a law the states would not suffer the loss of any substantial revenue, but would simply be prevented from making a collector out of a nonresident seller, and would collect tax directly from purchasers who are residents of those states.

8. The words of Justice Frankfurter, of the United States Supreme Court in his dissent in the Northwestern-Stockholm decision, deserve repetition here:

"There are thousands of relatively small or moderate sized corporations doing exclusively interstate business spread over several states. To subject these 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 diverse and variegated tax laws of fifty States, with their different times for filing returns, different tax structures, different modes for determining net income, and different often conflicting formulas of apportionment. This will involve large increases in bookkeeping, accounting and legal paraphernalia to meet these new demands. 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, especially in the case of small companies doing a small volume of business in several States.

9. During the past five years Congressional Committees have held numerous public hearings. For five consecutive years the House of Representatives has passed necessary legislation under "Interstate Taxation Acts" to impose jurisdictional limitation applicable to sales and use taxes on sales made by firms who do a strictly interstate business.

However, these Interstate Taxation Acts have never been permitted to get out of the Senate Finance Committee for a vote in the United States Senate.

STATEMENT OF JAMES H. PETERS, CHIEF TAX ATTORNEY, LONG LINES DEPARTMENT, AMERICAN TELEPHONE & TELEGRAPH CO.

My name is James H. Peters and I am Chief Tax Attorney of the Long Lines Department of the American Telephone and Telegraph Company. The American Company is the parent company of the Bell System, a group of companies composed primarily of 23 regional operating telephone companies, the Western Electric Company and Bell Telephone Laboratories.

Through its Long Lines Department, the American Company constructs, operates and maintains an integrated nationwide network of long distance facilities that interconnect the territories of the operating telephone companies and the territories of those companies with foreign telecommunications carriers in order to provide customers of the operating telephone companies, as well as customers of the some 2,000 other telephone companies in the United States, with interstate and international telecommunications services. For this purpose, the Long Lines Department of the American Company owns facilities in every State and chiefly because of this the American Company last year accounted for approximately $100 million of the $1.9 billion payment of State and local taxes made by the Bell System.

The office of the Chief Tax Attorney of the Long Lines Department administers the State and local taxes of the American Company which result from the interstate and international telecommunications business in which the Long Lines Department engages.

In general, the American Company supports S. 1245. There are two areas, however, of primary concern to the American Company in that bill and in other proposals for Federal regulation of State taxation of interstate commerce. They are: (1) the treatment of dividends received by a corporation from another corporation and, particularly, dividends received from a subsidiary corporation, and (2) the exclusion of investments in subsidiaries from the capital stock tax base.

INTERCORPORATE DIVIDENDS

S. 1245 excludes dividends received from a corporation in which the taxpayer owns at least 50 percent of the voting stock (80 percent in S. 2092) from income attributable to a taxing jurisdiction. All other dividends received which do not represent foreign source income are attributed to the State of commercial domicile of the taxpayer.

(A) Exclusion of Dividends Received from Corporations in which Taxpayer owns 50(80) Percent of the Voting Stock

The intercorporate dividend problem is a critical one for the American Company. Last year it paid dividends to its 3 million shareholders of over $1.6 billion. Funds to pay those dividends must come from its subsidiaries in the form of dividends paid to the American Company. Virtually all of those dividends were paid out of earnings subject to State and local income taxes.

If the American Company were required to pay State and local income taxes on dividends paid to it by its subsidiaries, the tax burden on the American Company would be increased many fold and result in tens of millions of dollars of additional tax. Most States recognize the discriminatory and multiple burden aspects of taxing intercorporate dividends and follow the Internal Revenue Code treatment of dividends received by a corporation.

Today there exists an effort on the part of a number of State tax administrators to reverse the traditional approach to the taxation of dividend income (the traditional approach is that such income is subject to tax only in the State of commercial domicile of the recipient corporation), and supplant it with a concept that dividend income should be subjected to tax in each State in which the recipient corporation conducts its own business operations. This is accomplished by including dividend income in business income to be apportioned by means of a formula. Of course, the State in which a corporation has its commercial domicile would be able to tax only so much of the corporation's dividend income as its business activities in the State would permit under the apportionment formula.

This effort is being pursued in proposals for Federal legislation supported by some State tax administrators, and this endeavor will have a significant impact on State taxation of interstate commerce. In our opinion, the failure of Federal legislation to exclude intercorporate dividends received from a subsidiary from income attributable to a taxing jurisdiction so that all intercorporate dividends are exposed to tax in the States in which the recipient of the dividends conducts its business will cause more and more States to ignore the inequity and discrimination inherent in the taxation of intercorporate dividends in favor of tapping new revenue sources which fall but lightly on their own residents.

Another recent trend that makes the problem of intercorporate dividend taxation one demanding the attention of the Congress is the increase in the number of local units of government resorting to income taxes as a means of raising needed revenues. A net income tax on intercorporate dividends at the sub-state level of government simply adds another layer of multiple taxation for an affiliated group of corporations.

A tax on intercorporate dividends is both unfair and discriminatory. This is particularly true with respect to a tax on dividends received from a subsidiary corporation. It applies only to businesses that must operate through subsidiaries. The problem is aggravated where the parent corporation of an affiliated group conducts business operations in a number of States and is unable to avoid such multiple taxation even through the State in which the parent has its commercial domicile would not tax dividends received from subsidiaries.

The Bell System represents a relatively simple corporate organization considering its size and the complexity of its operations. Our experience over many years clearly shows that separate operating telephone companies, each responsible for providing telecommunications services in a particular area, are necessary for the furnishing of the highest grade of service and result in many benefits to the users of the service. This is due primarily to the local nature of the services furnished (most of the 410 million conversations transmitted each business day are local calls), comprehensive regulation by State and local regulatory agencies and the size and complexity of the business operations of the telephone companies. A majority of the members of each company's Board of Directors is composed of outstanding persons in the fields of business and finance who are knowledgeable as to the local conditions in the operating territory of the company on whose Board they serve. The distinctly different nature of the business of Western Electric,

which manufactures and supplies equipment for the Bell System and does work for the United States Government, its size and the complexity of its operations account for its separate corporate existence. Also, the existence of separate corporations provides the needed flexibility in financing the large amounts of capital required for continued growth of the Bell System. The 1973 construction program will require $4 billion in new money, approximately three-quarters of which will be raised through debt issues of the operating telephone companies. Moreover, because of legal, operational or other business needs, many other industries also have no choice but to operate through subsidiaries.

The treatment of intercorporate dividends at the Federal level is instructive of the policy considerations involved. Until the enactment of the Revenue Act of 1935, dividends received from domestic corporations which were subject to the tax imposed on corporations were fully deductible from taxable income. The 1935 Revenue Act reduced the deduction to 90% and the 1936 Revenue Act changed the deduction to a credit equal to 85% of the amount of dividends received.

The reason for the reduction in the amount of dividends excluded from taxable income was to prevent avoidance of the graduated tax through the device of numerous subsidiaries or affiliates, each of which might technically qualify as a small concern even though all were in fact operated as a single organization. We might note that somewhat ironically the rationale for a graduated tax as stated in the message of the President to the Finance Committee was based on the advantages and protections conferred by the Federal Government and included the protection from State taxation of interstate commerce. It is described in the following passage from the message:

> "But perhaps the most important advantages, such as the carrying on of business between two or more States, are derived through the Federal Government—great corporations are protected in a considerable measure from the taxing power and the regulatory power of the States by virtue of the interstate character of their business. As the profit to such a corporation increases, so the value of its advantages and protections increases." (Senate Report No. 1240, 74th Cong., 1st Sess., 1935)

The tax on intercorporate dividends took the place of the tax on consolidated returns as such returns were prohibited after 1935 except with respect to railroads. The Revenue Act of 1942 made consolidated returns generally available at the option of taxpayers and reinstated the surtax on such returns.

The Revenue Act of 1964 revised the provisions of the Internal Revenue Code with respect to multiple surtax exemptions and the filing of consolidated returns in order to encourage the treatment of commonly controlled corporations as an economic unit for purposes of taxation. The Congress recognized that some corporations meeting the test of common ownership required for the filing of a consolidated return would not, or for one reason or another could not, file a consolidated return but would be willing to forego the benefit of multiple surtax exemptions if intercorporate dividends could be deducted from taxable income. For this reason, a 100% deduction for dividends received from domestic subsidiary corporations was included in the Act. The Report of the Committee on Finance contains a quotation from a letter of the Secretary of the Treasury which explains the reason for the President's recommendation with respect to taxation of subsidiary dividends. It states:

> "This amendment is designed to facilitate the adjustment to the elimination of multiple surtax exemptions in cases where the affiliated group does not, or cannot, file consolidated returns, but would recognize that the earnings of an 80-percent-owned operating subsidiary are more directly the earnings of the parent than is the case where one corporation merely derives investment income from an unrelated corporation." (Senate Report No. 830, 88th Cong., 2d Sess., 1964)

Statements of persons supporting this portion of the President's tax recommendations cite the need to encourage the free flow of funds between parent and subsidiary and the desirability of removing the need to keep the capital-to-debt ratio of a subsidiary as low as possible in order to avoid excessive taxes.

We believe that the policy recommendations which underlie the treatment of dividends received at the Federal level are equally applicable to the treatment of dividends received at the State level. State corporate net income tax laws generally contain flat rates or rates that have little graduation so that it would be impractical for an interstate business to create multiple corporate entities simply to take advantage of graduated tax rates in a State in which it conducts some of its

business activities. If graduated rates present a problem for a State with respect to affiliated corporations, it can be resolved in a more appropriate manner than by taxing intercorporate dividends. It is instructive to note that no State which taxes intercorporate dividends makes any attempt to relate the tax to a potential advantage for multiple corporations under its graduated tax rates. We suggest that it is against the national interest for States to impose a burdensome tax on businesses which operate through separate corporate entities, thereby creating the very problems for such a business that the Federal tax law is designed to alleviate. In our situation, such a tax will either be recovered from customers for telephone service as an additional expense of furnishing the service or through the added cost of attracting the large amounts of additional capital needed for future growth in our business in order to maintain a high quality of service. In our opinion, it is not proper to burden users of telephone service with excessive taxes that are not related to the ability to pay or benefits received.

Therefore, we urge the Congress to adopt the approach followed by S. 1245 or S. 2092 to State and local taxation of intercorporate dividends which excludes dividends received from a subsidiary from income attributable to a taxing jurisdiction.

Some State tax administrators may suggest that the right to file consolidated State income tax returns in which subsidiary dividends are eliminated sufficiently protects a multicorporate enterprise from excessive taxation. There are, however, wholly different policy considerations involved with respect to consolidated returns. Consolidated State income tax returns extend beyond the geographical boundaries of a State to include corporations which are not doing business within its borders. This raises a jurisdictional question and results in a shifting of income between States in which the affiliated corporations conduct their business operations. This shifting effect adds a dimension of complexity to consolidation at the Federal level where the elimination of intercorporate transactions and the offsetting of losses of one corporation against the net income of another are involved. Consolidated returns have had varied history in Federal tax law; at one time being mandatory, at another prohibited and at yet another optional with the taxpayer. When, in 1921, it was recommended that consolidated Federal income tax returns be made permissive at the option of an affiliated group, the Senate Finance Committee stated:

> "Under existing law affiliated corporations are required to make consolidated returns. Owing to the complexity of the consolidated return in certain instances, the corporations affected would prefer not to make such consolidated returns. . . ." (Senate Finance Committee, *Internal Revenue Bill of 1921*, 67th Cong., 1st Sess., Report No. 275, p. 20)

There are a number of reasons why the American Company does not recommend consolidated State income tax returns as a solution to the problem of duplicative taxation with respect to intercorporate dividends from subsidiaries. Because of the shifting effect heretofore described, consolidated State returns are not considered appropriate for regulated intrastate utilities. The complexity of such returns would add significantly to compliance costs. Consolidated State returns raise questions regarding jurisdiction. S. 1245 permits consolidated returns only in special situations for the reason, among others, that most States do not permit or require consolidated returns generally, and a radical departure from common practice may seriously affect the revenue systems of a great many States.

(B) Specific allocation of taxable dividends to State of taxpayer's commercial domicile

If any dividends received by a corporation are taxed, such taxable dividends should be assigned to the State in which the recipient corporation maintains its commercial domicile. There are several reasons why we favor this attribution of dividend income other than the previously stated concern that apportionment will encourage taxation of certain intercorporate dividends that should be excluded from the tax base. Dividends received by the American Company are primarily from its subsidiaries. The remainder (about 0.5%) are from other communications carriers in which the American Company owns a 50 percent or less interest. These latter investments are held by the American Company at its headquarters in New York and are rarely bought or sold by it on the open market. The holding of these investments is the function of the General Department of the American Company. In contrast to the Long Lines Department, the General Department occupies and uses very little real and tangible personal property, which is principally located in New York, and has relatively few employees, most of whom work at the headquarters of the American Company in New York. Its gross receipts consist primarily of dividends from the investments described above. It also receives fees

from the license contracts which the American Company has entered into with each of the operating telephone companies, interest on temporary investments of idle funds and on temporary advances to the telephone operating companies and royalty income from patents.

If dividend income is treated as ordinary business income in Federal legislation setting the limits on the amount of income attributable to a State or political subdivision, most States would tax dividends received by the American Company on the basis of a formula of real and tangible personal property, payroll and operating receipts. Such a result would be untenable because the real and tangible property, the payroll and the receipt of the Long Lines Department would dominate the factors of the apportionment formula, and dividend income received by the American Company is not generated by any of the real or tangible assets of the Long Lines Department, or by employees of the Long Lines Department, and bears no relation to the amount of telephone services furnished in a State by the Long Lines Department. The lack of congruence between the dividend income and the factors of the apportionment formula also raises a Constitutional issue.

The only State which can lay claim to the dividends received by a corporation with any foundation in economic fact is the State in which its commercial domicile is located. If the limit on income attributable to a taxing jurisdiction is set by assigning all income by means of a formula, then the State in which a taxpayer has its commercial domicile will not be able to assign to itself all taxable dividends received by a taxpayer. If the Congress considers certain dividends a fit subject for taxation by the States, we see no reason why the State in which the company maintains its headquarters and domicile should be restricted from taxing those dividends.

The taxation of dividends coupled with their apportionment by formula to the States in which the recipient corporation does business creates unsound business practices to which the taxpayer must resort in order to avoid burdensome taxation. It may be necessary to do business in a State through a subsidiary rather than the parent if that State taxes dividends and requires an out-of-state corporation to apportion its dividend income on the basis of a formula. A multicorporate business may refrain from entering a State because it taxes dividends when wise business judgment would dictate otherwise except for the additional tax burden. Also, a business will do all in its power to reduce its factors in a State that not only taxes its business income but its dividend income as well.

Therefore, direct allocation of dividend income to the State in which the recipient corporation maintains its commercial domicile is the more reasonable and perhaps the only proper method of assigning such income, and direct allocation is the method used by most States today.

INVESTMENTS IN SUBSIDIARIES

The capital invested in a business enterprise is not increased merely because that enterprise is made up of a number of corporations rather than a single corporation. It is duplicative taxation to tax the capital of a subsidiary corporation and then tax that part of the capital of its parent which consists of the parent's investment in the subsidiary corporation. A number of State laws now exclude investments in subsidiaries from their capital stock tax bases. In at least one instance where an exclusion was not contained in the law, the State supreme court sanctioned a multiform method of reporting which separated the holding company activities of the parent corporation from its operating activities in order to avoid what it considered an unconstitutional result. This approach is somewhat akin to specific allocation of dividend income for income tax purposes. It is a far less desirable solution to the problem of duplicative capital stock taxation than excluding investments in subsidiaries from the tax base. In addition, if investments in equity securities and debt obligations of subsidiaries are retained in the capital stock tax base of the American Company, the factors of the apportionment formula will have no rational relationship to those items in the tax base. This situation will give rise to a Constitutional question. Consolidated returns may represent a possible solution to the problem but the same difficulties are involved in filing a consolidated capital stock tax return as there are in filing consolidated income tax returns.

Therefore, the American Company urges that investments in and advancements to subsidiaries be excluded from the tax base in the provisions of any Federal bill defining the maximum capital attributable to a taxing jurisdiction.

IVINS, PHILLIPS & BARKER,
Washington, D.C., September 28, 1973.

OFFICE OF CHIEF COUNSEL,
Senate Finance Committee's Subcommittee on State Taxation of Interstate Commerce, Dirksen Senate Office Building, Washington, D.C.

GENTLEMEN: On behalf of H. J. Heinz Company, of Pittsburgh, Pennsylvania, we submit the following comments for consideration by the Subcommittee on State Taxation of Interstate Commerce in connection with its deliberations on S. 1245 and S. 2092.

Federal legislation that would provide uniform rules for taxation by states and local governments of businesses operating in interstate commerce is urgently needed to prevent double taxation of multistate businesses. The following comments will be confined to a discussion of two specific inequitable aspects of state taxation of interstate commerce of special concern to Heinz, namely, (1) the ability of states to require consolidation or "combined reporting" by affiliated corporations, and (2) the ability of states to tax intercorporate dividends. Both S. 1245 and S. 2092 contain provisions that would effectively eliminate the current inequities resulting from the present nonuniform and, in some cases, grossly inequitable state laws in these areas.

I. CONSOLIDATION OR COMBINED REPORTING OF "UNITARY BUSINESSES"

The aspect of state taxation of interstate commerce of greatest concern to Heinz is the current application by a few states of the so-called "unitary business" doctrine to multi-corporate enterprises. It is well established that in appropriate cases the business of a single corporation may be treated as unitary in nature and that the total income of such a corporation may properly be apportioned under a formula that fairly attributes a proportionate part of the corporation's income to a particular state. When applied in a multi-corporate setting, however, the unitary business doctrine of combined reporting requires that a corporation with a business location in the state include in its apportionable tax base not only the entire income of such corporation, but also the income of such of its out-of-state affiliates as are found by the state to participate with the corporation in a single business unit.

This broad approach to corporate taxation can in effect result in taxation by a state of the income of corporations that have no real contact with the state and, since it is not applied by all states, can result in more than 100% of a company's income being subjected to state taxation. And as it has been interpreted by a few states, such as California and Oregon, the unitary business concept can result in the income of foreign affiliates being included in the apportionable tax base of a corporation with a business location in the state, even though the activities in the state in no way contribute to the earning of such foreign income. The experience of Heinz in the States of California and Oregon clearly illustrates the inequities encountered when the unitary business concept of taxation is applied on a worldwide basis.

Heinz is a Pennsylvania corporation engaged primarily in the manufacture, packaging and sale of an extensive line of food products within the United States. It owns and operates eleven factories in this country, two of which are located in California and one of which is located in Oregon. Heinz's wholly owned subsidiary, Star-Kist Foods, Inc., a major canner of tuna and various other fish products at Terminal Island, California, is a California corporation with fish processing subsidiaries in Peru, Samo and Puerto Rico. Heinz acquired ownership of all the stock of Star-Kist in 1963. Since 1918, foreign subsidiaries of Heinz have manufactured and sold food products in many of the major world markets outside the United States. The bulk of such foreign sales in recent years have been handled by Australian, British, Canadian, Dutch and Venezuelan subsidiaries of Heinz, each of which has substantial processing and distribution facilities.

Both Star-Kist and the foreign subsidiaries of Heinz are operated in an independent and autonomous manner, and the activities of Heinz in California do not in any significant way contribute to the operations of its various subsidiaries. The foreign subsidiaries of Heinz purchase their own raw materials, manufacture their own products, make the great preponderance of management decisions, tailor make products for their individual cultures, do their own adverstsing and selling (with certain limited exceptions, *e.g.*, Heinz will sell foreign goods for a certain Western Hemisphere export area in return for an arm's length sales commission), have their accounting and legal work done by local professionals, handle their insurance on the local level, and, for the most part, provide their own working capital.

For franchise tax purposes, California law requires a corporation subject to California franchise tax to include in its apportionable tax base the income of those out-of-state affiliates of the corporation that participate with it in a unitary business. Heinz has consistently calculated its California franchise tax on the theory that its entire United States operations constitute a single unitary business. For the fiscal year 1960 and for all subsequent years for which the tax returns of Heinz have been audited, California franchise tax authorities have taken the erroneous position, which Heinz is litigating on both factual and constitutional grounds, that all foreign subsidiaries of Heinz should be combined with the United States operations of Heinz on a unitary business basis for the purpose of computing the combined corporate income apportionable to California. California has also included the income of Star-Kist and its foreign subsidaries in Heinz's apportionable tax base for taxable years after 1963.

In the judgment of Heinz, California attempts to treat worldwide Heinz operations as a unitary business only because during the past decade the foreign subsidiaries of Heinz have generally been relatively more profitable than the domestic operations of Heinz. In any event, the effect of such an approach is to increase greatly the taxable income of Heinz for purposes of the California franchise tax.

Oregon taxing authorities have also aggressively applied the unitary business concept to Heinz and its foreign subsidiaries to compute the liability of Heinz for Oregon income taxes during fiscal years 1966–1968. It is anticipated that Oregon will adopt the same approach in audits of tax returns for all years subsequent to 1968. Heinz is also contesting the position taken by Oregon.

Federal legislation is urgently needed to prohibit states such as California and Oregon from including the income (and payroll, property and sales) of foreign corporations (and domestic corporations operating almost exclusively abroad and not otherwise subject to a state's taxing jurisdiction) in the apportionable tax bases of companies such as Heinz through the guise of the unitary business concept of taxation. Application by a state of the unitary business concept on a worldwide level results in the inclusion in the apportionable tax base of income that is not even included in the determination of the federal income tax imposed by the United States. Such a practice conflicts directly with international tax policies of the federal government, as expressed in our federal income tax laws, which are designed to prevent double taxation of multi-national corporations.

The draftsmen of both S. 1245 and S. 2092 recognize that in order to avoid double taxation, states must be prohibited from applying the unitary business concept on a worldwide basis. S. 1245 would prohibit a state from requiring a corporation subject to its taxing jurisdiction to "combine" or "consolidate" its income with either (1) any corporation incorporated outside the United States, or (2) any domestic corporation that derives 50% or more of its ordinary gross income from "sources without the United States," as that term is defined for federal income tax purposes. In addition, S. 1245 would expressly exclude from apportionable income all income from sources without the United States. S. 2092 would also prohibit consolidation or combined reporting between domestic corporations and Western Hemisphere Trade Corporations, possessions companies, China Trade Act Corporations and corporations which derive 90% or more of their income from sources without the United States, as determined by application of the three-factor apportionment formula contained in S. 2092. Additionally, S. 2092 would expressly exclude from apportionable income all income from controlled foreign corporations taxable to United States shareholders under section 951(a)(1) of the Internal Revenue Code ("Subpart F Income").

In general, Heinz prefers the provisions dealing with foreign income contained in S. 1245 to those contained in S. 2092. S. 1245 is intended to prohibit consolidation of foreign source income on a broader scale than S. 2092. Heinz wishes to emphasize, however, that in spite of the fact that it considers the proposed provisions contained in S. 1245 with respect to consolidation preferable to those contained in S. 2092, it would welcome the enactment of a uniform federal law that contained consolidation provisions similar to those contained in S. 2092.

II. STATE TAXATION OF INTERCORPORATE DIVIDENDS

Another aspect of state taxation of interstate commerce that has proved especially troublesome to Heinz is the double taxation that results from the current practice of those few states that include dividend income in the apportionable tax base of corporations subject to their taxing jurisdiction. In addition, some states indirectly tax dividend income through the so-called "interest offset

provisions." Again, a description of the inequitable state practices to which Heinz is currently being subjected will serve to illustrate the urgent need for a uniform rule with respect to state taxation of intercorporate dividends.

As a part of its overall operations, Heinz is engaged in the State of Michigan almost exclusively in the marketing of food products. It also makes periodic purchases of agricultural products in the state, and operates a small plant located in Holland, Michigan, principally for the processing and packaging of pickles. As a result of its business activities in the state, Heinz is subject to Michigan income tax. In an audit of the state income tax returns of Heinz for the fiscal years from January 1, 1968 to April 30, 1970, the Michigan taxing authorities included in its apportionable business income dividends in the amount of $24,358,663 received by Heinz during such period from its foreign subsidiaries on the theory that dividend income from foreign subsidiaries is business income subject to apportionment among the states. Heinz is currently litigating such determination.

California is another example of inequitable treatment of dividends received by Heinz from its foreign subsidiaries. California does not include dividends received by a corporation subject to its taxing jurisdiction in such corporation's apportionable tax base. However, California indirectly attempts to tax dividends received by Heinz from its subsidiaries by offsetting apportionable interest expense against nonapportionable dividend income. Heinz is also currently litigating this so-called "interest offset provision" of California law.

The draftsmen of both S. 1245 and S. 2092 recognize that dividend income received from both domestic and foreign sources by a multistate corporation with a business location within a particular state is completely unrelated to the business activities of the corporation in that state. Accordingly, both bills would in effect provide that dividend income be excluded from a taxpayer's apportionable income tax base. In addition, both bills would prohibit the indirect inclusion of dividends in the apportionable tax base through use of the "interest offset provision" described above.

Both bills would also prohibit the state of domicile from taxing intercorporate dividends received from affiliated companies. It is well recognized that double taxation results from the taxation of profits in a subsidiary corporation and the subsequent taxation of dividends from those profits when they are paid to the parent corporation. In recognition of the clear inequity of taxing both corporate profits and corporate dividends received, the federal government and numerous states have granted relief by giving full or partial exclusions or deductions for domestic intercorporate dividends received. In addition, the federal government allows a foreign tax credit for dividends received from a 10% or more owned foreign affiliate. Many states, however, have not enacted legislation that would prevent double taxation in this area and for this reason federal legislation on the subject is appropriate and necessary.

Under S. 1245, both dividends from foreign corporations (including the gross-up element) and dividends from corporations in which the taxpayer owns 50% or more of the voting stock are not taxable in any state. S. 2092 contains helpful but more limited provisions. It would exempt from taxation in any state dividends from corporations in which the taxpayer owns 80% or more of the voting stock. Although S. 1245 provides a more inclusive solution to the problem of double taxation in the intercompany dividend area, enactment of the provisions of S. 2092 would greatly alleviate the potential for double taxation of intercorporate dividends.

III. CONCLUSION

Heinz strongly urges the Subcommittee to report favorably legislation that would adequately deal with the two major problems Heinz has encountered in the area of state taxation of interstate commerce. Solutions to these problems are contained in both S. 1245 and 2092. Although Heinz generally prefers the provisions contained in S. 1245 to those contained in S. 2092, it considers S. 2092 adequate to deal with the pressing problems resulting from attempts by the states to tax foreign source income and intercorporate dividends from affiliates. Regardless of whatever action that might be taken on other aspects of state taxation of interstate commerce by this Subcommittee, Heinz reiterates the pressing need for uniform federal legislation in these two areas.

If the Subcommittee should decide to recommend enactment of S. 1245, section 522 thereof should be amended to expressly include "Subpart F income" in the definition of income from sources without the United States. Such an amendment is

necessary because Subpart F income is not expressly included in the definition of foreign source income contained in section 862 of the Internal Revenue Code.

Very truly yours,

JAY W. GLASMANN.

STATEMENT PRESENTED BY JOHN S. NOLAN, ATTORNEY, MILLER & CHEVALIER

EXTENSION OF THE CALIFORNIA UNITARY BUSINESS CONCEPT FOR TAXATION TO FOREIGN-BASED MULTI-CORPORATE GROUPS

Recent efforts by the State of California to extend their unitary business concept to tax an allocated portion of the worldwide income of foreign-based multi-corporate groups raises anew the familiar conflicts between the power of the states to tax on the one hand and the Constitutional prohibitions on undue interference with interstate or foreign commerce and denials of due process on the other hand. Congress has enacted no legislation of significance to limit the power of the states to tax foreign or interstate commerce, or to limit the jurisdictional reach of the state taxing power on due process grounds, and the limitations which exist derive from a long line of Supreme Court decisions.

Historical Development

As indicated, the due process clause raises the question whether there is adequate jurisdiction to tax. It requires an examination of the connections between a taxpayer and a state. It will ordinarily be satisfied in those instances where a state provides benefits or services sufficient to permit the state to ask for something in return.

The interstate commerce clause addresses itself to a reconciliation of the competing demands of the state and national interests concerned. Various tests have evolved in applying the commerce clause. Under one test, if a state tax constituted a direct burden on interstate commerce it was held invalid while if a tax constituted an indirect burden it was not invalid. A second test was the multiple taxation doctrine: if a state tax subjected a taxpayer to a risk of multiple taxation, the tax would be invalid. A state could not discriminate against interstate commerce and in favor of local business. The objective in all cases was to avoid an undue burden on interstate commerce.

The unitary business concept was one of the means of accommodating the conflicting interests of the state and federal governments. It had its origin in the ad valorem taxation of railroad companies. In the last half of the nineteenth century, the railroads were the largest industrial organizations, particularly as a group. The states wished to reach and assess for ad valorem tax purposes some of the wealth of the railroads beyond the bare value of the tracks and ties permanently located within the state. The method devised was to determine the entire valuation of the company and then to allocate to the taxing state the proportion of such valuation that the track mileage of the company within the state bore to track mileage of the company everywhere. This practice was upheld by the Supreme Court in numerous instances, first with respect to railroads, and later with respect to telegraph, telephone, and express companies. The Court permitted the companies to be valued as a unit because it saw a unity in the use of the entire property for a common specific purpose. See *Adams Express Co.* v. *Ohio*, 165 U.S. 194 (1897).

The unitary rule was not of unlimited scope. The Court described the requisite unity as being something more than a mere unity of ownership. The unity had to arise from the character and necessities of the business. The states were not permitted to include within the property to be valued under the unitary rule any property not connected with the unitary business. *Fargo v. Hart,* 193 U.S. 490 (1904). The states were also prevented from applying the unitary rule in situations where its use would plainly result in an unjustified increase in the tax imposed by the states. *Wallace v. Hines,* 253 U.S. 66 (1920).

Eventually, the unitary business concept was extended to a franchise tax measured by net income. *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920). The result was that where a taxpayer was doing business in more than one state, the income taxable by each state would not be determined by a separate accounting on the books of the taxpayer for the activities engaged in within the state, but would instead by determined by allocating a portion of the entire net income of the taxpayer to the state on some formula basis.

The use of formulas to apportion entire net income is now widespread and widely accepted. While imperfect, the use of a formula is more likely to result in an appropriate allocation of the entire net income of a unitary business to an individual state than other methods of allocation. The typical formula is a three factor (property, payroll, and receipt) formula which measures the ratio of the in-state amount of these factors to the total amounts.

California has been the leading proponent of the unitary business concept. The State had won a signal victory in the leading case of *Butler Brothers v. McColgan,* 17 C. 2d 664, 111 P. 2d 334 (1941); aff'd 315 U.S. 501 (1942). In that case, the California Supreme Court established a test for determining the unitary nature of a business which looks for the following circumstances: "(1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. . . .". It subsequently extended the concept to apply to a group of corporations, only one of which did business within California, engaged in a common business. *Edison California Stores, Inc. v. McColgan,* 30 2d 472, 183 P. 2d 16 (1947). The specific situation involved a retail shoe business conducted through fifteen subsidiary corporations, each located in a separate state. The situation was one where the economic justification for use of the unitary business concept was essentially the same as if a single corporation had engaged in the same activity through branch offices. The California court permitted the state to allocate a portion of the entire net income of the group of corporations to the state. In so doing, it set forth a second test for determining if a business is unitary: "if the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state, the operations are unitary".

Ever since the *Edison* case, California has viewed an affiliated group of corporations connected by more than 50 percent stock ownership as being no different for purposes of applying the unitary concept than a single corporate taxpayer which has no affiliations. The state courts have been moderately concerned with the jurisdictional problems involved in including within the measure of a tax the income of corporations which are not doing business or qualified to do business within the state. They overcome their concern by rationalizing that the return required to be filed by the state is a "combined report" and not a consolidated return. A combined report is then said to be merely a means of ascertaining the portion of unitary income arising from sources within the state, which does not disregard the separate corporate entities. Thus, the total gross income of the combined group is supposedly not included in the measure of the tax, and the combined return is said to be the return only of the corporation doing business within the state and not of the other corporations, whose income is included only to measure the taxpayer's income apportionable to the state. The tax is thus supposedly imposed only upon the taxpayer's income and not upon the income of the other members of the group.

The line of reasoning is highly strained. Under any sort of logical, objective analysis, it is the group whose income is being apportioned and not a separate taxpayer's income. While only the taxpayer can be made liable for payment of the tax, it is in substance the group which is being taxed. Examples can be found where the portion of the combined net income proposed to be allocated to the state greatly exceeds the portion of the taxpayer's actual income, much less that part which could reasonably be viewed as attributable to sources within the state after every possible adjustment of income and expense allocations to an "arm's length" basis.

Furthermore, while unity of use and operation, or dependency on contribution between in-state and out-state business is theoretically required, California in fact seems to require little more than the normal attributes of common ownership.

Extension To Foreign-Based Corporate Groups—Constitutionality

California has recently made public its intention to apply its unitary business concept to worldwide groups. It has in the past, although not always successfully, included the income of some foreign members of affiliated groups based in the United States within the combined net income of the group where it has been able to find some contributing links. This latest change, however, is designed to reach the combined net income of *foreign-based* affiliated groups. Thus, the income of a foreign parent and all of its foreign subsidiaries will be combined with the income of its United States subsidiary in determining the liability of the United States subsidiary for state income tax (or franchise tax based on income).

Such action by the state may well violate the due process clause of the Fourteenth Amendment to the Constitution. The state would not in fact be making an effort to determine the portion of the income of the domestic subsidiary attributable to sources within the state, as the unitary rule is intended to accomplish. It would instead be making an effort to determine the portion of the foreign parent's consolidated net income that can be allocated to the state under the rules developed for allocating the income of domestic corporations among the states. Oregon is the only other state that has made a real effort to apply the unitary concept to multicorporate groups in a manner similar to California. The failure of the other states to move in this direction is probably indicative of their concern with the constitutionality of such a method of taxing interstate and foreign commerce.

The accepted bases for jurisdiction to tax under the due process clause are residence, citizenship or place of incorporation, source of income, location of mind and management (a substitute corporate citizenship test), and, to some degree, control and ownership (by a resident or citizen) of an income producing entity. Taxation by a state based on income of a foreign non-resident parent company from outside the U.S. which is owned and controlled by non-U.S. shareholders living outside the U.S. is beyond accepted bounds of jurisdiction. Taxation of a controlled subsidiary's income as the parent's where the parent is a resident domestic company is closer to internationally accepted jurisdictional standards and is, therefore, distinguishable.

A state may not tax a foreign parent and its foreign subsidiaries merely because such parent has a domestic subsidiary which does business within the state. There are no connections between the state and the foreign parent. The state does not provide the foreign parent with services or benefits for which the state can ask something in return. There is no substance in the position that although the state is using the income of the foreign parent to measure the tax it imposes, it is not taxing the foreign parent but is merely determining more accurately the tax of its domestic subsidiary. The effect of California's approach *is* to tax the parent company's income; it does *not* establish the effect of wholly independent dealing, which is all the state can constitutionally seek to approximate. Such an extraterritorial reach is a violation of the Due Process Clause. Such action would open up a frightening new dimension to international double taxation and is contrary to accepted international standards for avoiding such effects. (See Art. 7 and 9 of OEEC Model Income Tax Treaty.)

The proposed California action also violates the commerce clause of the Constitution. Among those powers delegated to the United States was the power to regulate commerce with foreign nations. U.S. Const., Art. I, Sec. 8, Cl. 3. California would impose its taxing system upon foreign corporations that are not doing business within California and usually not within the United States. This practice is certain to constitute a burden on foreign commerce. If the practice spreads to other states the burden will surely become an undue burden.

The Supreme Court's acceptance of income apportionment is based on the concept that the apportionment fairly reflects the income *earned* in the several states. Where allocation factors are used which do not fairly represent the earning power of the business, or assets and income are included which are not part of the business, there is a violation of the Constitution. The use of property, labor, and the amount of sales activity are major factors in the earning of income. The use of (apportionment) factors such as the cost of the property, dollar amount of payroll, and dollar amount of sales where all of the States are within the same economic system and, hence, the factors used are, in effect, homogeneous is reasonable. It is quite another matter, however, to use factors such as the cost of property and wage levels on different continents, and in entirely different economies, as coequal measures of income producing activity.

For example, wage levels are considerably lower in Japan, Italy, or almost any other country, than in the United States for the same work. In 1969, the cost of engineering work in Japan was only 70% of that in the U.S. (England was 75%, Holland 80%, France 90%). In 1972, the cost of skilled construction labor in Japan was approximately $14 per day including social charges. In Argentina, the cost was $7 per day. In England, it was $10 per day, In the United States, the cost is about $25 per day. An apportionment system which allocated twice as much income to California (U.S.) than to Japan because it costs twice as much to do the job in California produces a grossly distorted result. The income is not properly apportioned to local activities.

The same type disparity exists as the cost of plant or property. For example, it would have cost $244 million in California in 1969 to build an oil refinery to produce 125,000 barrels per day; the cost of the same refinery in Germany, however, would have been only about $190 million. Similarly in 1964–70, the average investment needed to provide employment to one person in the rubber industry in the U.S. was $137,000 while an average of only $58,000 was required outside the U.S.

An apportionment of worldwide income based on property and payroll could never, under these circumstances, properly apportion the income to the local activities which produced it.

A second major reason why apportionment of worldwide income does not result in fairly reflecting the income earned in California is the unusual manner in which some industries are taxed by other countries. California would attempt to allocate worldwide *before-tax* income, but in the case of the oil industry, for example, the oil producing countries often impose levels of taxation which are substantially higher than that imposed by the U.S. or other industrialized countries.

California's use of revenues before tax in these situations would produce a major distortion of economic income as a vastly greater amount of income would be deemed to arise from foreign operations than actually could be retained by the producer.

Thus, California's proposed action will result in an undue burden on foreign commerce which is direct and immediate, violating the Commerce clause of the Constitution. If left unchecked, the burden on foreign-based corporate groups will multiply as additional states follow the California lead. The allocation proposed by California could allocate an amount of income to California in excess of the total net income of the domestic subsidiary doing business in California. In any event, the foreign-based group will be subjected to unreasonable requirements for record-keeping and financial disclosure so that California may administer its concept. A U.S. parent is already technically obligated to keep records as to its subsidiaries on a U.S. tax basis. A foreign-based company, however, has no reason or obligation to maintain records based on U.S. rules, and the bulk of its activity is outside the U.S. Hence, the additional mechanics of compliance would be a far heavier burden on the foreign-based company.

Other Considerations

The California proposal is completely inconsistent with the fiscal policies of the Federal Government. The United States has at the present time a serious balance of payments problem. Every effort is being made to attract foreign capital to the United States to alleviate the imbalance. If the states pursue taxing policies that are discriminatory or unreasonably burdensome to foreign-owned companies, foreign capital will not be attracted. A foreign parent's investment in the U.S. which resulted in the inclusion of worldwide activities in the local tax base would be abhorrent to most foreign-based companies. They simply will not comprehend any basis for California's action because it is contrary to all international tax norms. They certainly will be unwilling to provide California with financial information as to their operations outside the United States.

The Treaties of Friendship, Commerce, and Navigation between the U.S. and many foreign countries require fair and equitable treatment and freedom of commerce and prohibit unreasonable measures impairing rights or interests of parent companies. The California action is contrary to this statement of policy.

The proposed California practice is also inharmonious with United States tax policies. The United States does not tax the income of foreign corporations that are not engaged in trade or business within the United States except for fixed or determinable annual or periodical income received from sources within the United States. The United States does tax the income of a domestic subsidiary of a foreign parent. All of the domestic subsidiary's income would be subject to tax just as would the income of any other domestic corporation. In any case where it appears that the income of the domestic subsidiary is understated because of the method of accounting for intercompany transactions between it and the foreign parent or other subsidiaries of the parent, the United States makes adjustments to the income of the domestic subsidiary to place it on a parity with an uncontrolled party dealing at arm's length with another uncontrolled party. These same adjustments could be made by the states as well to ensure them that the taxable income reported to the state by the domestic subsidiary was not understated. In fact, most states (including California) require that all audit adjustments made by the United States be reported to them, after which the states' taxes are adjusted accordingly.

Even if the legal and policy objections are overlooked, there is still a serious question as to the ability of a foreign-based affiliated group to comply with a taxing system such as that of California. Accounting policies are not uniform throughout the world. Most other countries do not have the same elaborate requirements for record keeping and reporting that are common in the United States. The tax systems of other countries also tend to require less volume of information than does that of the United States. The information that will be necessary to file a combined report of net income for an entire foreign-based group will thus not be readily available to the extent it relates to the foreign parent and its foreign subsidiaries. The foreign parent, if it were to fully comply with California requirements, would be required to adopt a completely different and probably otherwise useless system of accounting.

Furthermore, as previously suggested, the foreign parent may be unwilling to supply the information necessary to file a combined return in California even in cases where the information is available. It is unlikely that there is any way the state can force a foreign parent to comply if the foreign parent is not doing business in the United States. The information would not ordinarily be available through the domestic subsidiary because it would not be within its knowledge. Such information as is likely to become available to the state will probably support nothing better than an arbitrary assessment. State officials have informally indicated that in a situation involving a foreign-based affiliated group, California would first request the domestic subsidiary to provide a combined return for the group; if the domestic subsidiary refuses to do so, the state will request the foreign parent to provide the required information; if the parent refuses, the state will rely upon whatever information is available in the nature of annual reports to shareholders and in financial reporters such as Moody's. Once the state makes an assessment, the taxpayer would have the burden of showing that the assessment results in extraterritorial values being taxed. This is a difficult burden to carry in a situation where the rules followed are as theoretical as here.

Finally, some recognition should be given to the probability that some form of retaliation will eventually occur if the practice adopted by California begins to be applied to foreign-based groups. In essence a political subdivision of the United States is stretching its taxing powers outside its borders and even outside the United States when it resorts to such mechanisms. If other states follow this lead, retaliation will be very likely. Our own U.S. corporations may then be required to file a combined report of their worldwide net income with political subdivisions in every country in which one of their subsidiaries did business. The disruptive effect that such a situation would have on the progress that has been made in coming to agreements with other countries to eliminate international double taxation would be profound. And yet it would seem to be a natural consequence of the practice adopted by California.

FINANCIAL EXECUTIVES INSTITUTE,
New York, N.Y., September 27, 1973.

Re Interstate taxation bills S. 1245 and S. 2092.

Hon. WALTER F. MONDALE,
Chairman, Senate Finance Subcommittee on Taxation of Interstate Commerce, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR MONDALE: Financial Executives Institute is the recognized professional organization of financial management in the United States, Canada, and Puerto Rico. Our membership, which consists of some 8,000 individual members, represents a broad cross-section of American business and includes policy-making executives in the financial function of approximately 4,800 companies. One of the primary objectives of our organization is to provide a means for the members to make joint studies and recommendations on matters of broad financial significance.

The Institute, through its Committee on Taxation and its predecessor National Committee on State and Local Taxation, has devoted efforts for more than twenty years on the achievement of uniformity among the States in the taxation of interstate commerce. It welcomes the opportunity to submit its views to the Senate Finance Committee in connection with its consideration of Interstate Taxation Bills S. 1245 by Senators Abraham A. Ribicoff and Charles McC. Mathias and S. 2092 by Senator Warren G. Magnuson.

The Institute has long been concerned with the chaotic problems that have been caused by the lack of uniformity among the States and local communities in jurisdictional standards, apportionment formulae, etc. On numerous occasions in the past, the Institute has voiced to the Congress its support of some form of uniformity. It has frequently commented on various proposals at hearings held on this subject, and has presented its recommendations from a background of professional experience in practical corporate tax management.

It is our opinion that an Interstate Taxation Act, as presently proposed, subject to certain revisions recommended in this statement, will basically provide important and necessary legislation which will aid the conduct of interstate commerce by the adoption of uniform jurisdictional standards, a uniform income tax base and a uniform apportionment formula. We therefore support early passage of such an Act.

FEI supports S. 1245 and believes it is by far the best legislation yet proposed, but we wish to make certain comments and recommendations designed to bring the proposed Act into closer conformity with prevailing accepted practices and point out technical difficulties that would be experienced in the application of certain of its provisions.

JURISDICTIONAL STANDARD

While Section 101 of Title I of S. 1245 represents a substantial improvement with respect to the establishment of a uniform jurisdictional standard for the levying of net income, capital stock and gross receipts taxes, we believe a further clarification of the term "solicitation" is required in view of the varying interpretations the States have applied to this term in recent years. An example of the lack of uniformity in the interpretation and application of this term has been illustrated in the conflicting results reached in the cases of *Clairol, Inc. v. Director, Division of Taxation*, 57 N.J. 199 (1970) in New Jersey, and *Smith, Kline and French Laboratories v. State Tax Commission*, 80 Ore. Adv. Sh. 785 (1965) in Oregon. On fact patterns not differing substantially from each other, the two courts reached opposite conclusions with respect to whether or not the taxpayer's activities came within the statutory exclusion provided for "solicitation".

It is clear from the Congressional committee reports on P.L. 86-272 that Congress intended not only to exempt the actual solicitation of an order by a salesman but also the activities generally associated with and necessarily attendant thereto. As the Oregon Supreme Court stated in the Smith, Kline and French case, "these reports show that Congress intended to exempt not only the specifically described phase of interstate sales efforts but also all lesser, included phases."

Consequently, we believe it to be in the interest of all business taxpayers to have this term defined once and for all by Congress with greater specificity to avoid the increasingly arbitrary applications being made by the States. Such a definition should include, but not necessarily be limited to, activities such as the ownership or leasing of salesmen's cars, "detailing" or missionary work, resident salesmen, the carrying and distribution of point-of-purchase samples and promotional literature, and salesmen's business cards and stationery listing a home telephone and address.

INCOME SUBJECT TO APPORTIONMENT AND ALLOCATION

Of utmost importance is the provision defining apportionable income. Section 207 of the proposed Bill provides that apportionable income means taxable income as determined under State law, excluding income from outside the United States and dividends. This does not give effect to longstanding practices in force in most States, which are supported by a rather extensive body of law, of allocating separately outside of the apportionment formula, interest, rents, royalties and capital gains.

The generally established practice today is to distinguish between business and non-business income, the former being apportionable and the latter being specifically allocable depending on circumstances. Inherent in this distinction is the concept that a portion of business income, based on established formula, has its source in the taxing State and may be subjected to levy there. Business income generally is defined as that arising from transactions in the regular course of taxpayer's business, including income from intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. Here, integral is defined as being essential or necessary.

Non-business income is that derived from sources that ordinarily do not originate from conduct of a business in a State and is allocated to either the State of commercial domicile or to the State of geographic situs depending on the nature of the income. Thus, interest, rents, royalties, and capital gains, being incidental income and not integral to the main business operations should not be apportioned; this type income would only be apportioned if the activity that generates it constitutes the principal or regular business of the taxpayer.

We strongly recommend that Section 207 be amended accordingly and that additional sections be added to the proposed Act that would insure that only income earned in the course of a corporation's regular trade or business would be apportioned.

Allocable income should be allowed to States by specific provisions. We therefore recommend that the following provisions be adopted which would minimize the present confusion that now exists between allocable "non-business" income and "business" income which is apportioned among the States:

1. Rents and royalties from real or tangible personal property

Rents and royalties from real or tangible personal property should be allocated to the State where the property is located or utilized in the State.

The exception that should be made to this general rule for allocating net rents applies to the renting of real or tangible personal property when this is the "principal business" of the taxpayer or the rental of such property is an "integral part" of the taxpayer's principal activity. In these instances, this type of income should be regarded as "business income" to be apportioned among the States. This is in accord with present practice under the Uniform Division of Income for Tax Purposes Act (UDITPA).

2. Gains and losses from sales of assets

In general, gains and losses from sales of real property and tangible personal property should be allocated to the State where the property is located at the time of sale and gains and losses from intangible personal property should be allocated to the State of commercial domicile of the taxpayer.

Here again, an exception should be made to this general rule when the gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes "business income" arising from the acquisition, management and disposition of the property constituting integral parts of the taxpayer's regular trade or business operations and to the extent such property was used in the property factor of the apportionment formula. In such case, the income should be subject to apportionment.

3. Interest

Ordinarily, interest income should be allocated to the State of commercial domicile, as in Section 7 of the Uniform Act, except in instances where the interest is "business income" derived from business activities which constitute integral parts of the taxpayer's regular trade or business operations, in which case it should be apportioned among the States.

4. Dividends

We agree with the proposed Act eliminating dividend income from apportionment; it should be allocated to the State of commercial domicile as in Section 7 of the Uniform Act except for dividends received from affiliated companies which should be excluded from any tax base.

The elimination of dividends received from affiliates from the tax base recognizes that such income is not appropriately taxed at this point—that to do so results in multiple taxation. This principle has long been recognized in the Internal Revenue Code (Sec. 243) by the 85% dividend received credit. In 1954 the House Ways and Means Committee considered the complete removal of such dividends from the tax base, but decided against it because it "is not believed appropriate at this time in view of present revenue needs." The 1964 and 1969 Revenue Acts permit or require 100% exclusion of affiliated dividends under certain circumstances. The State treatment of intercorporate dividends is described on pages 266–267 of Volume I of the Report of the Special Subcommittee on Interstate Taxation (The Willis Subcommittee).

5. Patent and copyright royalties

Patent and copyright royalties should be allocated to the State where utilized by the payer as in Section 8 of the Uniform Act. Trademarks, licenses and service

contracts should be added to this category. We do not approve of the "throwback" or "recapture" provision in Section 8(b)2 which allocates to the State of the Taxpayer's commercial domicile if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable.

Items 1 through 5 of the foregoing discussion speak broadly of "business" and "non-business" income. Controversy is bound to arise as to just when income from interest, rents, royalties, and capital gains cease to be incidental to the main business of the taxpayer and become integral parts of its regular trade or business operations. We suggest that the Act provide for making such determination based on all facts and circumstances but that in no event shall income be classified as "business" if it constitutes less than 10% of total gross income.

THE APPORTIONMENT FORMULA

We agree with the three factor formula contained in the proposed Act and believe it will be acceptable to most of the parties involved in this issue.

PROPERTY FACTOR

We recommend that consideration be given to covering two further areas in the property factor definition in order to eliminate inconsistencies and disputes currently experienced in State practices. The two areas are as follows:

1. Consideration should be given to the inclusion in the property factor of U.S. Government-owned facilities used by a company for the production of income since its exclusion does not reasonably reflect the property used by it in a particular State for the production of income. In this connection, we suggest a review of the California case of *McDonnell Douglas Corp. v. Franchise Tax Board* (California Supreme Court, November 4, 1968) which decided in favor of the inclusion of such property.

2. Some States improperly regard progress payments received under Government contracts as offsets to inventories and consequently are excluding such inventories from the property factor on the premise that title thereto is vested in the Government. This practice is objectionable since the title vesting is merely a security title in nature; the contractor is still liable for risk of loss in the event of theft, destruction of or damage to any such inventories before delivery to and acceptance by the Government. Moreover, those States that regard title passage to such inventories as having taken place are taking the inconsistent position that a sale is not considered to be consummated until the inventories are delivered to and accepted by the Government.

S. 2092

In considering a proposed form of Interstate Taxation Act, we feel that it is necessary to comment on several of the objectionable features of S. 2092, introduced in the U.S. Senate by Senator Magnuson.

This bill would give Congressional consent to a State to enter into the Multistate Tax Compact and would give the Multistate Tax Commission the power to adopt rules and regulations to implement the provisions of the bill. These rules would be binding on the States unless they acted to reject them by using their own procedure for adoption or rejection of regulations relating to the subject matter involved. The bill would also provide a system for taxation of interstate commerce among the States that differs in many respects from the other proposals for an Interstate Taxation Act.

FEI is opposed to the Congressional consent to the Compact as being unnecessary since it would introduce another level of tax administration bureaucracy, consequently compounding the problems of the taxpayer, and would also take administration out of the hands of tax administrators. Enactment of this form of legislation would not solve the problems of the taxation of industry and commerce but would create others.

We believe the Multistate Tax Compact does not afford a satisfactory substitute for Federal legislation because of the practical difficulty in securing the consent of the legislatures of numerous States to the Compact.

FEI also regards the Compact's failure to deal with the question of jurisdiction for taxing income as a serious short-coming. Unlike S. 1245, S. 2092 contains no provisions further restricting the States' power to impose income taxes on interstate companies. Even if such a provision were added to the Compact, it would not affect the ability of nonmember states to assert jurisdiction for taxing such enterprises.

FEI believes that the Federal jurisdictional guidelines set forth in the proposed Interstate Taxation Act S. 1245 provide the better approach and would also provide recourse to the Federal courts for their enforcement. In our opinion, there is no need for further rule making authority to be granted to any agency by the Congress. Coordinating agencies already in existence, such as the National Association of Tax Administrators, can and will provide adequate guidance to the States in the administration of the Federal guidelines.

The Magnuson Bill makes no provision for jurisdictional standards to capital stock and gross receipts taxation. FEI is opposed to this omission and believes that the jurisdictional standards should be extended to such taxes to foster uniformity.

S. 2092 does not make a distinction between allocable "nonbusiness income" and apportionable "business income." The three factor formula would be applied to total income with the exception of: (1) foreign source income described in Section 951(a)(1) of the Internal Revenue Code, (2) dividends paid by a corporation in which the taxpayer owns at least 80% of the voting stock, both of which items would be exempt, and (3) other dividends which would be taxable only by the state of commercial domicile. FEI strongly believes that many problems will be avoided if the concepts of nonbusiness and business type income are adhered to as set forth in this statement with respect to S. 1245. However, if Congress moves towards accepting the Magnuson Bill, then we believe that Section 301(b) of the Magnuson Bill, should be extended to make it clear that any income not apportioned in accordance with this title should not be assigned or allocated to any state or political subdivision. The subsection should also be modified to make it clear that no state has the power to determine the type of income which is apportionable under this title. Section 306(a) should be revised to expand the exclusions from foreign source income to include items such as foreign dividends, foreign royalties and foreign service charge income.

SEPTEMBER 27, 1973.

The Magnuson Bill contains a provision allowing the determination of apportionable income of a corporation by reference to the combined income and apportionment factors of all corporations of an affiliated group of which the corporation is a member, at the option of either the corporation that is a member of an affiliated group or the State. As indicated previously in this letter, we strongly favor the adoption of the approach in S. 1245 which would prohibit a State from requiring a corporation with a business location in the State to include in its combined income the income of an affiliated corporation which does not have a business location in the State. We have also urged that an inclusion in combined income of the income of an affiliated corporation that does have a business location in the State should not be required or permitted if the affiliate operates at an arm's length basis. In our opinion, the power of a State to require combined reporting and the power of an individual taxpayer to achieve combined reporting should be limited to circumstances where it can be demonstrated that, in the absence of combined reports, there would be a distortion of income attributable to the State.

We believe that uniformity among the States in the taxation of interstate commerce can never be fully achieved without some form of Federal legislation. We believe that the passage of an Interstate Taxation Act in the form of S. 1245 would provide important legislation towards accomplishing this objective. We strongly urge its passage and suggest that the recommendations made above will help to make the Bill generally more acceptable and equitable.

Very truly yours,

C. C. HORNBOSTEL.

ASSOCIATED EQUIPMENT DISTRIBUTORS,
Oak Brook, Ill., September 19, 1973.

Hon. WALTER F. MONDALE,
Chairman, Special Subcommittee on State Taxation of Interstate Commerce, U.S. Senate, Washington, D.C.

DEAR SENATOR: This letter is the first of two being submitted on behalf of the Associated Equipment Distributors for inclusion in the record of the Subcommittee's hearings on S. 1245—the Interstate Taxation Act of 1973.

AED is a national trade association composed of approximately 900 independent distributors located throughout the United States who sell, rent, and service construction equipment, both new and used. Our distributor members account for over 80% of the $4 billion annual volume of sales in the nation's construction equipment industry.

Most frequently, a distributor's area of primary sales responsibility is not co-extensive with state lines, but is determined instead by geographic marketing areas. A distributor in Memphis, Tennessee, for example, may have the West portion of Tennessee and parts or all of the states of Alabama, Mississippi, Arkansas and Missouri. Similarly, a distributor in Baltimore may cover Delaware and the District of Columbia as well as Maryland. Accordingly, distributors are intimately concerned with the problem which S. 1245 is intended to remedy—that is, the state taxation of interstate commerce.

Essentially, S. 1245 would prohibit any state from imposing a net income tax, gross receipts tax, or capital stock tax upon a corporation unless the corporation has a business location within the state. The bill would also afford relief from sales tax liability for businesses without a business location within the state through a system under which the buyer or customer would assume liability for payment of any state or local sales or use tax that may be due.

It is our understanding that, to enable the Subcommittee to receive a wider expression of views on S. 1245 than it might otherwise obtain, all parties who have a common position or the same general interest in the legislation have been urged to consolidate their testimony and designate a single spokesman to present their common viewpoint orally to the Subcommittee.

The construction equipment distribution industry, of course, is a segment of our nation's wholesale-distribution industry—and our members typically share the same dilemmas vis-a-vis state taxation of interstate commerce experienced by other small businesses in the overall wholesale-distribution field.

Moreover, a business panel including, among others, a representative of the wholesale-distribution industry is appearing before the Subcommittee today for the purpose of offering a coordinated, multi-business statement with respect to the bill.

Under these circumstances, it is the purpose of this initial letter to confirm that AED and its distributor members support in principle the major concepts of S. 1245 described above, and endorse the general views of the business panel appearing in support of the bill today.

In our subsequent letter, we will focus on specific aspects of the legislation with respect to which we believe particularly unique features of our industry suggest a need for individual comment over and above the general multi-business views to be offered by the panel today.

Respectfully submitted.

ANTHONY J. OBADAL, *Washington Counsel.*

ASSOCIATED EQUIPMENT DISTRIBUTORS,
Oak Brook, Ill., September 28, 1973.

Hon. WALTER F. MONDALE,
Chairman, Special Subcommittee on State Taxation of Interstate Commerce, U.S. Senate, Washington, D.C.

DEAR SENATOR: This letter is the second of two being submitted on behalf of the Associated Equipment Distributors for inclusion in the record of the Subcommittee's hearings on S. 1245—the Interstate Taxation Act of 1973.

AED is a national trade association composed of approximately 900 independent distributors located throughout the United States who sell, rent, and service construction equipment, both new and used. Our distributor members account for over 80% of the $4 billion annual volume of sales in the nation's construction equipment industry.

Most frequently, a distributor's area of primary sales responsibility is not co-extensive with state lines, but is determined instead by geographic marketing areas. A distributor in Memphis, Tennessee, for example, may have the West portion of Tennessee and parts or all of the states of Alabama, Mississippi, Arkansas and Missouri. Similarly, a distributor in Baltimore may cover Delaware and the District of Columbia as well as Maryland. Accordingly, distributors are intimately concerned with the problem which S. 1245 is intended to remedy—that is, the state taxation of interstate commerce.

Essentially, S. 1245 establishes a "business location" test as the jurisdictional prerequisite for the imposition of various state and local taxes upon a business.

Briefly stated, no state or political subdivision thereof could impose either a net income tax, capital stock tax, or gross receipts tax upon a corporation unless the corporation has a business location within the state.

Similarly, the bill affords protection from liability for state sales and use taxes to companies selling to out-of-state businesses. Specifically, if a seller does not have a business location in a state, he will not be liable for the collection or payment of state sales or use taxes on his sales of tangible personal property to business buyers in that state, if he obtains from the buyer, in writing, the buyer's state tax registration number. Once the seller obtains this number from the buyer, the state can look only to the buyer for collection of any sales or use taxes. Every person with a business location within a state who purchases goods in interstate commerce would have to obtain a tax registration number for that state. This assures that business buyers would have tax registration numbers to furnish their out-of-state suppliers.

As indicated in our first letter, dated September 19, 1973, AED and its distributor members enthusiastically endorse, in principal, these major concepts of S. 1245. Thus, we were pleased to be signatory to the joint, multi-business statement filed in general support of the bill by a total of 129 separate business organizations on that same date.

At the same, time, however, we believe that certain aspects of our own individual industry's operations suggest a need for specific comment over and above the general, multi-business views previously offered. It is the purpose of this second letter, therefore, to offer particular recommendations in areas where we believe the experience of our own industry may be useful to the members of the Subcommittee in considering possible salutary refinements in the legislation.

LEASING AS BUSINESS LOCATION FACTOR

Specifically, we wish to address the criteria enumerated in the bill for determining whether or not a firm has a business location within a state.

Section 513 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, (2) has one or more employees located in the State, (3) regularly maintains a stock of tangible personal property in the State for sale in the ordinary course of his business, or (4) regularly leases to other tangible personal property for use in the State.
>
> "For the purpose of paragraph (3), property which is on consignment in the hands of a consignee, and which is offered for sale by the consignee on his own account, shall not be considered as stock maintained by the consignor. If a person has a business location in a State solely by reason of paragraph (4), he shall be considered to have a business location in the State only with respect to such leased property."

Clearly, a sufficient nexus exists in the circumstances described by the first, second and third criteria to warrant a determination that a business location exists. This is not always true where leases are concerned, however.

Accordingly, we believe that the fourth criterion should be modified, at the very minimum, to distinguish between those leases which may legitimately be said to give the lessor a nexus with the state involved and those which may not. In other words, the term lease should be defined to embrace only pure rentals—and should not include transactions which in economic reality amount to conditional sales.

The rationale for such a distinction was expressed most clearly by the Willis Committee when, in discussing the treatment of leases under a proposed income apportionment formula, it stated:

> "Since leasing arrangements are often used to finance the sale of personal property to the lessee, determining the "owner" of leased personalty can be difficult. In many cases the lessor—the legal owner—is not the owner in an economic sense. In many other cases, even if the lease is not used as a financing device the lessor has no economic interest in controlling the physical location of the property during the term of the lease. Under these circumstances it is considered inappropriate to attribute the lessor's income on the basis of the property's location in the hands of the lessee. As a result the Committee recommends that unless the term of the lease is 1 year or less, leased-out property should be excluded from the lessor's property factor. This rule would automatically cause most leases of the financing type to be treated as sales. It

is a rule which would be simple to apply and would obviate the need for the lessor to control the location of leased-out property solely for tax purposes." [1]

This analysis is particularly apt for the construction equipment distribution industry.

Because the construction equipment handled by distributors is often extremely expensive (a power shovel, for example, may cost over $200,000), distributors originally began "renting" largely as a way of demonstrating equipment to potential buyers. This practice has evolved over the years to the point where, today, the overwhelming majority of equipment "leases" fall into one of three categories. These are:

(1) *Rental Purchase:* Rental of equipment for a period with *commitment* to purchase at an agreed-upon time under prescribed terms;

(2) *Rental With Option To Purchase:* Transaction which gives the customer an *option* to purchase under predetermined terms after a period of rental. Similar to a "rental purchase" except that the customer makes no commitment at the contract's outset; and

(3) *Leasing:* Long-term use of equipment with no purchase option, but where the cumulative total of payments amounts to full purchase price or substantial commitment thereof.

Significantly, whichever of these methods is used, the distributor typically regards the transaction as a form of installment selling. He is accommodating the "buyer" with no-downpayment, low-payment financing for what is actually a purchase, or is expected to end up being a purchase.

Where rental agreements contain an option price at which the lessee may take title to the specified piece of equipment, the option price is customarily arrived at by deducting from the original negotiated selling price of the machine all monthly rental payments called for by the contract and paid. In other words, monthly rentals plus the option purchase price equal the initial selling price. Generally, for such a transaction to be construed as a true lease, the option purchase price would have to be the equivalent of the fair market value of the machine in question at the time of transfer of title. This is frequently not the case. Such a lease is, substantively, a sale of property with the sales price collectible over a period of time.

Under these circumstances, we believe it is essential that, for the purposes of Section 513(4), a legislative distinction be drawn between the traditional rental-for-rent transaction and the rental-for-sale transaction which is tantamount to a conditional sale.

In the former case, there is usually no intention or expectation on the part of either party to the transaction that the rental will ultimately be converted to a sale or purchase—(a classic example is automobile rentals)—and the lessor clearly retains a substantial residual economic interest in the property.

In the latter case, by contrast, the character of the lessor's residual economic interest is vastly different. In this instance, the "lease" clearly does not constitute a nexus sufficient to support a business location determination.

The importance of a legislative recognition of this distinction is underscored by an examination of the practical result which would flow from the bill as presently written.

Thus, a seller without property, employees or inventory in a state would not be deemed to have a business location within that state simply because he sells to buyers in that state. This is true even if such sales are regular and recurring. Yet the same seller would be deemed to have a business location in the state if he regularly "leases" property for use there. Thus, while an outright sale would not lead to a business location determination, a lease which was tantamount to a conditional sale would.

We are confident that the Subcommittee will be anxious to remedy this inequity, and we would be pleased to offer whatever assistance may be needed in devising an appropriate solution.

By way of an example, it may be that an adequate resolution may be to specify that, for the purposes of Section 513(4), the term "lease" refers solely to transactions which would be treated as leases under the rules and regulations of the Internal Revenue Code of 1954, as amended.

Beyond this, the Subcommittee may well wish to consider adoption of a *de minimis* test providing that Section 513(4) would not be operative in instances in which lease transactions account for an insubstantial percentage of a firm's

[1] Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 89th Congress, 1st Session, Volume 4, House Report No. 952, September 2, 1965, p. 1152.

operations. This approach clearly has much to commend it in practical terms of simplification of tax recordkeeping and enforcement problems. In a typical construction equipment distributorship, for example, rentals account for only 12% of annual revenues. If those transactions which represent conditional sales are carved out, as recommended above, the protion of annual revenues attributable to pure rental transactions become relatively insignificant. In such instances, it would seem appropriate to suggest that the dual interest of tax simplification and freedom of interstate commerce substantially outweigh any possible state interest in revenues from this source.

Respectfully submitted.

ANTHONY J. OBADAL, *Washington Counsel.*

STATEMENT ON BEHALF OF THE AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.

ATMI represents some 85 percent of the U.S. spinning, weaving, knitting and finishing capacity for processing cotton, wool, silk and man-made fibers. More than one million persons are employed in textile mills today, with another one million, three hundred and fifty thousand workers in the apparel and related products industry, putting these industries among the largest employers in the manufacturing sector in this country.

The members of ATMI, all of which are engaged in interstate commerce to some degree, have long been concerned with the inequities and difficult compliance problems that result from a lack of uniformity with respect to the various jurisdictional standards, income tax bases and apportionment formulae applied by states and local governments in the taxation of interstate commerce. Since the enactment of Public Law 86–272 fourteen years ago, ATMI has supported the many unsuccessful efforts to obtain Federal legislation that would provide some measure of uniformity in this troublesome area. It has frequently commented on various proposals in House hearings on the subject of state taxation of interstate commerce. ATMI therefore greatly appreciates the opportunity to submit its comments regarding S. 1245 (the Interstate Taxation Act of 1973), submitted by Senators Mathias and Ribicoff and supported by Senator Humphrey, and S. 2092, submitted by Senator Magnuson.

Since the enactment of Public Law 86–272, the need for uniform Federal legislation in the area of interstate taxation has intensified. There are 46 separate corporate income tax laws and 45 sales and use tax laws in effect at the state level, as well as numerous other laws, such as gross receipts tax laws and capital stock laws. In addition, local governments commonly impose one or more of such taxes. As a result of the increasing need for additional revenues at both the state and local levels, the tax laws affecting interstate commerce have become more numerous and more complex. This trend will undoubtedly continue in the future. Of course, taxes do burden business, but these taxes are more burdensome than they need be because of their lack of uniformity. There have been some state efforts toward reform; however, it is apparent that Federal legislation providing uniform standards offers the best prospect for a real solution to this problem. Under such legislation, businesses operating in interstate commerce could be more certain of their liability for income, sales, use, franchise and other taxes in the various states.

For the reasons discussed below, ATMI is of the opinion that of the two proposals before this Subcommittee, S. 1245 embodies the better approach toward a solution to the ever-growing problem of state taxation of interstate commerce. Senate action on this urgently needed Federal legislation should not be postponed. ATMI therefore supports early passage of S. 1245.

JURISDICTION TO TAX

S. 1245 provides a "business location" jurisdictional standard for the imposition of a corporate net income tax, a gross receipts tax, or a capital stock tax. The "business location" minimum jurisdictional standard recognizes that the policy of requiring a corporation to contribute to the support of the government of each state that provides a market for its goods or services is outweighed by the policy of freeing business firms that operate in interstate commerce from the burdensome recordkeeping and tax reporting requirements imposed by states and localities with which their economic contacts are very small. In addition, the "business location" test provides a uniform minimum jurisdictional test not presently exist-

ing under the various state laws. In contrast, S. 2092 merely adopts the jurisdictional limitations of Public Law 86-272 and leaves to the various states the determination of whether particular out-of-state businesses are otherwise subject to the states' income tax laws.

Under both S. 1245 and S. 2092, the basic sales and use tax jurisdictional standards represent a major concession to the states by the preservation of existing sales and use tax jurisdictional bases through the codification of the major Supreme Court decisions on the subject rather than the adoption of a "business location" standard. With the exception discussed below, both bills provide that a person making interstate sales may be required to collect and remit a sales or use tax to a state if he (1) has a business location therein, (2) regularly makes deliveries therein other than by common carrier or U.S. mail, or (3) regularly engages therein in the solicitation of orders for sales of tangible personal property by means of salesmen, solicitors or representatives. S. 1245 contains an important additional feature, however, namely, that a seller without a business location in the state who sells to a person with a business location in the state cannot be required to collect a sales or use tax when such seller obtains the buyer's registration number in writing.

The registration procedure contained in S. 1245 is strongly supported by ATMI. It is needed to enable small and medium-sized businesses to compete in interstate commerce if the jurisdictional base for sales and use taxes contained in both bills is retained. In addition, the registration procedure would benefit the states by curtailing the current widespread noncompliance with state sales and use tax laws resulting from the smaller businesses' lack of knowledge of such laws or inability to comply with them.

A favorable provision in both bills is that which prohibits the thousands of political subdivisions that impose sales or use taxes from requiring an interstate seller to collect a sales or use tax on an interstate sale unless the seller has a business location or makes regular deliveries into the subdivision or unless the local tax is imposed in all geographic areas of the state on like transactions at the same combined state and local rate, is administered by the state, and is uniformly applied. The various other provisions of both bills relating to sales and use taxes are generally consistent with previous proposals and will aid in bringing uniformity to a difficult compliance area.

OPTIONAL THREE-FACTOR FORMULA

ATMI favors the optional three-factor formula contained in S. 1245 to define the maximum income or capital that can be attributed to a particular taxing jurisdiction. There is a pressing need for a uniform formula for the division of income and capital among the states, both to provide more equitable treatment of businesses operating in interstate commerce and to lighten their compliance burdens. Inclusion in the formula of a sales factor, in addition to property and payroll factors, is essential if an equitable apportionment of income is to be accomplished. The three-factor formula, which is in general usage in the states, gives proper consideration to the role of the marketing state in the production of income and prevents the overallocation of income to those states in which property and personnel are heavily concentrated.

The straight destination test for assigning sales to a particular state is an additional favorable feature of S. 1245. Such a test is less expensive to administer than the so-called "throwback" or "recapture" provision, which requires a taxpayer to account for most sales on a destination basis and others on an origin basis. S. 2092 contains an optional three-factor formula and provides a straight destination basis for foreign shipments, except for sales to the United States Government which are delivered to a place outside the United States. Such a "throwback" provision on export sales to the Government should be eliminated because of the administrative problems it creates for taxpayers required to account for some sales on a destination basis and others on an origin basis.

STATE TAXATION OF DIVIDENDS AND FOREIGN SOURCE INCOME

ATMI also favors the treatment of dividend income and foreign source income in S. 1245.

A. Dividend income

S. 1245 excludes dividend income from the definition of apportionable income unless the taxpayer's principal activity is dealing in securities. In addition, dividends from foreign corporations (including the gross-up element) and from

corporations in which the taxpayer owns 50 percent or more of the voting stock are not taxable in any state. Dividends from less than 50 percent owned corporations are allocable to the taxpayer's state of commercial domicile and that state has the authority to tax such dividends. The exclusion from the tax base of dividends from affiliates and from foreign corporations is designed to prevent double taxation. The treatment of dividend income in S. 1245 is basically in harmony with the Internal Revenue Code, which allows a 100 percent deduction on intercompany dividends received from 80% or more owned domestic corporations, an 85% dividend exclusion for all other intercompany domestic devidends, and a foreign tax credit for dividends received from a 10% or more owned foreign affiliate.

S. 2092 also contains helpful but limited provisions which exclude from the apportionable and allocable income tax bases dividends from affiliates (defined as corporations in which the taxpayer owns 80% or more of the voting stock) and Subpart F income. It is the opinion of ATMI, however, that the provisions of S. 1245 with respect to dividends are clearly preferable to those contained in S. 2092, because of their more inclusive solution to the problem of double taxation involved in the intercompany dividend area.

B. Foreign Source Income

The laws of the various states presently do not contain provisions similar to those of the federal income tax laws which define when income is derived from sources outside the United States and provide the extent to which that income should be taxed, if at all. However, a few states, in effect, seek to tax foreign source income by utilizing the so-called "unitary business" concept of taxation, which results, under "combined" or consolidated reporting, in the income of domestic or foreign affiliates outside the state being included in the income base of a corporation having a business location in the state. The federal tax laws relating to the taxation of foreign source income are designed to avoid double taxation in the international area. It is essential that a uniform federal law parallel to the federal income tax laws be enacted to restrict state taxation of foreign source income. Only then will it be assured that individual state tax laws will not thwart international tax policy.

S. 1245 attempts to provide a uniform federal law with respect to state taxation of foreign source income. It provides that all income from sources outside the United States, as that term is defined for federal income tax purposes, shall be excluded from apportionable income. It is apparent that the draftsmen of S. 1245 consider that this provision, when combined with the requirements that (1) all dividends be excluded from apportionable income, and (2) all dividends from sources which constitute income from sources outside the United States be excluded from allocable income, will result in the exclusion of all foreign source income derived from affiliates from state tax bases. However, income from controlled foreign corporations taxable to United States shareholders under section 951(a)(1) of the Internal Revenue Code ("Subpart F income") is not explicitly included in the definition of income from sources outside the United States under section 862 of the Code or in the Code's definition of dividends. It is recommended that S. 1245 be amended to expressly provide that Subpart F income is excluded from both apportionable and allocable income.

It should be noted that S. 2092 specifically excludes Subpart F from apportionable income, and thus largely accomplishes the result suggested in the preceding paragraph. In addition, S. 2092 contains certain other provisions which, in effect, exclude most other foreign source income from both apportionable and allocable income. However, this is accomplished by applying the traditional three-factor state formula to the income in question rather than by applying federal source of income rules. ATMI believes the provisions dealing with foreign income contained in S. 1245 are generally preferable to those contained in S. 2092, inasmuch as the provisions of S. 1245 would be more consistent with the federal income tax treatment of foreign source income. Both bills, however, clearly recognize the general rule that the individual states really have no sound basis for attempting to impose their taxes on income earned outside the United States.

CONSOLIDATION

S. 1245 provides that the apportionable income of related domestic corporations that are found to engage in non-arm's length transactions may be consolidated. In addition, states may permit domestic affiliated corporations to file consolidated returns. However, consolidation is not permitted with a corporation incorporated

outside the United States or with a corporation that derives 50 percent or more of its gross income from sources without the United States. If a domestic corporation is found to have engaged in non-arm's length transactions with an excluded corporation, the state may make a section 482 type adjustment to the domestic corporation's income.

The consolidation rules contained in S. 1245 would provide uniformity in a very troublesome area of state taxation of interstate commerce. They contain a mechanism which allows a state to clearly reflect the income of a corporation with a business location within the state that engages in non-arm's length dealings with domestic affiliates. At the same time, such rules would alleviate the serious inequity to multistate taxpayers resulting from the present practices of those few states that require the income of so-called unitary businesses to be consolidated or combined at a time when most other states refuse to permit such consolidation or combination. In addition, such rules, combined with the provisions of S. 1245 relating to the exclusion of foreign source income from apportionable income, would prohibit the current practice of a few states, such as California, which attempt to include foreign source income in the apportionable tax base. This provision is essential to conform state apportionment rules to the international policies formulated in the federal income tax laws.

In general, S. 2092 would allow any state to require consolidation of a domestic affiliated group and would permit taxpayers in return to require consolidation. S. 2092 would also prohibit consolidation or "combined reporting" between dometic corporations and certain affiliated corporations deriving income from sources outside the United States. This provision is considerably more limited than its counterpart in S. 1245. ATMI prefers the consolidation provisions in S. 1245 which prohibit consolidation of foreign source income on a broader scale than S. 2092. In addition, ATMI feels the non-arm's length standard for requiring consolidation contained in S. 1245 provides an adequate vehicle to the various states to protect their tax bases, and that consequently domestic consolidation should generally not be required.

JURISDICTION OF COURT OF CLAIMS

ATMI also favors the provision in S. 1245 that gives exclusive jurisdiction to the United States Court of Claims to review de novo disputes arising from the application of the Interstate Taxation Act. Such a provision would assure uniform interpretations rather than individual and conflicting bodies of precedential law in state courts, would avoid undue litigation of similar issues in numerous states, and would result in the development of an expert court to interpret the Interstate Taxation Act.

TEXACO, INC.

Hon. WALTER F. MONDALE,
Chairman, Subcommittee on State Taxation of Interstate Commerce of Senate Finance Committee, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: The following observations and suggestions are respectfully submitted for the consideration of your Subcommittee.

Texaco Inc. carries on business in every state and in almost every local taxing jurisdiction throughout the United States and, therefore, has a vital interest in the development of fair and equitable state and local tax systems. Texaco expresses its support for Federal legislation which would achieve these desirable ends.

Any Federal legislation must adequately protect and preserve the taxing power of the individual states and local governments, while insuring a free flow of commerce unburdened by discriminatory state and local taxes. State and local governments have difficulty collecting revenues from out-of-state tax-payers doing business within their several jurisdictions. On the other hand, local taxes frequently tend to favor local industry at the expense of the multistate taxpayer. In addition, more than 100% of a multistate taxpayer's income could be subjected to state taxes under the various and frequently conflicting state laws.

We believe that the Congress of the United States is the proper forum for establishing fair and equitable rules regarding state and local taxation of interstate commerce. Therefore, we urge the Congress to act decisively in this area, by enacting guiding principles which will provide some certainty for the business community as to its liability for state and local taxes applicable to interstate business. The principles which we would recommend for consideration in drafting Federal legislation are as follows:

A. In regard to sales and use taxes, the multistate taxpayer and the local taxpayer should be accorded equal treatment insofar as possible, and no favored treatment should be given either.

B. Income of multistate corporations should be assigned, either through apportionment formulae or rules of specific allocation, only to those taxing jurisdictions in which the activities which give rise to the income take place.

C. Capital values of the multistate corporation subject to state franchise taxation should be assigned only to those taxing jurisdictions in which the capital is actually employed in furtherance of the corporation's business.

D. Income derived from sources outside of the United States and capital values which are attributable to investments in business operations carried on outside of the United States should be excluded from the tax base for state taxation purposes.

With respect to the principal types of state taxes and the treatment of foreign source income, we have the following comments and recommendations:

Sales and use tax.—Some proponents of Federal legislation have urged that the interstate seller without a business location in the destination state be given an exemption from the collection of sales and use taxes on interstate sales. We believe that such an exemption would unfairly favor the interstate seller over the local merchant and result in an erosion of the state and local tax base.

Greater equity in sales and use taxation could be accomplished by having the seller collect tax on every interstate sale at a uniform rate established by the destination state by averaging the combined rates of state and local sales or use taxes of such destination state. Under such procedure the interstate seller would report and pay all taxes collected to the taxing authority of the destination state which would, under appropriate state procedures, remit to the local taxing jurisdictions their respective shares of the tax collected. The purchaser could then apply to his own state and local taxing authorities for any refunds, credits or adjustments. Thus, the interstate seller and the local seller would be taxed on fairly equal terms and the compliance burden of the interstate seller would be substantially reduced.

Income tax.—The extractive industries particularly have experienced a diversity of treatment in regard to the allocation and apportionment of income by the various states in the administration of similar taxing laws. Under almost identical taxing statutes, some states require separate accounting for income generated within such states, while others require apportionment by formula of the taxpayer's entire income. In addition some states require combined reporting of the incomes of parent and subsidiaries, while others have prohibited combined reporting and have taxed intercorporate dividends on various bases. In short, the conflicting theories of state taxation may, and often do, result in multiple taxation of the same income.

We submit that in order to cure the chaos that now exists and avoid multiple taxation of the same income by the states, there should be some uniform method of apportionment and allocation. All income should be apportioned by formulae consisting of those factors that reflect the activities of the taxpayer within the state which gave rise to the income. For instance, we suggest all income earned through employment of capital (tangible property) and labor (payroll) be apportioned by the uniform three factor formula (property, payroll and receipts).

By contrast, income earned through the employment and management of intangible property, such as dividends, royalties and interest, should be apportioned either by a formula other than the uniform three factor formula or by direct assignment of such income to the jurisdiction in which the underlying income was earrned. There is no rational basis for continuing the policy followed by some states of apportioning such investment income by use of the uniform three factor formula. Such formula does not ascribe the income to the proper taxing jurisdiction. The jurisdiction to which intangible income is properly attributable for tax purposes is the state in which the "payor" corporation is doing business, or the location at which the receiving corporation maintains its commercial domcile and manages and controls its investment capital.

The question of whether dividends from related companies should be subjected to state taxation is a more complex question. To the extent that states exempt intercorporate dividends paid by local corporations and tax the recipient company only on those dividends paid by corporations not doing business within the taxing state, there is an obvious discrimination against investments in affiliates or subsidiaries not doing business in the tax state.

Accordingly, we suggest that a limitation be placed upon the states' authority to tax intercorporate dividend income. We submit that a state should tax only those dividends derived from corporations doing business within the taxing state and then only to the extent that the payor corporation is doing business within such taxing state. This procedure, which has been followed successfully by the State of New York, appears to offer a fair and equitable solution to the problem of state taxation of intercorporate dividends.

Capital value tax.—We believe that the capital value attributable to investment assets should not be apportioned by use of the uniform three factor formula. Instead, a procedure should be adopted whereby capital attributable to investment assets would be directly allocated to a particular state or apportioned among several states on a more equitable basis.

An appropriate method for state taxation of capital attributable to investment assets would be to allocate such capital to the states in which the investment assets are actually employed. For example, if the investment is in a subsidiary or affiliate or other corporation, the capital representing the investment in such corporation should be assigned to the states in which the subsidiary, affiliate, or other corporation is doing business. That state may, as a matter of its own legislative policy, tax both the capital of the subsidiary, affiliate or other corporation and the capital of the parent corporation to the extent that such capital is employed within the taxing state. We believe, however, that a state should not be permitted to tax that capital attributable to investment assets not employed in the taxing state.

Foreign source income.—Through subsidiaries and affiliates international companies generally have substantial investments in operating facilities overseas. The income earned by these overseas companies is usually remitted to the U.S. parent in the form of dividends and interest. Since foreign taxes have already been paid by the entities actually doing business in the foreign countries, such foreign source income is effectively insulated from double taxation at the Federal level through the operation of the foreign tax credit provisions of the Internal Revenue Code.

However, the states for the most part do not provide for relief from double taxation of foreign source income. Indeed, in many instances the state laws do not even permit deduction of foreign taxes directly paid by the recipient in the form of withholding taxes levied by the foreign governments. Therefore, to the extent that such foreign income is subjected to state taxation, the Federal policy in regard to taxation of foreign investments is wholly frustrated.

We believe that our foreign commerce should not be impeded by onerous taxation of foreign source income by the states. The taxation of foreign source income or foreign investment capital should be a matter solely and exclusively within the province of the Federal Government. Indeed, we submit that the states should be barred from taxing foreign source income.

Accordingly, foreign source income as defined by the Internal Revenue Code should be excluded from state taxation. In addition, we suggest a prohibition against the indirect taxation of foreign source income by any state through the method of requiring a combined return which would include both corporations operating within and without the United States.

Similarly, investments in and advances to subsidiaries and affiliates operating outside the United States should be excluded from any state capital value tax.

Cooperation between States and businesses.—We at Texaco are ready to cooperate with your Subcommittee and the various state taxing authorities in developing reasonable and equitable solutions to these problems. In the final analysis, however, we believe that Federal legislation is essential to establish the parameters within which the states and the business community can operate with any degree of tax certainty. Accordingly, we urge that your Subcommittee continue its active participation in this area to the end that workable solutions may be found.

Respectfully submitted.

MAURICE F. GRANVILLE.

STATEMENT SUBMITTED ON BEHALF OF THE B. F. GOODRICH COMPANY BY R. C. WISE, MANAGER, STATE AND LOCAL TAXES AND DAVID C. WILCOX, DIRECTOR OF TAX ADMINISTRATION

The B. F. Goodrich Company is composed of the parent company with six operating divisions, eight domestic subsidiary companies, and thirty-four foreign subsidiaries. The Company's principal activities consist of the manufacture, distribution and sale of rubber, chemicals and related products. The parent company and the operating divisions are authorized to do business in all states.

The domestic subsidiaries are authorized to do business in several states. The Company's business activities include owning real or tangible personal property and having employees in 49 states.

Considering the state and local tax consequences of doing business in all states, we believe we are in a position to conform with experience and authority the disorder that exists in state and local taxation for a multistate company as reported by the Special Subcommittee on State Taxation of Interstate Commerce in 1965.

The report issued by the Special Subcommittee on State Taxation of Interstate Commerce under the Chairmanship of Representative Edwin E. Willis clearly revealed the chaotic conditions that existed in state and local taxation. Since the time of the Special Subcommittee's report, there has been no remedial action. As predicted by the Willis Subcommittee, the worst features of state and local tax laws and regulations which then existed have multiplied and compounded resulting in tax laws which governmental units are incapable of equitably enforcing and with which business is incapable of complying.

In its study, the Special Subcommittee found major problems which were common to all taxes studied, including sales and use, income, gross receipts, and capital stock. Because of the complex nature and the many variables inherent in state and local tax obligations, it is not practicable to elaborate on all of the various aspects of the problems. However, the summary of the defects existing in state and local taxation which were included in the report issued by the Special Subcommittee are applicable to the present disorder and are worthy of repeating. These defects are as follows:

First, it was found that the system is characterized by widespread noncompliance. This includes both a failure to file returns, especially where jurisdiction is asserted on the basis of something less than a place of business in the State, and a failure among companies which do file to comply accurately with the requirements of the prescribed system. For the States, the gap between what is prescribed and what is practiced means a loss of revenue. For business, the result is inequity among similarly situated taxpayers, some of whom comply and most of whom do not. However, were noncompliance to be replaced by full compliance with all of the requirements of the prescribed system, it is likely that the inequities of haphazard taxation would be transformed into the burden of excessive compliance costs.

A second defect of the current system is its tendency to give rise to overtaxation and undertaxation. Overtaxation is implicit in inconsistencies in the rules prescribed by the various states. These inconsistencies also give rise to undertaxation, which is augmented by noncompliance. The Subcommittee's studies confirm the fact that both of these departures from a coherent system do in fact occur.

A third defect of the present system is the existence of provisions which are advantageous to locally based companies relative to competitors based elsewhere. While litigation might ultimately invalidate some of these provisions, the generally low level of State tax rates and the expense and uncertainty of the litigation process discourage taxpayers from seeking relief by that means.

A fourth defect of the present system is the attitude which it has generated among taxpayers, especially small and moderate-sized companies. The diversities and complexities in legal rules, the prevalence of returns in which the cost of compliance exceeds the tax, the demand that a distant seller account for a local buyer's tax under circumstances in which taxability depends on what the buyer is to do with the goods—these and other aspects of the present system have produced widespread resistance to the assumption of taxpayer responsibility.

The impact of state and local tax obligations as related to the larger multistate companies becomes more obvious by considering the current statistics on the number of tax laws and taxing jurisdictions that must be contended with. There are presently 45 state income tax laws, over 2,000 local income laws, 45 separate state sales and use tax laws, over 3,500 sales and use tax laws levied by cities and counties, several state capital stock tax laws and numerous state and local gross receipts tax laws. Most of these tax laws are unique in some manner requiring separate accounting procedures and separate compliance requirements.

The significance of these numbers cannot be passed over by assuming that large multistate companies do not comply as has been stated in previous reports. The existing practice by state tax officials to concentrate their auditing efforts on large taxpayers combined with the provision in state statutes of the state's "presumption of correctness" encourages estimated deficiencies. Consequently, the costly and time consuming burden of rebuttal and litigation for abatement is

shifted to the taxpayer. Consideration of these practices and statutory penalty provisions demand that large multistate taxpayers with a national reputation make every effort to ensure that compliance requirements are followed for all known tax obligations. However, even the most conscientious effort leaves exposure which is unknown until the time of a state or local audit.

We believe S. 1245 provides a practical solution to these long standing and complex problems. This legislation contains provisions which will enable state tax officials to equitably enforce and competently administer state tax laws. It will provide business with a means to responsibly comply with state and local tax laws. We hope the Subcommittee will develop a uniform and workable solution, such as that contained in S. 1245, to the problems in interstate taxation.

STATEMENT OF THE ILLINOIS STATE CHAMBER OF COMMERCE, PRESENTED BY CARLTON P. MORIN, CHAIRMAN, TAXATION COMMITTEE, AND ALLEN J. BREWER, CHAIRMAN, SUBCOMMITTEE—STATE TAXES, ISCC TAXATION COMMITTEE

STATEMENT IN SUPPORT OF S. 1245

The Illinois State Chamber of Commerce believes that it is time to act responsibly in breaking down the tax barriers that impede the free flow of commerce between the 50 states. Our Taxation Committee, through its Subcommittee on State Taxes, wishes to submit this statement for the record on S. 1245, the Interstate Taxation Act of 1973. In so doing, it is important to recognize that the State Chamber does not represent any particular segment of the business community, or any particular type of business. Through its 6,500 member businesses, large and small, in 400 communities throughout Illinois, it has been known as the voice of Illinois business for more than 50 years.

The issue is a simple one: Should the federal government determine the equitable standards for state taxation of interstate commerce—or should each state determine its own standard? Stated another way—when commerce crosses state lines, what sort of contact within a state will create a power to tax? Congress provided a sense of direction in 1959 with the passage of PL 86-272 which set at least one federal standard and provided for "full and complete studies of all matters pertaining to the taxation of interstate commerce." The problem has been before the Congress each session since that time. Legislation has not been passed even though a large portion of our economic activity now crosses state lines bringing with it new liabilities for state and local taxes.

The laws and related regulations under which interstate businesses are taxed are voluminous, often vague, and contradictory. Businesses expanding into a number of state and political subdivisions often find their tax obligations are uncertain and tax accounting extremely costly. Utilizing the experience gained from hearings and legislative proposals in the years since 1959, S. 1245 exemplifies the partnership which can exist between business and government; outer limits are set, but flexibility is maintained. The bill represents substantial compromise by businessmen in their effort to deal productively with state and local officials, tax administrators, and academicians.

Several features of the proposal are of particular importance to Illinois businesses. These are:

Uniform jurisdictional standards.—The business location test for income, capital stock and gross receipt taxes will provide valuable guidance when utilized with the existing guideline, PL 86-272. In the sales and use tax area, both compliance by the growing business, and enforcement by local governments are strengthened by the uniformity provisions and enlightened utilization of the registration and licensing procedure.

Apportionment and allocation of income.—The difficult and tenuous decisions concerning what income is taxable and how it is to be divided among taxing states is essentially resolved by S. 1245 in the following manner:

1. Heavy reliance on the apportionment technique makes division of income uncomplicated, and more importantly—realistic.
2. The optional three factor formula provides flexibility for the interstate businessman and at the same time permits a state to construct an apportionment formula which will provide tax incentive for location and expansion within its borders.
3. The elimination of the sales throwback rule quite properly recognizes the importance of the destination state in providing a forum for expansion of commerce.

Illinois is the corporate headquarters for many firms with affiliates in other states and in foreign countries. This important segment of our economy has long sought equitable treatment for foreign source income, and for dividend income from affiliates. Importantly, S. 1245 recognizes the impropriety of state taxation of income wholly unrelated to activity within its borders. At the same time, we want to draw the committee's attention to the important contribution made by Illinois exports toward a favorable balance of trade for our nation. Total exports by Illinois producers are expected to exceed $5 billion in 1973. In a number of industries where the U.S. reports a trade deficit (food, transportation equipment, primary metals), these Illinois sectors are net exporters. This important segment of our national economy deserves equitable teratment commensurate with their national responsibility. Because foreign trade is so important to Illinois, we invite your attention to the study, "The Impact of Foreign Trade on the Illinois Economy" which is enclosed.

Consolidated or combined returns.—The majority of states do not allow consolidated or combined reporting. The most unfair results of combinations are obtained where the unitary business theory forces a business to subject more than 100% of the income to state taxation. The approach taken by S. 1245, requiring consolidation if there are non-arms length transactions between affiliates is completely realistic, and removes one of the most onerous interstate taxation burdens of affiliated groups.

Jurisdiction of Federal courts.—There is ample evidence of the conflict already created by state court determinations in matters relating to the subject matter of S. 1245. Therefore, we feel that the development of expertise by a single court at the federal level will be a substantial contribution toward achieving equity.

We commend your thoughtful approach to the important problems existing in the area of state taxation of interstate commerce, and urge favorable consideration of this important legislation.

NEW YORK STATE BAR ASSOCIATION,
September 24, 1973.

TOM VAIL,
Chief Counsel, Committee on Finance,
Dirksen Senate Office Building,
Washington, D.C.

DEAR SIR: It is my privilege to submit to the Senate Finance Committee's Subcommittee on State Taxation of Interstate Commerce two Reports of the New York State Bar Association Tax Section's Committee on Interstate Taxation regarding major proposals for Federal legislation dealing with State and local taxation of multistate business. Three copies of each report are enclosed.

The first Report, "Proposals for Improvement of Interstate Taxation Bills", adopted in December 1971, sets forth the Committee's general philosophy as to jurisdiction to tax, division of income, and related corporations.*

The second Report, "Supplemental Proposals for Improvement of Interstate Taxation Bills", adopted in August 1973, examines recent proposals for Federal legislation in the light of that philosophy.

The Tax Section is hopeful that these Reports will assist your Subcommittee in its study of this subject and hereby requests that the full text of both Reports be published as part of the proceedings of the Hearings held on September 18 and 19, 1973.

Respectfully submitted,

RALPH O. WINGER,
Chairman of Tax Section.

NEW YORK STATE BAR ASSOCIATION TAX SECTION, SUPPLEMENTAL PROPOSALS FOR IMPROVEMENT OF INTERSTATE TAXATION BILLS, REPORT OF COMMITTEE ON INTERSTATE TAXATION

NEW YORK STATE BAR ASSOCIATION.

RALPH O. WINGER, Esq.,
Chairman of Tax Section,
New York State Bar Association,
New York, N.Y.

DEAR MR. WINGER: During the past year the Committee on Interstate Taxation has engaged in a study of several Bills now pending before the Congress which deal with Federal legislation to regulate State and local taxation of enterprises

*This report was made a part of the official files of the Committee.

engaged in interstate commerce. These Bills embody several important proposals not previously considered by our Committee in preparing its Report on "Proposals for Improvement of Interstate Taxation Bills" issued in December 1971.

The Committee's study of these new developments is reflected in its new Report on "Supplemental Proposals for Improvement of Interstate Taxation Bills", which is intended to augment and update the views expressed in our original Report, without duplication of our prior analysis.

The new Report is a Committee effort. Messrs. Welch, Hauser, Berlin and Nitzburg, along with the undersigned, participated in its drafting. Our Committee is grateful to Peter Miller, the Tax Section's former Chairman and author of our original Report, for his extensive participation in successive revisions of the current Report.

After its adoption by our Committee without dissent, the Report was unanimously approved in principle on behalf of the Tax Section by its Executive Committee on August 16, 1973 and was thereupon put in final form with the authorization of the Officers of the Tax Section.

Very truly yours,

JAMES H. PETERS,
Chairman of Committee on Interstate Taxation.

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NEW YORK STATE BAR ASSOCIATION TAX SECTION SUPPLEMENTAL PROPOSALS FOR IMPROVEMENT OF INTERSTATE TAXATION BILLS

INTRODUCTION

This Supplemental Report sets forth the results of a study made by the Committee on Interstate Taxation of developments concerning possible Federal legislation to regulate State taxation of multistate business which have occurred since the publication in December 1971 of the Committee's prior report entitled "Proposals for Improvement of Interstate Taxation Bills (H.R. 1538 and S. 317)". (hereafter called the "original report").*

*Reproduced in 25 *The Tax Lawyer* (Bulletin of the American Bar Association (1972) at 443–472.)

The purpose of this Supplemental Report is to describe and comment on important features of several Bills now pending before the 93d Congress which, in some instances, differ from the Bills considered in our Committee's original report. On March 15, 1973, Senators Mathias and Ribicoff introduced S. 1245, the "Interstate Taxation Act of 1973", which contains a number of features not present in former bills on the subject. On June 27, 1973, Senator Magnuson introduced S. 2092, the so-called "Ad Hoc Committee Bill", which would authorize a compact between the several states relating to taxation of multistate taxpayers and would also attempt to reconcile certain differences between certain views

expressed by representatives of the business community and the States. Senators Cranston and Tunney have introduced S. 282, the "Interstate Sales and Use Tax Act", which is identical to S. 1210 introduced in the 92d Congress; and Congressman Rodino has introduced H.R. 977, the "Interstate Taxation Act", which is identical to H.R. 1538 introduced in the 92d Congress. Our study also includes the so-called "Plan" published under the auspices of the Multistate Tax Commission.**

In general, our Committee's recent study has led the Committee to reaffirm many—but not all—of the views expressed in its original report and to adopt new positions as to several matters not considered in that report. In particular, our Committee's continuing study of problems arising in State taxation of interstate transactions has reinforced the Committee's initial opinion that enactment of comprehensive Federal legislation is desirable to alleviate major problems concerning jurisdiction to tax, division of income, and related corporations.

In the interest of brevity, the present report does not recapitulate all of the reasoning of the original report and therefore is intended to supplement, rather than to supersede, that report with respect to most of the issues discussed therein. Reference should therefore be made to that report for a statement of the issues of policy considered and the major recommendations made.

I. JURISDICTION TO TAX

Original Report

The original report of our Committee supported the "business location" test set forth in the Rodino Bill, which would limit the power of a State to impose a net income, capital stock or gross receipts tax. That report also endorsed proposals giving the State of destination the exclusive right to impose a sales or use tax on an interstate sale and prohibiting the State of origin from imposing an equivalent tax in the form of a gross receipts tax.

With respect to sales and use tax collection requirements, the Committee favored the approach of the Cranston-Tunney Bill, which would codify the Supreme Court decisions in *Scripto* [1] and *National Bellas Hess* [2] and overrule the decision in *Miller Bros.*[3] Thus, a State could require a seller to collect sales and use taxes if the seller regularly solicits orders by means of salesmen, solicitors, or representatives in the State (unless the seller's activity in the State consists solely of solicitation by direct mail or advertising via newspapers, radio or television) or the seller regularly engages in the delivery of property in the State other than by common carrier or United States mail.

Current Proposals for Prohibition of Income, Capital Stock and Gross Receipts Taxes

With respect to jurisdictional limitations on the power of the States to impose net income, capital stock and gross receipts taxes, S. 2092 (the Ad Hoc Committee Bill) differs substantially from the Rodino Bill previously supported by our Committee as to this topic. S. 2092 contains no jurisdictional limitations beyond those in P.L. 86-272 except with respect to the collection of sales and use taxes. The bill also contains no restrictions on the power of a State to impose a capital stock or gross receipts tax.

By contrast, S. 1245 follows the general scheme of the Rodino Bill in that it would prohibit a State from imposing a net income or capital stock tax on a corporation or a gross receipts tax with respect to a sale of tangible personal property on a seller, unless the corporation or seller has a "business location" in the State. Unlike the Rodino Bill, however, S. 1245 does not exclude corporations which have an average annual income in excess of $1,000,000 from the protection afforded by the Bill.

In the Rodino Bill, a "business location" is acquired when a person owns or leases real property within a State, or has one or more employees located in a State, or regularly maintains a stock of tangible personal property in a State for sale in the ordinary course of business. The "business location" test in S. 1245 includes the three elements set out in the Rodino Bill and, in addition, establishes a "business location" when a person regularly leases to others tangible personal property for use in a State. In that event, however, the person is considered to have a "business location" in the State only with respect to such leased property. (It is not clear what is intended by this restriction or in what manner it would be applied in specific instances.) Whether or not leased property is leased for use in

**CCH State Tax Review, Vol. 31, No. 48 (December 1, 1970), at p. 6.
[1] Scripto, Inc. v. Carson, 362 U.S. 107 (1960)
[2] National Bellas Hess, Inc. v. Dept. of Revenue of the State of Illinois, 386 U.S. 753 (1967)
[3] Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954)

a State will turn, it is assumed, on the rules for locating property used in a State with respect to the property factor, so that there would be a congruence of jurisdiction and assignment of net income and capital.

A person is considered to have a "business location" if that person has one or more employees located in a State. Both the Rodino Bill and S. 1245 incorporate the language of P.L. 86–272 in making an exception to the general rules for locating an employee (which are similar to the rules for locating an employee for payroll factor purposes) in those instances where the employee's only activities in a State involve solicitation of orders sent outside the State for approval or rejection and the orders are filled by shipment or delivery from outside the State. In addition, both Bills extend the exception to an employee whose only activity in a State is the installing or repairing of tangible personal property which is the subject of an interstate sale by his employer, but only if that activity is incidental to the sale. Also, the Rodino Bill contains a special provision for locating employees of contractors and extractors.

Our Committee agrees with the broad definition of "business location" contained in S. 1245, which includes both the regular leasing of property for use in a State and the exception which protects a taxpayer whose only activities in a State either would not subject it to a net income tax under present law or would consist of installing or repairing tangible property that is the subject of an interstate sale and is incidental to such a sale. The presence in a State of leased property owned by a corporation which derives income from the leasing operation should be sufficient to grant jurisdiction to tax that corporation on income earned or capital employed in that State.

Our Committee takes no position as to the special rule in the Rodino Bill for locating employees of contractors and extractors for jurisdictional purposes.

The definition of "business location" in the Rodino Bill includes two provisions that are not included in S. 1245. One provides an exception with respect to the maintenance of a news gathering office. Our Committee is not in a position to express an opinion on this provision but as a general rule looks with disfavor on special exceptions. The other provision has to do with special cases where a person does not meet the tests for a "business location" in any State. In that event, the taxpayer is considered to have a "business location" (1) in the State in which the principal place from which the trade or business is conducted is situated, or (2) in the State of legal domicile. The latter provision appears reasonable in order to cover all conceivable circumstances.

In our original report, we expressed our view that the approach taken in the Rodino Bill, which excludes corporations having "an average annual income in excess of $1,000,000" from the benefit of the "business location" limitation on the power of a State to impose a net income, capital stock or gross receipts tax, represents an acceptable compromise, for the immediate future between the positions expressed in the Bills under discussion and the "Plan".[4] By contrast, the jurisdictional limitations in both S. 2092 and S. 1245 apply to corporations irrespective of size. For the reasons stated in our original report (especially the need to move slowly in an area that might seriously reduce State tax revenues), we do not recommend such broad jurisdictional limitations. However, we continue to recommend that the protection already afforded by P.L. 86–272 [5] be applicable to all corporations, both large and small.

Recent court decisions have narrowly construed P.L. 86–272 so that very little activity other than that which is undeniably part of direct solicitation can be carried on in a State without subjecting an out-of-state corporation to tax.[6] This narrow judicial interpretation suggests that the language of P.L. 86–272 might well be clarified to provide express protection for (a) the activity of installing or repairing tangible personal property which is the subject of an interstate sale where such activity is incidental to the sale, and (b) the activity of salesmen who, in soliciting sales, promote their products by assisting customers in merchandise displays and inventory control. Such an amendment of P.L. 86–272 might also make clear that its protection will not be lost by reason of the fact that salesmen possess samples and use company cars.

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[4] The "Plan" is the product of a drafting committee appointed to incorporate in legislative form the views of representatives from 35 states meeting as a so-called "Committee of the Whole". The "Plan" was published on November 20, 1970 under the auspices of the Multistate Tax Commission, but has never received the official approval of the Commission or of any State.

[5] We do not express an opinion, however, as to the reasonableness of $1,000,000 as the test for extending the protection of the proposed Federal statute to a business enterprise.

[6] See *Clairol Inc.* v. *Kingsley* 57 N.J. 199, 270 Atl. 2nd 702 (1970)

Section 201 of the "Plan" provides that a corporation will be conclusively presumed not to have derived any income from within a State if that State is denied the power under P. L. 86-272 to impose a net income tax on the corporation. The "Plan" also provides, however, that with respect to any corporation exempt from tax solely by reason of P.L. 86-272, a State may impose a net income tax in any taxable year in which the corporation had made more than $300,000 in gross sales having a destination in the State, if the total sales for that year and for each of the three next preceding years exceeded $2,000,000. Similar limitations would be placed on the power to impose a capital stock tax.

The rationale supporting this so-called "circuit-breaker" approach to jurisdiction is that the "business location" rule turns on the mechanics of the way in which a particular business enterprise operates to enjoy the market afforded by a State. Some businesses may be able to utilize the State's market without owning property or having employees in that State. Another business may not be able to arrange its affairs in such a manner as to avoid the imposition of a tax. If both businesses are selling in the same market to a substantial degree, it may be considered unfair for one to be free of tax while the other is subject to tax.

Our Committee is inclined to believe that this "circuit-breaker" approach is less desirable than that of the Rodino Bill. The overall size of a business enterprise is more easily ascertained than its gross receipts in each State. A business may be relatively small in size and yet meet the requirements for reporting in a State under the "Plan".

Even if the Congress were to adopt the "circuit-breaker" approach taken in the "Plan", we again recommend (as noted above) that, regardless of size, all business enterprises continue to enjoy the protection they already receive from P.L. 86-272, contrary to the provisions of the "Plan". Both S. 2092 and S. 1245 contain a provision which states that nothing in those bills shall be considered to repeal P.L. 86-272.

Current Proposals for Prohibition of Sales and Use Tax Collection Requirements

With respect to the collection of sales and use taxes, our Committee continues its support for the broader rules found in S. 2092 and S. 282 which incorporate the leading court decisions in the field.[7] The reasons supporting our position in this regard are set out in detail in our original report (pp. 13-20).

The issue here involves the propriety of a tax which is imposed on a local incident (clearly subject to tax by the local State) and not strictly a jurisdictional limitation on the power to tax. Partly for this reason, our Committee supports the relatively limited restrictions on State power found in S. 2092 and S. 282.

In contrast to these bills, S. 1245 contains an additional limitation on the right of a State to require a seller without a "business location" in a State to collect a sales or use tax. S. 1245 provides that when a seller has obtained in writing a buyer's registration number in accordance with section 304, a State may not require the seller to collect or pay a sales or use tax with respect to an interstate sale to that buyer. Section 304 requires all persons with a "business location" in a State to obtain a registration number. Accordingly, some interstate sales would be free of any requirement for collection of the related sales or use tax by the out-of-state seller.

We understand, however, that the burden upon the State to collect its sales and use tax would be increased by this provision. Our Committee does not believe that the States should suffer this added restriction on their ability to enforce their sales and use tax laws, particularly in view of the restrictions that would be imposed by section 306 of S. 1245 (and by similar provisions in S. 2092) on the collection of municipal and local sales and use taxes. In our view, the latter provisions would serve well to alleviate the more onerous compliance problems faced by an out-of-state seller. Therefore, our Committee supports S. 2092 with respect to both its restrictions on the power of a State to require a person to collect and remit a sales or use tax with respect to an interstate sale of tangible personal property[8]

[7] Unlike the other bills before the Congress, S. 282 includes provisions regarding the power of a State to *impose* a sales tax as well as to require a vendor to collect a sales or use tax. It is conceivable that the former provisions might be interpreted to permit the imposition of sales taxes in circumstances not hitherto permitted.

On the other hand, S. 2092 addresses itself only to the power of a State to require collection of a sales or use tax. Thus, under S. 2092, a State would not have the power to require a person to collect and remit a sales or use tax with respect to an interstate sale of tangible personal property unless the person (1) has a "business location" in the State, or (2) regularly makes deliveries in the State other than by common carrier or United States mail, or (3) regularly engages in the State in solicitation of orders for the sale of tangible personal property by means of salesmen, solicitors, or representatives (unless such solicitation of orders is carried on solely by direct mail or advertising by means of newspapers, radio or television).

[8] However, the definition of "business location" should be that described in the earlier part of this report.

and its provisions designed to reduce the possibility of multiple sales and use taxes and to encourage uniformity with respect to sales and use taxes impysed by municipalities and other political subdivisions.

II. DIVISION OF INCOME

Current Proposals for Allocation and Apportionment

Title III of S. 2092 sets forth an optional three-factor formula which is to be applied to a corporation's apportionable income for the purpose of determining the maximum amount of a multistate corporation's income taxable in a State. Apportionable income is net income as determined under State law adjusted by elimination of both dividend income and income described in section 951(a)(1) of the Federal income tax provisions of the Internal Revenue Code (relating to "subpart F income"). Dividends received from a corporation in which the taxpayer owns less than 80% of the voting stock would be assigned to the State of taxpayer's commerical domicile. All other dividends and income described in Internal Revenue Code, section 951(a)(1) would be completely excluded from the tax base.

Title II of S. 1245 describes an optional three-factor formula which is to be applied to a corporation's apportionable income or capital in determining the maximum amount of income or capital taxable by a State. The apportionable net income tax base is taxable income as determined under State law except for dividends and for income derived from sources outside the United States as defined in section 862 of the Internal Revenue Code. (Dividends would, however, be included if the corporation's principal business activity is dealing in securities). The apportionable capital stock tax base would be the entire capital of the corporation as determined under State law, reduced by investments in and advancements to subsidiary and affiliated corporations. Dividends, other than dividends which constitute income from sources outside the United States, received from corporations in which the taxpayer owns less than 50 percent of the voting stock would be assigned to the State or taxpayer's commercial domicile. All other dividends and foreign source income would be excluded from tax.

The apportionment fraction prescribed by both Bills is the average of the corporation's property, payroll and sales factors. In S. 2092, a factor having a denominator which is less than 10% of one-third of the corporation's net income would be excluded. In S. 1245, factors with a zero denominator are excluded; if the denominators of all factors are zero, "then the apportionment fraction for the State where the corporation has its business location shall be 100 percent."

In S. 1245, the property factor is limited to the average value of the corporation's real and tangible personal property owned and used or rented and used during the taxable year and located in the United States. Owned property is valued at its original cost. Rented property is valued at eight times the net rents payable during the taxable year. Inventory is included.

The rules for determining the location of property are somewhat complex. Movable property is considered to be located in a State if (1) the operation of the property is localized in the State (that is, operated entirely within the State or operated both within and without the State but the operation without the State is occasional or incidental to its use in transportation within the State or with respect to production, construction or maintenance of property located in the 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 the State. The term "base of operations" is defined as the premises at which property is regularly maintained (but not the dwelling place of an employee). Property which cannot be located under the foregoing rules is excluded from the factor.

The property factor in S. 2092 differs from that in S. 1245 in that the denominator does not include the value of any property located in a State in which the corporation is not taxable and property rented to the corporation is valued at eight times the *gross* rents payable during the taxable year.

The payroll factor in S. 1245 includes wages as defined for purposes of the Federal Unemployment Tax Act paid to employees located in the United States. The term "employee" has the same meaning as it has under Chapter 24 of the Internal Revenue Code. The location of an employee for purposes of computing the amount of wages paid in a State is determined under the provisions of section 515 of the Act. Those provisions were adopted from the Model Unemployment Compensation Act which has been enacted in all the States so that a taxpayer will have readily available data in order to compute its payroll factor in any State.

The payroll factor in S. 2092 defines compensation as wages, salaries, commissions and any other form of remuneration paid to employees for personal services. The denominator of the factor excludes compensation paid to an employee located in a State in which the corporation is not taxable.

The gross receipts or sales factor of S. 1245 includes receipts from all sales and rentals of tangible personal property. Sales of tangible personal property are assigned on a destination basis. Sales other than sales of tangible personal property are assigned by reference to income-producing activity. Rental receipts are assigned to the State in which the property is located. Only sales within the United States are included.

By contrast, the sales factor set out in S. 2092 excludes all gross receipts from sales other than sales of tangible personal property, real property and services. Receipts from the rental of tangible personal property are included. Sales of tangible personal property having a destination in a State in which the corporation is not taxable or sales to the United States Government in which the property is shipped outside the United States are assigned to the State from which the property was shipped. For this purpose, the District of Columbia is treated as a place outside the United States. (This rule does not apply to tangible personal property shipped outside the United States or to the District of Columbia when the purchaser is not the United States Government.) Sales of services are assigned in proportion to the direct costs of performance incurred in each State by the corporation in rendering the services. Sales of real property are assigned to the State in which the property is located but only if the corporation is engaged primarily in the business of selling real property. Sales everywhere are included in the denominator.

Section 207 (b) of S. 1245 provides for adjustment of the apportionment factors to include property, payroll and sales attributable to sales of tangible personal property having an ultimate destination outside the United States if income from such sales is included in the apportionable base.

Evaluation of Current Proposals

The design of the Bills is to prescribe rules of allocation and apportionment that represent a reasonable approach to State taxation of interstate commerce and, at the same time, recognize the importance of preserving the taxing power of the States by permitting them to pursue their own tax policies within the limitations or ceiling of the new Federally prescribed allocation and apportionment provisions. The inclusion of allocation and apportionment provisions as a limitation or ceiling on State taxing powers will protect multistate businesses from overtaxation and will aid in reducing existing uncertainty and diversity to manageable proportions.

Any Federally prescribed rules of allocation and apportionment must also recognize Constitutional principles of due process as well as the importance of developing both fair and practical rules for assigning income and capital among the several States.

Principles of fairness and equity are often elusive and subject to great differences of opinion. Nevertheless, there appears to be general agreement that a corporation should not be subjected to "taxation without representation", i.e., that it should be taxed by a State or locality on only so much of its income and capital as bears a demonstrable relationship to its assets and activities within that jurisdiction.

In our original report we stated our belief that Federal legislation to improve State taxation of multistate business firms should deal with the question of how the net income or capital of a multistate enterprise should be divided among those States which can properly exercise their taxing jurisdiction over the enterprise. Subject events have reinforced that belief.

Although there has been a movement among the States to adopt the Uniform Division of Income for Tax Purposes Act,[9] there has been considerable diversity of views as to the interpretation of that Act, particularly in regard to the identification of those types of income to be apportioned by formula. Illinois was the first State to adopt comprehensive regulations under the Uniform Act. The Illinois Regulations interpreted the Uniform Act in such a manner that virtually all income is apportioned by formula. The National Association of Tax Administrators ("NATA") next proposed Regulations under the Uniform Act which also require virtually all income, with the notable exception of dividend income, to be apportioned, but which differ materially from the Illinois Regulations. The "NATA" Regulations have to date been adopted only by Kentucky and Oregon.

[9] 1957 Handbook of the Conference of Commissioners on Uniform State Laws.

California adopted the "NATA" Regulations in 1971 but revised them in 1973 to conform to subsequent Regulations proposed by the Multistate Tax Commission ("MTC") with one major exception in regard to dividend income. The "MTC" Regulations which have also undergone revision, differ from both the Illinois and "NATA" Regulations. Thus, the Uniform Act has had little uniformity of interpretation. A number of States belonging to the Multistate Tax Compact have taken steps toward adoption of the "MTC" Regulations. However, other States (including Indiana) appear disposed to depart from those Regulations in material respects.

State court decisions and the refusal of the United States Supreme Court to review cases involving division of income have recently added to the uncertainty and instability of State taxation of interstate enterprises.[10] These cases serve to demonstrate the excessive burden on interstate commerce imposed by diverse State approaches to division of income by their denial of judicial relief from duplicative taxation. They also call attention to the present reluctance of the United States Supreme Court to interfere with State tax determinations as to division of income.

In addition to the current disagreement as to interpretation of the Uniform Act, diversity results from important differences between the concepts embodied in State tax statutes pertaining to division of income. Thus, Florida recently enacted a corporation income tax that contains a unique apportionment formula which gives more weight to the sales factor than to the other two factors (reflecting property and payrolls). Both that income tax law and those recently adopted by the legislatures in New Hampshire and Washington fail to incorporate the Uniform Act's distinction between "nonbusiness income" and "business income", and subject all taxable income to apportionment by formula. Several other States, such as New Jersey, Vermont and Pennsylvania, have income tax laws that also differ substantially from the Uniform Act in this regard.

In our original report, our Committee took the position that the Congress should exercise special caution in imposing new Federal restrictions on the ability of the States to provide for their revenue needs. Accordingly, we agreed with the approach in the prior Rodino and Ribicoff Bills which provided certain rules for division of income among the States but left untrammeled discretion to each State as to the computation of the amount of net income or capital to be so divided. At the same time, we recognized the problem faced by related corporations with respect to multiple taxation of income received in the form of intercorporate dividends. Although we considered it premature to attempt to deal with the question of exclusion of some or all dividend income from the tax base altogether, we urged that dividend income be allocated in its entirety to the State in which the recipient corporation maintains its commercial domicile. We also concurred in the view that Federal legislation as to division of income should merely provide an alternative to the use of existing State rules in the form of a "ceiling" on the amount of net income or capital taxable in any one State.

Both the Rodino and Ribicoff Bills discussed in our original report denied corporations with average annual incomes in excess of $1,000,000 the benefit of the proposed limitation on the amount of net income or capital that might be taxed by any State having jurisdiction to impose a tax. This restriction was sharply criticized by our Committee, which stressed the need to apply any Federally prescribed rules for division of income to all companies engaged in interstate commerce without discrimination.

Neither S. 2092 or S. 1245 would exclude large businesses from the application of their proposed rules for division of income. We continue to agree with that approach.

Although we also continue in our general support for a "ceiling" approach with respect to Federal legislation affecting the division of net income and capital among the States, the trend of subsequent events has led us to modify somewhat our prior position with respect to the types of income which should be specifically allocated to a State on a situs basis as contrasted with income which should be apportioned by formula. As previously indicated, recently enacted State corporation income tax laws and Regulations adopted by the Multistate Tax Commission indicate that a significant number of States are in favor of subjecting the entire net income of a multistate business enterprise to formula apportionment. We now believe that this approach should be restricted by Federal legislation that will assure not only that certain easily segregated items of income will be specifically allocated to a State, but also that certain income and capital be excluded from the

[10] Kennecott Copper Corp. v. State Tax Commission, 27 Utah 2d, 119, cert. denied, 93 S. Ct. 323 (1972); Commonwealth v. Emhart Corporation, 443 Pa. 397, 278 A. 2d 916 (1971), cert. denied, 92 S. Ct. 451 (1971).

State tax base altogether. In our opinion, any such legislation should provide for such allocation and exclusions in order to achieve its fundamental objectives of fairness, uniformity and simplicity. The following sections of this Report discuss the desirability of (i) exclusion from the tax base of certain dividend and other income and certain capital and (ii) specific allocation of other dividends and capital gains and losses.

Desirability of Exclusions from Tax Base

Although financial institutions and holding companies are expressly excluded from the operation of the Bills under consideration, many large multistate corporations function as both sellers of goods and services (requiring direct and active business operations) and as investors in shares and debt obligations of other corporations (requiring supervision of portfolio or subsidiary holdings). For this reason, they have significant amounts of income from such investments in the form of dividends, interest and occasionally capital gains. This investment income raises many of the more serious problems which arise with respect to attribution of income among the several States. In particular, the prescribed factors of the apportionment formula have little relationship to income in the form of dividends, interest or gains from the sale of investments or to capital in the form of investments in or advancements to subsidiary corporations. Moreover, taxation of dividend income and capital represented by investments in the shares of other corporations presents the issue of duplicative State taxation.

One possible approach to these problems is illustrated by the provisions of S. 1245 which completely exclude from the tax base dividend income received from and investments in and advancements to subsidiary or affiliated corporations together with certain foreign source income. We will discuss each of these exclusions in turn.

(a) *Dividend Income.*—Should corporate earnings be subjected to income tax by the States more than once prior to their distribution to noncorporate shareholders? Should a distinction be made with respect to dividends received from an affiliated corporation for the purpose of making ultimate distributions to noncorporate shareholders or to supply needed funds to other affiliated corporations? Should public policy encourage the free flow of funds between related corporations and relieve the need to resort to practices such as maintaining a low capital-to-debt ratio by a subsidiary corporation? Should the taxation of intercorporate dividends be treated solely as an aspect of consolidation or combined reporting?

These questions indicate the range of issues involved in the taxation of intercorporate dividends. Many conflicting arguments have been advanced as to these issues. After careful study of these problems, our Committee recommends that dividend income excluded from the corporate tax base for Federal income tax purposes should similarly be excluded from the tax base for State income tax purposes.

The Federal income tax statute has long mitigated multiple corporate taxes on the income represented by such dividends by allowing the recipient an offsetting deduction equal to 85% of such dividends.[11] Although complete elimination of duplicative corporate taxes would require a 100% deduction, Congress has refrained from providing full relief apparently by reason of concern that a 100% deduction would encourage the use of multi-tiered corporate structures to obtain additional surtax exemptions (which are intended to assist small businesses).[12] Thus, it was not until 1964 when more stringent legislation was adopted to restrict use of the surtax exemption by related corporations[13] that Congress increased the intercorporate dividend received deduction from 85% to 100% of the dividends received from certain subsidiaries.[14]

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The Secretary of the Treasury in his explanation of this provision to the Ways and Means Committee stated:

> "The elimination of the intercorporate dividend tax in this type of parent-subsidiary relationship would extend to such groups one of the tax advantages

[11] Sections 243, et seq., Internal Revenue Code.
[12] Senate Report No. 1240, 74th Congress, 1st Sess. "The President suggested as the most effective method of preventing evasion of a graduated tax on corporations, a tax on dividends received by corporations. Under existing law, dividends received by a corporation from a domestic corporation are allowed as a deduction from gross income in computing net income. Your Committee has amended existing law by restricting the deduction to 85 percent of the dividends received from domestic corporations." p. 6.
[13] Section 235, Revenue Act of 1964, P.L. 88-272.
[14] Section 214, Revenue Act of 1964.

generally now available only to affiliated groups which file consolidated returns. This amendment is designed to facilitate the adjustment to the elimination of multiple surtax exemptions in cases where the affiliated group does not, or cannot, file consolidated returns, but would recognize that the earnings of an 80-percent-owned operating subsidiary are more directly the earnings of the parent than is the case where one corporation merely derives investment income from an unrelated corporation." [15]

The adverse effect on efficient business practices of a tax on certain intercorporate dividends is set out in the testimony of those persons supporting this provision of the President's tax recommendations. They cite the need to encourage the free flow of funds between parent and subsidiary and the desirability of removing the need to keep the capital-to-debt ratio of a subsidiary as low as possible in order to avoid excessive taxes.[16] The amendment also was thought to eliminate discrimination against those business enterprises which, for sound economic and legal reasons, find it necessary to use subsidiary corporations.

An argument is sometimes made that the United States imposes the Federal income tax on dividends received by a domestic corporation from corporations organized under the law of a foreign country (without allowance of any offsetting deduction for dividends received) and that a State should, therefore, be permitted to impose a tax on dividends received by a domestic corporation from out-of-state corporations. The difference in treatment between intercorporate dividends from domestic and from foreign corporations under the Internal Revenue Code is presumably justified by the fact that the United States does not usually tax the income of the foreign-organized corporation from which the dividends are received, i.e., the United States does not subject the same income to multiple taxation.

This argument ignores the credit allowed by the Federal statute for income taxes paid to foreign governments on the earnings out of which the dividend is paid.[17] Moreover, except in rare and unusual cases, the Federal Government does not require a corporation organized under the law of a foreign country which engages in business within the United States (a) to pay any tax on dividend income from other foreign corporations, or (b) to pay tax at the regular corporate rate on dividends from United States corporations. Thus, the analogies drawn from the Federal income tax treatment of dividend income received from and by foreign corporations appear to be highly questionable. In addition, the policies that underly the taxation by the Federal Government of the world-wide income of corporations organized in the United States (which result in Federal taxation of foreign source income) are not the same as those underlying either the Commerce Clause of the Constitution with respect to the regulation of interstate commerce or the Due Process Clause with respect to the limitations on the right of a State to tax an out-of-state corporation.

It appears reasonable to our Committee that corporations organized under the laws of a State of the United States should be protected from duplicative taxation by the States at least to the same degree as they are protected from duplicative taxation at the national level, if Congress is to fulfill its role in protecting and encouraging interstate commerce.

Our Committee is of the opinion that relief from duplicative State taxation with respect to intercorporate dividends should not be solely a function of consolidated returns. In a subsequent section of this Report, we reiterate our position opposing the "unitary business" approach and set forth our present reservations concerning Federal legislation that would sanction combined or consolidated reporting. Regardless of how Federal legislation may treat the issue of consolidated returns or combined reports, however, we believe that the circumstances under which such reports or returns are used should not affect the exlusion of intercorporate dividends from State taxations in view of the different policy considerations involved.

In the light of the foregoing policy considerations, we consider it desirable, as a policy matter, that dividend income excluded from taxable income for Federal income tax purposes should be excluded for State income tax purposes.

We are not, however, completely confident that the Congress would have power under the Commerce Clause to limit the amount of income which may be attributed to a State in all instances involving the receipt of dividend income. Specifically, we are uncertain as to whether a State in which a corporation has its commercial domicile could, under the Commerce Clause, be prohibited from taxing dividends

[15] Senate Report No. 830, 88th Cong., 2d Sess. (1964) p. 74-75.
[16] Hearings before the Committee on Ways and Means, House of Representatives, 88th Cong., 1st Sess., pp. 1922-3, 1949-52.
[17] Sections 901 and 902, Internal Revenue Code.

received from another corporation whose activities are wholly confined to that State. A variant on this question arises where the payor is present and active in only one State which is a different State than that of the recipient corporation's commercial domicile. Another variant occurs where the payor corporation operates business facilities in several States. As we have not made a study of the authorities bearing on these Constitutional questions, we express no opinion as to precisely what circumstances would warrant Congress' exercise of its power to regulate interstate commerce in a manner that would prohibit the State of commercial domicile from taxing corporate income in the form of dividends.

We have no doubt, however, as to the power of the Congress to limit States *other* than the State of commercial domicile from taxing an out-of-state corporation on dividends received by it. For this reason, we also make the alternative recommendation (previously made in our original report) that whatever dividend income is taxable should be allocated entirely to the State of the recipient corporation's commercial domicile. See discussion below at p. 15

(b) *Investments in Subsidiaries.*—The foregoing arguments with respect to dividends received from a subsidiary corporation are also pertinent to State capital stock taxes on equity securities and debt obligations of a subsidiary corporation.

The capital invested in a business enterprise is not increased merely because that enterprise is made up of a number of corporations rather than a single corporation. Accordingly, the same capital should not be taxed twice: first as a a capital stock tax on the subsidiary corporation and a second time as a capital stock tax on the parent corporation by reason of the latter's ownership of equity securities and debt obligations of the subsidiary. This burdensome duplicative taxation should, we think, be restricted by the Congress. In support of this view, we note that if investments in equity securities and debt obligations of subsidiaries are retained in the capital stock tax base, the factors of the apportionment formula will seldom have a rational relationship to those items in the tax base. As a result, capital will be assigned to States that have no demonstrable connection with the capital being taxed.

(c) *Foreign Source Income.*—In S. 1245, "foreign source income" (as defined therein) is excluded from the State income tax base.

By its very nature, income generated by assets and activities outside the United States cannot be reasonably attributed to any State. Such foreign income will ordinarily be subject to taxation, not only by the national government of the country in which it arises, but also by one or more provincial, cantonal, municipal, or other types of local government whose taxing powers will not be affected by whatever legislation may be adopted by the United States Congress to limit overlapping taxes by the States of the United States.

Adoption of an exclusion of foreign income from the State tax base would be consistent with the long-standing goal of the United States to eliminate international double taxation by means of both (a) allowance for a credit against the Federal income tax for income taxes imposed by foreign governments on income derived within their borders by United States taxpayers, and (b) the series of Income Tax Conventions (treaties) which partially define the various types of income which each government may tax. The exclusion of foreign income from the State tax base would provide assurance that income from international business transactions of United States taxpayers will be protected from duplicative taxes imposed by the States as well as those levied by the Federal Government.

If this proposal is accepted in principle, it will be necessary to devise a suitable definition of "foreign source income". Our Committee recommends that this definition be based on the familiar Federal income tax concepts set forth in sections 861 through 863 of the Internal Revenue Code, which specify the circumstances under which many common types of income (dividends, interest, rents, royalties, fees for personal services, profit from sales of goods, etc.) will be considered to be derived from a foreign source. Use of these well known rules will both (i) correlate with the credit for foreign taxes on such income allowed for Federal income tax purposes, and (ii) provide a large body of judicial and administrative authorities that will be useful in resolving many questions of interpretation, including the identification and computation of those deductions which pertain to such "foreign source income".

Distinction between Allocable and Apportionable Income

(a) *Dividend Income.*—In S. 1245, that dividend income which is not exempted from State income taxation (i.e., dividends from United States corporations in which the taxpayer owns less than 50 per cent of the voting stock and dividends which represent foreign source income) is specifically assigned to the State of commercial domicile.

There are several reasons why our Committee favors this attribution of dividend income. First, such income can be readily accounted for separately. Second, the activities which produce such dividend income normally take place at the taxpayer's headquarters, i.e., in the State of taxpayer's commercial domicile. Third, such dividend income typically has little or no economic connection with the business assets and activities which generate the taxpayer's approtionable income from sales of its products or services. Specifically, dividend income is not related to any of the three factors of the apportionment formula because (1) it is not the product of the tangible property used in the production or sale of the taxpayer's goods or services, (2) very little of the taxpayer's payroll is normally associated with it, and (3) it seldom is factually related to the State of destination of the goods or services generated by the taxpayer's direct business operations.

These policy considerations have long been reflected by the many State income tax statutes which have allocated dividend income on a situs basis rather than apportioned it by formula. Moreover, the courts have often recognized that the State of commercial domicile has a strong claim to tax dividend income received by a corporation.[18] Accordingly, assignment of such income to the State of commercial domicile by the proposed Federal statue will avoid Constitutional problems raised by recent attempts by several States to tax portions of the same income (which imply a denial of the right of the State of commercial domicile to tax the entire amount of such income). Since attribution to the State of commercial domicile has been the general practice among the States, at least until recently, such treatment of dividend income by S. 1245 would not seriously affect State income tax revenues.[19]

(b) *Interest Income.*—Many of the foregoing policy considerations for specific allocation of dividend income to the State of commercial domicile would seem to apply to interest income. Nevertheless, S. 2092 and S. 1245 include all interest income in the apportionable base.

It has been argued that interest income should be apportioned by formula on the grounds that (i) many investments producing interest income arise out of the ordinary business operations, such as the proceeds of regular sales of goods and services, and (ii) the purpose for acquiring and holding certain types of investments is often related to or incidental to such operations, e.g., short-term investment of funds reflecting seasonal inventory fluctuations. Although these arguments are persuasive with respect to both (a) interest income from customers in deferred payment transactions and (b) temporary investments of working capital, their validity is less apparent when applied to long-term investments in debt obligations of subsidiary corporations and portfolio debentures, which often bear many resemblances to equity investments in subsidiary corporations or portfolio securities. Ideally, interest income derived from the latter types of debt obligations should be allocated entirely to the State of the recipient's commercial domicile in recognition of the right of that State to tax all income from intangible property not having a business situs in some other State.

Although our Committee believes that the latter position is meritorious, we also recognize the potential for controversy inherent in applying the distinction between two categories of interest income, one apportionable among the States as business income and the other allocable entirely to the State of commercial domicile.[20] These practical difficulties have led the Committee to conclude that

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[18] Opinion of the Attorney General of the State of North Carolina, 1 CCH N.Car. Tax Cases, ¶201-470; Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48, 156 P. 2d 81 (1945). *Cf.* California Packing Corp. v. State Tax Commission, 97 Utah 367, 93 P. 2d 463 (1939); Gulf Oil Corp. v. Clayton, 267 N.C. 15, 147 S.E. 2d 522 (1966); Square D Company v. Ky. Bd. of Tax Appeals, 415 S.W. 2d 594 (1967).

[19] The exclusion of intercorporate dividends with respect to subsidiaries may have a material revenue effect in the few States that now tax such dividends, such as California. That State has, however, traditionally followed the practice of allocating dividend income to the State of taxpayer's commercial domicile. As to the general rule among the States as of 1954, see Cohen, "Apportionment and Allocation Formulae and Factors Used by States in Levying Taxes Based on or Measured by Net Income, etc. — A Research Report Prepared for Controllership Foundation, Inc."; and Humble Oil & Refining Co. v. Calvert (Tex. Civ. App.), 414 S.W. 2d 172 (1967).

[20] These difficulties are illustrated by those experienced with respect to interpretation of sections 4-8 of the Uniform Division of Income for Tax Purposes Act. See the Examples set forth in the Regulations issued by the Multistate Tax Commission, which purport to interpret that Act's distinction between "business" interest income and "non-business" interest income.

the proposed Federal statute could reasonably provide for formula apportionment of all types of interest income. In this connection, we note that no problem of duplicative corporate taxes (comparable to that previously discussed with respect to intercorporate dividends) can arise in connection with interest income received from another corporation because of the concomitant deduction for interest expense allowable to the payor corporation in computing its income subject to formula apportionment.

(c) *Capital Gains and Losses.*—Different policy considerations apply with respect to gains and losses which are treated as gains and losses from sales or exchanges of various types of capital and other assets (as distinguished from inventory and similar property held primarily for sale to customers). In many cases, such gains and losses result from infrequent transactions, distort current income, and have little or no relation to the factors reflected in the apportionment formula (particularly in those cases in which they result from dispositions of intangible property).

Perhaps the strongest argument for formula apportionment of capital gains is that with respect to those types of real or tangible personal property, e.g., plant and equipment, previously used in the regular business operations of the taxpayer and which have generated depreciation deductions taken against apportionable income. Section 1245 of the Internal Revenue Code and, to a lesser extent, section 1250 appear to mitigate this problem to some extent by "recapturing" such prior depreciation and treating it as ordinary income. To the extent that the gain is treated as ordinary income, it would in many States be apportioned by formula. However, even this argument is open to the objection that the gain apportioned by the formula reflects the current year's distribution of the taxpayer's property, payroll and sales among the several States, which may bear little resemblance to the distribution that existed during prior years when the depreciation was deducted.

It is the recommendation of our Committee that gains and losses which are treated as gains and losses from sales or exchanges of capital assets under the Federal income tax statute should be specifically allocated to a single State according to rules generally similar to those of the Uniform Division of Income for Tax Purposes Act. Thus, gains and losses from sales or exchanges of intangible property should be assigned to the State of taxpayer's commercial domicile. Gains and losses from sales or exchanges of real property should be assigned to the State in which the real property is located. The same rule should apply with respect to gains and losses from sales or exchanges of tangible personal property except in those (relatively unusual) cases in which the taxpayer is not taxable in the State of situs and should, therefore, be required to assign such gains to the State of the taxpayer's commercial domicile.

(d) *Other Income.*—All other types of income are apportioned by the pending Bills by means of a three-factor formula. This "full apportionment" concept obviates the necessity of identifying the sources of particular items of income and of determining the character and amount of those deductions which are fairly assignable to the income which is specifically assigned. For example, under the Uniform Division of Income for Tax Purposes Act patent and copyright royalties are assigned to the State in which the patent or copyright is utilized. The necessity for determining the place of utilization may give rise to complexity in administration, increasing the burden of compliance on the part of the taxpayer and the burden of enforcement on the part of the State. Moreover, in many situations a patent or copyright is developed as part of the regular business operations of a company, and it is impracticable to identify the items of cost and expense incurred, either currently or in previous years, in development of the patent or copyright.

Similar problems of segregating income and expenses and of determining the proper situs of the income may arise with respect to several types of income other than dividends and capital gains, suggesting that formula apportionment affords a convenient approach for assigning such income.

Desirability of a Three-Factor Formula

In our original report, we stated our belief that there are sound reasons of policy for inclusion of a gross receipts factor in whatever formula is used to apportion ordinary business income from interstate sales of goods and services. We continue in that belief. If the market for goods or services produced or rendered by a business is in a State, some part of its net income or capital should reasonably be attributed to that State. As a gross receipts factor is commonly incuded in the apportionment formulas used by the States, its omission from a Federal apportionment formula could have a substantial effect on State tax revenues. Such a result

could be undesirable both for the States and for taxpayers. Although some States would experience a windfall, others would be required to raise tax rates in order to sustain their present level of tax revenues. Multistate taxpayers would be likely to experience additional tax burdens as States would seek to compensate for such disruptions of existing revenues.

In our piror report, we noted that one of the major arguments advanced in favor of a two-factor formula is based on the fact that in some instances gross receipts are assignable to a State in which the taxpayer could not be taxed by reason of P.L. 86-272 or by enactment of the jurisdictional provisions of the proposed Federal legislation under discussion. Our recommendation with respect to jurisdictional limitations reduces the extent of the problem. An alternative solution to the problem (of accounting for 100 per cent of a corporation's gross receipts in the gross receipts factor) would be to construct the gross receipts factor in such a way that there will be full accountability of all gross receipts included in the factor. The latter concept is discussed in the following portion of this Report.

Definition of Gross Receipts Factor

The development of a gross receipts factor presents several problems. The Uniform Division of Income for Tax Purposes Act contains one set of rules for locating gross receipts from sales of tangible personal property in a State and a second set of rules for locating gross receipts from other sales. Sales are defined to include only items of gross receipts not specifically allocated under sections 4 through 8 of the Act (dividends, interest, rents, royalties and gains), which leaves receipts from sales of services as the principal, if not only, receipts to be located by this second set of rules. Thus, the Uniform Act does not contemplate a gross receipts factor with any significant amount of receipts other than from sales of tangible personal property and services. If the Uniform Act is interpreted to include virtually all income in the apportionable base, as the "MTC" Reglations do, then the receipts in the sales factor will include dividends, interest, rents, etc. As we note in a subsequent paragraph, it is not logically sound to include those kinds of receipts in the sales factor.

Of the various proposals for a sales or gross receipts factor, the general approach taken by the "Plan" seems to us to be the most reasonable. Only gross receipts from sales or rentals of tangible personal property, from sales of services, and from sales of real property (if the corporation is engaged in the business of selling real property) are included in the factor. This is also true of the sales or gross receipts factor in S. 2092. Our Committee believes that this represents a reasonable definition.

Under the "Plan" and S. 2092, the principal gross receipts omitted from the factor but included in the apportionable base are interest income, royalties, and the proceeds of certain sales of capital assets.

In our opinion, the basic issue involving the congruence between the apportionable base and the factors of the apportionment formula is the question of what income can be appropriately apportioned by a formula rather than the question of what receipts should be included in the sales factor. For example, if the decision is made to apportion all interest income, it would partially frustrate that policy to assign all such income to the State of the corporation's commercial domicile in constructing the sales factor.

A related problem arises with respect to capital gains because a very large amount of gross receipts may be associated with very little gain or loss in the apportionable base. Of course, specific allocation of capital gains or losses would avoid that problem.

The "Plan" describes the sales or gross receipts factor as a fraction, the numerator of which is the sales of a corporation which are located in the State during the taxable year, and the denominator of which is the sum of the corporation's sales factor numerators for such year for all States in which the corporation is taxable. The limitation placed upon the denominator of the fraction makes certain that there will be no gross receipts assigned to a State in which the corporation is not taxable and, therefore, that all of the income or capital of the corporation will be subject to tax by the several States.

In both the "Plan" and S. 2092, gross receipts from sales of tangible personal property are assigned to the State of destination. An exception is made with respect to gross receipts from sales having a destination in a State in which the corporation is not taxable, in which event the receipts are located in the State from which the property was shipped, normally the State in which the seller's factory or warehouse is located. This provision is designed to accomplish the same

result as the provision limiting the amount of gross receipts in the denominator of the factor, viz. the full accountability of all gross receipts. The considerations for and against this provision are fully discussed at p. 43 et seq. in our original report. We stated there that our Committee was not in agreement as to whether the segment of income from sales that cannot be taxed by the customer's State (for lack of sufficient contacts and expense incurred, either currently or in previous years, in development of the patent or copyright.

Similar problems of segregating income and expenses and of determining the proper situs of the income may arise with respect to several types of income other than dividends and capital gains, suggesting that formula apportionment affords a convenient approach for assigning such income.

Desirability of a three-factor formula

In our original report, we stated our belief that there are sound reasons of policy for inclusion of a gross receipts factor in whatever formula is used to apportion ordinary business income from interstate sales of goods and services. We continue in that belief. If the market for goods or services produced or rendered by a business is in a State, some part of its net income or capital should reasonably be attributed to that State. As a gross receipts factor is commonly included in the apportionment formulas used by the States, its omission from a Federal apportionment formula could have a substantial effect on State tax revenues. Such a result could be undesirable both for the States and for taxpayers. Although some States would experience a windfall, others would be required to raise tax rates in order to sustain their present level of tax revenues. Multistate taxpayers would be likely to experience additional tax burdens as States would seek to compensate for such disruptions of existing revenues.

In our prior report, we noted that one of the major arguments advanced in favor of a two-factor formula is based on the fact that in some instances gross receipts are assignable to a State in which the taxpayer could not be taxed by reason of P.L. 86–272 or by enactment of the jurisdictional provisions of the proposed Federal legislation under discussion. Our recommendation with respect to jurisdictional limitations reduces the extent of the problem. An alternative solution to the problem (of accounting for 100 per cent of a corporation's gross with that State) should properly be attributed to another State, such as the State from which the goods are shipped.

It seems to us that attribution of such income to the State from which the goods are shipped would be preferable to limiting the denominator of the factor because it does reflect the situs of an activity factually related to the receipts in question. By contrast, the effect of limiting the denominator would be to increase the factor for those other States with which the taxpayer has sufficient contacts to be subject to tax. Those States would, therefore, receive the benefit of attribution of additional net income unrelated to any activity taking place within their boundaries.

In S. 2092 a further exception would be made with respect to sales to the United States Government when the goods are delivered or shipped to a place outside the United States or to the District of Columbia, i.e., such receipts would be assigned to the State from which the goods were shipped. Our Committee expresses no opinion with respect to the proper treatment of sales to the United States Government.

In both the "Plan" and S. 2092, sales of services are included in the numerator of the State in which the service is performed. Services rendered in two or more States are divided between those States in proportion to the direct costs of performance incurred in each State by the taxpayer in rendering the services. Sales of real property would be included in the numerator of the State in which the property is located only if the corporation is engaged in the business of selling real property. If not in such business, the gross receipts would be ignored for factor purposes.

Gross receipts from the rental of tangible personal property would be included in the numerator of the State in which the rented property is located. The location of rented-out property may be difficult for the taxpayer to ascertain. The specific provision with respect to the location of rented-out personalty in the Rodino Bill might ease this problem because it locates such property in the State in which was located the last base of operations at or from which the property was delivered to a lessee, a fact easily ascertained by the lessor-owner.

Definition of property factor

The property factors prescribed in S. 2092 and S. 1245 are, for the most part, similar and reflect property factors in common usage in State income tax laws. They differ, however, in certain minor respects.

Of these differences, only that with respect to the treatment of rented property requires comment by the Committee. S. 2092 determines the value of rented property on the basis of *gross* rents payable, while S. 1245 determines such value on the basis of *net* rents payable. The latter method inserts an additional complexity into the computation of the property factor. It is conceivable that a negative value may result. In our opinion, the value of owned property in the property factor should reflect the capital investment of the taxpayer rather than income-producing capability. Similarly, there is no compelling reason to value rented property on the basis of income from subrentals. Therefore, the Committee recommends adoption of the method found in S. 2092 for determining the value of rented property for property factor purposes.

The Rodino Bill also contains specific rules for determining the situs of personal property which is rented out to another person (See p. II–19). Such rules may be helpful as an alternative to applying the rather complex rules regarding movable property.

Definition of payroll factor

The Committee recommends that the payroll factor be limited to wages paid to employees as defined in the Internal Revenue Code with respect to F.I.C.A. and F.U.T.A. taxes and the Model Unemployment Compensation Act in effect in all of the States. This permits a taxpayer to develop its payroll factor without generating data specifically for that purpose which is not otherwise required in its business. Likewise, it permits the States to administer their tax laws easily. Accordingly, the Committee recommends adoption of the principle found in the payroll factor of S. 1245.

Sections 203 and 515(b) of S. 1245 require some revision of a technical nature. The reference to section 3306(b) of the Internal Revenue Code should be amended to make clear that the amount of wages in the payroll factor will not be limited to $4,200 per employee. The reference to Chapter 24 of the Internal Revenue Code should be changed to a reference to the Chapters imposing F.I.C.A. and F.U.T.A. taxes.

Application of apportionment formula to capital stock taxes

In its original report, our Committee did not attempt to study in detail the various problems presented in developing Federal legislation to limit the amount of a multistate taxpayer's capital that could be subjected to State taxes on capital stock.

The development of the law of capital stock taxation has had a somewhat different history than that with respect to income taxation. Capital stock tax laws were originally conceived as laws exacting a fee for the privilege of doing business in a State. This fact prompted many courts to be very lenient in their scrutiny of the measure of such fees. However, since the maximum attribution provisions of any Federal legislation cannot distinguish between capital stock tax laws that are imposed on the privilege of doing business in a State (and measured by capital) and those that are imposed directly upon capital employed in the State, the maximum capital attributable to a State should meet the same test of reasonableness as with respect to income for income tax purposes.

The test commonly applied where the tax is not upon the privilege of doing business is the extent of the capital employed or used within a State. It is difficult to quantify the concept of using capital in a State. Nevertheless, our Committee believes that the three-factor fromula to be applied to net income can normally be applied to capital with reasonable results. This is particularly true if investments in and advancements to subsidiary companies are excluded from the capital stock tax base. However, problems arise in those cases where the taxpayer's only activities in the State involve the selling of its product and the taxpayer has no property or employees in the State. In such cases, no capital of the taxpayer is actually used in that State. Notwithstanding this difficulty, a number of capital stock tax laws presently contain a three-factor apportionment formula which includes a sales factor.

Two or more businesses of a single taxpayer

Regulations of the Multistate Tax Commission adopt the theory that a single corporation may engage in two or more businesses requiring separate application of the apportionment formula in order to determine the income or capital attributable to a State. By contrast, S. 1245 is silent as to this theory.

In our opinion, implementation of such a theory would introduce undue complexity and would result in much fruitless litigation, particularly in view of the difficulties encountered in identifying each separate business which are described

in the critique of the "unitary business" technique of our original report at pp. 50–55. Those difficulties would seriously aggravate compliance and enforcement problems. Moreover, the "unitary business" concept has thus far been adopted by very few States. Therefore, the Committee believes that the approach of S. 1245 is preferable and should be adopted.

III. RELATED CORPORATIONS

In its original report, our Committee set forth in some detail the grounds for its objections to the practice, introduced by California, of requiring a corporation with a local place of business to apply the three-factor apportionment formula to the combined income of that corporation and those out-of-state affiliates found to participate with it in a single business unit or "unitary business". That study led our Committee to recommend that the "unitary business" method of combined reporting should be restricted by Federal legislation along the lines of the provision contained in the Ribicoff Bill, discussed in our prior report.

S. 1245 embodies a different approach. Section 209 thereof provides that if either a State or a taxpayer establishes that the taxpayer has engaged in non-arm's-length transactions (as defined) which cause a "material distortion" of income apportioned to the State, the State may require or the taxpayer may elect to determine apportionable income by reference to the "consolidated apportionable income and apportionment factors" of all parties to the non-arm's-length transactions. "Consolidated apportionable income" is defined as the sum of the apportionable income of all corporations consolidated with all intercorporate transactions eliminated.

This approach appears to eliminate many, but not all, of the problems, described in our prior report, which arise under the California technique for combined reporting with respect to identification of a "unitary business" and ascertainment of the net income and apportionment factors pertaining to the "unitary business." A variety of new problems would, however, be created. Thus, it is doubtful whether a satisfactory definition of "material distortion" can be developed. Moreover, although Section 209 seeks to achieve fairness by permitting a taxpayer to elect to report on a combined basis by establishing the existence of non-arm's-length transactions, it could invite deliberate manipulation of relationships with affiliated corporations in those cases in which the combined computation would result in tax savings. Another difficulty arises from the fact that Section 209—quite reasonably—contemplates combination of apportionable income and apportionment factors solely with respect to those related corporations which engaged in non-arm's-length transactions with the taxpayer; this creates a dilemma in cases in which the taxpayer engages in non-arm's-length transactions with two or more affiliates that do not engage in non-arm's-length transactions with each other.

Our Committee believes that these problems, together with other problems inherent in any consolidation approach, deserve intensive study before Congress takes action to adopt this or any similar provision which would appear to authorize a State, in some circumstances, to impose tax on income of an out-of-state corporation beyond the jurisdiction of that State as defined in prior decisions interpreting the "Due Process Clause" of the Fourteenth Amendment.

The foregoing considerations have led our Committee to conclude that, pending full study of the ramifications of a Federally-sanctioned consolidation provision, prudence would suggest that current Federal legislative proposals might appropriately provide protection of State tax revenues from possible tax avoidance maneuvers involving related corporations by sanctioning reallocations of income, deductions and other tax attributes among affiliated entities under circumstences similar to those contemplated by Section 482 of the Internal Revenue Code. We recognize the merit of some of the reservations expressed by State tax administrators with respect to the reallocation technique, but we believe that several of those reservations can satisfactorily be resolved along the lines suggested in our prior report. Our Committee therefore reaffirms its support for the Ribicoff proposal, which would both restrict the use of combined reporting and expressly authorize use of the reallocation approach.

IV. JURISDICTION OF FEDERAL COURTS

Title IV of S. 1245 introduces a new concept not present in S. 3333 nor commented upon in the original report of the Committee. This title is designed to give concurrent jurisdiction with State courts to the U.S. Court of Claims for disputes arising under S. 1245 or P.L. 86–272.

Within 90 days after a decision by a State administrative body from which the only appeal is to a court, any party (the State as well as the taxpayer) may petition the Court of Claims for a review de novo of any of the issues resolved by the State administrative body.

Title IV further provides that a determination by the Court of Claims is binding for the taxable years involved on any State given notice or appearing as a party, notwithstanding the fact that there had been a prior determination by a State court or administrative body which was completed after notice was given to the State of the Court of Claims proceeding. Finally, Title IV provides that no statute of limitation shall bar the right of the State or a taxpayer to recover an increase in tax or a refund in accordance with the determination of the Court of Claims, provided that an action has begun within one year after the determination of the Court of Claims has become final.

Our Committee believes desirable the objective of having a single Federal court which could develop an expertise in the area of interstate taxation and which would provide a forum for the uniform application of Federal law in this area.

The Court of Claims, either through the use of its Commissioners or sitting as a panel, would be able to hear cases drawn from all parts of the country and, therefore, would be preferable to the use of the Federal District Courts for this purpose.

The need for uniform application of the law in this area may be illustrated by the inconsistent results reached in recent California and Utah decisions. In *Chase Brass & Copper Co. Inc. v. Franchise Tax Board*, 10 Cal. App. 3rd 496 (1st Dist.), cert. denied, 400 U.S. 961 (1970), it was held that both Kennecott Copper Corporation and its subsidiary, Chase Brass & Copper Co., were parts of a "unitary business" required to file a combined franchise tax report, even though Kennecott was not separately engaged in business in California. In *Kennecott Copper Corporation v. State Tax Commission*, 27 Utah 2d 119, cert. denied, 93 S. Ct. 323 (1972), on essentially the same facts involving the same companies, the Utah Tax Commission, although finding a "unitary business", required separate reporting. In both cases, the U.S. Supreme Court refused to hear the appeal of the taxpayer on the stated ground of lack of a question subject to Federal jurisdiction. By granting jurisdiction to the Court of Claims to decide issues such as those involved in the Kennecott cases, inconsistent treatment of taxpayers in such situations can be avoided.

Our Committee recognizes that conferring jurisdiction on a Federal court to resolve disputes arising under Public Law 86–272 and S. 1245 presents a question of Constitutional law involving the Eleventh Amendment. We have not studied the authorities bearing on this question and, therefore, express no opinion as to the propriety of such a procedure. The comments that follow assume that any Constitutional obstacles to providing a Federal forum can be overcome .

Title IV requires certain technical revisions. Section 401 of Title IV provides that "Notwithstanding section 1251(a) of Title 28 United States Code, the United States Court of Claims shall have jurisdiction to review de novo any issues relating to a dispute arising under this Act or under Public Law 86–272, as amended." Section 1251(a) deals with original and exclusive jurisdiction of the Supreme Court and provides for such jurisdiction where there are controversies between two or more States. Section 1251(b) provides that the Supreme Court shall have original but not exclusive jurisdiction of, inter alia, actions or proceedings by a State against the citizens of another State. The reference to section 1251(a) may imply that the disputes arising under S. 1245 are to be considered as a contest amongst the different States to determine the proper allocation to the various States of a taxpayer's total tax liability with the taxpayer in the position of a mere stakeholder. This approach might also be inferred from Section 402 of the Bill which states that the decision of the Court of Claims is binding upon any State given notice. Our Committee does not believe that such an approach is appropriate in light of the purpose of S. 1245 to regulate the taxation of interstate commerce and also may be questionable under the Eleventh Amendment. Issues are likely to arise as to the proper application of the law to a particular taxpayer, and only the State, the decision of whose administrative body is being reviewed, should be affected. Accordingly, the reference to section 1251(a) should be deleted, i.e., the reference should be to section 1251 generally.

The Committee suggests that Chapter 91 of Title 28 of the United States Code which deals with the jurisdiction of the Court of Claims be amended. A new section should be added to Chapter 91 to give the Court of Claims jurisdiction to hear disputes arising under S. 1245 or P.L. 86–272.

Our Committee also suggests that it would be advisable to expand the scope of section 1500 of Title 28 of the United States Code to provide that the Court

of Claims shall not have jurisdiction of any action under S. 1245 or P.L. 86-272 where the plaintiff or an assignee of the plaintiff has instituted an action on the same matter in any other court. Our Committee further suggests that the Court of Claims be given the authority to stay any proceedings instituted by a State against a taxpayer under S. 1245 or P.L. 86-272 either prior to or subsequent to the commencement of an action by the taxpayer in the Court of Claims.

The reference in the last sentence of section 401 to section 1254 of Title 28 United States Code should be changed to section 1255 of Title 28 United States Code. This would permit Supreme Court review of decisions of the Court of Claims either by writ or certiorari or by the certification of a question of law by the Court of Claims. However, it will also be necessary to amend the language of section 1255 to include the granting of certiorari upon petition of either a State or a taxpayer.

Section 402 of Title IV provides that the determining of a dispute by the Court of Claims shall be binding for the taxable years involved on any State given notice or appearing as a party notwithstanding the fact that any prior determination of a State court or administrative body is completed after notice is given to that State of a Court of Claims proceeding. Our Committee believes that the purpose of this section which is to prevent a State from short circuiting the Court of Claims proceeding by instituting and quickly receiving a decision of a State court on the identical issue pending before the Court of Claims, is a valid one and would be further strengthened, as mentioned above, by granting to the Court of Claims the authority to stay any State court or administrative proceeding after the institution of a proceeding in the Court of Claims in accordance with Title IV.

Finally, our Committee recommends that the last sentence of section 402 of the Bill be clarified to read as follows: "No statute of limitations shall bar the right of a State to make an assessment or of a corporation to seek a refund of an amount of tax determined by the Court of Claims provided such assessment or refund proceeding is begun within one year after the determination has become final."

Statement of Charles V. Chase, Special Studies Staff, Advance Schools, Inc.

Mr. Chairman and Members of the Committee:

It is a pleasure to submit to you a statement containing the views of Advance Schools, Inc. with relation to State Taxation of Interstate Commerce, in general, and to the measures before your Committee for consideration, S. 1245 and S. 2092, in specific.

Mr. Chairman, I would like to first describe the corporate activity and experience of Advance Schools so that the Committee might better know the background on which we base our views.

Advance Schools is a home study educational institution which provides complete training in the occupational career fields entirely through the mail. The occupational career fields training consists of trade, or technical, or secretarial, or business skill development, whichever is necessary for the particular held chosen by the student. Our school serves more than 80,000 students in 46 states.

As a corporation, Advance Schools has more than 200 offices in the same number of states. Our offices are categorized as follows: District Sales Office, Area Sales Office, Regional Sales Office, Zone Sales Office, and Service Centers. Our sales representatives are salaried and operate out of the District Sales Office, and their responsibility is to solicit applications for enrollment (solicit orders) but they do not accept or reject them, inasmuch as that is an educational function. The District Sales Offices come under the jurisdiction of the Area Sales Offices which come under the jurisdiction of the Regional Sales Offices which come under the jurisdiction of the Zone Sales Office which reports to the Vice President of Marketing.

Our Service Centers (of which there are approximately 15) serve a function different from that generally connoted by their name. They serve not the need of the consumer directly but rather the needs of the sales force, by insuring the totality and correct completion of all necessary paperwork involved in the application for enrollment. As you well imagine, Mr. Chairman, because many of our students receive financial aid, veterans' benefits, etc. and because we must meet all state requirements for such business transactions, the student fills out some 10 to 15 different forms. With over 6,000 such applications each month, you can see that if there were not some form of localized, pre-screening, the delay in getting a student applicant from New Mexico, for example, on his way toward achievement

of his educational goals could severely affect his motivation. However, as a result of the prompt service we offer, our students maintain a lesson completion rate in excess of 60%.

Our courses range in tuition cost frôm $500 to $1,500. This tuition is paid, in full, upon application (either in cash or through financial assistance arrangements). At this point, the student awaits word from the School in Chicago as to whether or not he has been accepted. This notification generally arrives 15 to 28 days after application. The percentage of students not admitted to the School (for whatever reason) is between 10% and 15%.

As an industry leader, Advance Schools has operated since 1967 with a modified pro-rata refund. Similarly, we began with a 10 day "cooling-off" period which was subsequently expanded to 15 days. Our present policy provides an indefinite "cooling-off". Should the student decide not to pursue his course prior to submission of any lessons, he receives a total refund of *all* monies paid, which includes the insurance premium (if he has applied for the Guaranteed Student Loan) and the State Sales or Use Tax where applicable.

Should the student cancel after submission of one or more lessons, he is liable only for a pro-rata portion of the tuition—the residual portion is refunded to the student. Therefore, as you can see, Mr. Chairman, the School has earned no income until a student has mailed in a lesson. For all students outside the State of Illinois, the student's lesson materials must cross state lines before it arrives at the School. The School then earns a portion of the tuition already remitted as lessons are completed.

These lessons, Mr. Chairman, are submitted to the School in Illinois for correction and evaluation. Should the student require educational assistance, this is all carried out by mail or telephone from the home office in Chicago.

It is for these and other reasons to follow, Mr. Chairman, that the only form of taxation that we think is for a business such as ours is a tax based on net corporate income. An uniform formula, such as that expressed in S. 1245 and S. 2092, seems reasonable and fair. We, as a responsible business, have absolutely no objection to tendering our portion of the support of the government which facilitates the carrying on of interstate commerce. However, we object to a recent trend toward the imposition of what we consider to be the unfair, economically oppressive, and unduly encumbering gross receipts taxes by various states. We submit that the legislation as finally enacted will be unavailing unless the states are precluded from circumventing its effect through the gross receipts tax.

Mr. Chairman, our net income, as explained earlier, is earned as a result of services performed over a 14 to 18 month period and is derived from the gross income received at the beginning of that time period. We pay net income tax to the State of Illinois and to approximately 45 other states on that portion of our income determined to have been earned from students residing in those states.

The State of Indian has just sent us an assessment under the provisions of its gross income tax for fiscal years 1971 and 1972 requiring us to remit immediately approximately $37,000 of which $35,000 represents tax, $1,000 represents penalty, and $1,200 represents interest. We had remitted $4,500 in compliance with a *net* income tax calculation. However, Indiana wrote back advising us that we had erred in our caculation of our *gross* income tax. We consider their determination unfair.

The State of New Mexico has just sent us an audit (not a billing) for a period beginning in December 1970 and ending in April 1973. This audit yielded a result that there would be due approximately $51,000 tax, $5,000 penalty, and $3,000 interest totalling $59,000. Mr. Chairman, if other states were to consider this as a lucrative revenue source, you can see that we would be faced with a tax bill close to $2.4 million!

We have already paid tax on our income. We do not manufacture or sell tangible property. If we did, then once the materials have been delivered to the student it would not be necessary for him to remit a lesson for us to retain his tuition payment. However, such is not the case at all as previously outlined. The student has signed a contract in anticipation of an extended service. This service is performed outside the state.

The State of New Mexico even has that specific language in its statutes, to wit: "Receipts from performing services outside New Mexico are not subject to the Gross Receipts Tax." However, New Mexico has excluded us from this provision: "Receipts of a correspondence school from selling correspondence courses to students in New Mexico are receipts from selling property in New Mexico and are subject to the Gross Receipt Tax."

Mr. Chairman, in each case, the bundle of corporate activities takes place entirely outside the other states and inside Illinois. Nowhere can it be construed

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that there is sufficient local incident to warrant such a tax especially when compared with the extent of activities carried on outside the state. The business which earns us income is not done "within the state." By its very nature, the gross receipts tax is unfair when imposed on interstate commerce. It is supposed to be a tax on the privilege of earning gross income within a state but the income, in our case, is not earned in, for example, Indiana. The tax in no way reflects the fact that the income is earned in Illinois.

We agree with the Statement issued by the Supreme Court in 1888 in the case of *Leloup* v. *Port of Mobile*, 127 U.S. 640, 648.

> "[N]o State has the right to lay a tax on interstate commerce in any form, whether by way of duties laid on the transportation of the subjects of that commerce, or on the receipts derived from the transportation, or on the occupation or business of carrying it on, and the reason is that such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to the Congress."

We also agree with the opinion written in 1946 by the Supreme Court in the case of *Freeman* v. *Hewit*, 329 U.S. 249.

> "[A] seller State has various means of obtaining legitimate contribution to the costs of its government, without imposing a direct tax on interstate sales. While these permitted taxes may, in an ultimate sense, come out of interstate commerce, they are not, as would be a tax on gross receipts, a direct imposition on that very freedom of commercial flow which for more than a hundred and fifty years has been the ward of the Commerce Clause."

Mr. Chairman, one must consider the possible effects that the imposition of a gross receipts tax on an interstate company would have on the company's ability to compete with local companies. Inasmuch as the gross receipts tax is a cost which must be shifted (either to the consumer, or to the employees through lower wages) one can expect prices to rise to off-set such imposition. This raises the price in those states which do not levy gross receipts taxes. This means that a local competitor, not being faced with such a cost, could undersell the interstate company.

Further, it has been generally found among those states that impose Gross Receipt Taxes that 1/2 of 1% is the maximum amount bearable. Indiana was forced, through agitation, to lower its Gross Income Tax on retailers from 1% in 1934 to 0.5% in 1964. However, the obverse has been true for its Gross Income Tax on "nonretailers." This tax has gone from 1% in 1934 to its present 2%—the rate at which we have been assessed. Mr. Chairman, a moderately successful company earning $5 out of every $100 would be taxed by Indiana at the rate of 40% of its profits! This is economically oppressive and unduly burdens interstate commerce. The State of New Mexico would tax 80% of such a company's profits. At this rate, the tax becomes confiscatory.

Mr. Chairman, we do not believe that there is any conceptually just basis for an educational institution such as ours to be subject to gross receipts taxes. In particular, we have paid taxes to both Indiana and New Mexico and Illinois (our home state). These other states would like to doubly tax us because they have found, they think, a way to increase their revenues, at the expense of the constitutional rights of already heavy tax-paying business.

As a result, we request that S. 1245, Title I, Sec. 101 be expanded to include a subpart (5) which would read: "to impose a gross receipts tax on a business earning receipts from performing services outside the taxing state."

Mr. Chairman, this concludes my statement. Should you desire more information, please do not hesitate to contact me at 5900 Northwest Highway, Chicago, Illinois 60631. Telephone: 312-775-8585 ext. 370.

WESTERN HIGHWAY INSTITUTE,
San Francisco, Calif., September 26, 1973.

Hon. WALTER F. MONDALE,
U.S. Senate,
Senate Office Building,
Washington, D.C.

DEAR SENATOR MONDALE: At the suggestion of my friend and long time colleague, Mr. Frederick J. Lordan, who is at present staff director of the United States Senate Commerce Committee, I am enclosing a brief statement of my background, and some views on viewpoints which may deserve consideration by the Congress in its investigation of legislation prescribing the manner in which states may tax interstate business or transactions.

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Western Highway Institute, which I serve as executive director, is a research organization engaged in engineering, economic, and legal research for the highway transportation industry in western North America. This organization has not adopted any position with respect to matters under consideration by the Senate Finance Committee's Subcommittee on State Taxation of Interstate Commerce. My sole interest in writing to you is to present some background and suggestions which might be helpful additions to the mass of testimony which I am sure your subcommittee has already accumulated. For this reason, I will try to avoid requirements of form or style or detail usually employed in legal articles; instead I will rely on your own familiarity with the subject, as well as that of your highly competent staff. If at a later time you should desire a more formal presentation it can be readily supplied.

RELIANCE ON U.S. SUPREME COURT

State tax administrators in the late 30s and early 40s believed that the decisions of the United States Supreme Court furnished them with pretty fair guides as to the taxability of interstate businesses. The hardnosed Fisher's Blend (1936), and Puget Sound Stevedoring (1937) decisions had been apparently modified by a line of cases starting with Western Livestock in 1938, and the group of three cases which came down on the same decision day in 1944 (reported in 322 U.S.). To state departments, particularly those administering gross receipts and sales and use taxes, the decision in Freeman v Hewit in late 1946 came as a veritable explosion of a bombshell when the Court said:

> "To attempt to harmonize all that has been said in the past would neither clarify what has gone before nor guide the future. Suffice it to say that especially in this field opinions must be read in the setting of the particular cases and as the product of preoccupation with their special facts." *Freeman* v. *Hewit* (1946) 329 U.S. 249, 252

The attorneys general of fifteen states joined the state of Indiana as amici curiae, and petitioned for rehearing. The thrust of the petition was to urge upon the Court that it continue to assume the posture it had previously adopted over the years, and that it clarify its opinion (not necessarily reverse it) "to furnish a guide for future state administrative and legislative action".

As author of the brief and petition on behalf of the fourteen states, in addition to Indiana, of California, Connecticut, Florida, Kentuck, Maine, Nevada, New Mexico, North Dakota, Washington, West Virginia, Utah, South Dakota, New Hampshire, Pennsylvania, I can verify the sense of frustration with which this decision was received. As chairman of the attorney's section of the National Association of Tax Administrators, I reported on this subject in some detail at their annual meeting in 1947.

RECOURSE TO CONGRESS SUGGESTED

There is little point in enumerating successive decisions which increased the sense of frustration of tax administrators. Suffice it to say that the opinion in Freeman, quoted above, was prophetic. In 1956, having participated in a number of discussions on this subject at the annual workshop sessions of the American Bar Tax Section Subcommittee on State and Local Taxes, I prepared a paper, copy enclosed, suggesting that perhaps it was time for the Bar to take the Court seriously, and approach the Congress of the United States for solutions to the problems of state taxation of interstate commerce. In the conclusion of that paper, on page 16, it was suggested that unless a group with broad objectives was willing to take the lead in bringing the matter before Congress, it was likely that a number of groups might act and propose solutions of their own particular problems. The present proposals before the Congress deserve analysis in this regard.

A STATE LAW FOR UNIFORM APPORTIONMENT

A year later, the same American Bar subcommittee had before it for consideration UDITPA. Its sponsors were frank in presenting this act for uniform adoption by the various states as a method for precluding intervention by the Federal government. In the original draft, Section 2, business activity did not include ". . . activity as a financial organization or public utility . . ." The National Conference of Commissioners on Uniform State Laws included a note in fine print indicating that type of apportionment would be handled by a state's regulatory bodies. This may explain why proposed Federal allocation or appor-

tionment statutes have adopted the phrase "excluded corporation." Of course, it is also true that no agreement about apportionment was forthcoming from those "excluded."

BAR ASSOCIATION REACTION TO NORTHWEST-STOCKHAM

The 1959 meeting of the ABA Subcommittee on State and Local Taxes included three interesting presentations, all of which were directed toward the February 24 and March 2 decisions issued earlier that year. (Northwestern States Portland Cement, Stockham Valves, and E.T. & W.N.C. Transportation). Professor William Pierce of the University of Michigan School of Law, one of the principal architects of UDITPA, had this to say: "Unless more state interest can be evolved in uniformity, even at the expense of readjustment of tax rates in order to receive the desired revenue, Congress should be requested to intervene on both the nexus and apportionment problems. A situation, long intolerable has become even more so because of the recent decisions and state legislative action based upon them." [At that time, only one state had adopted UDITPA; the later rash of adoptions was in direct response to heightened activity at congressional level.]

Another speaker had represented the state of Georgia in Stockham Valves. He was Professor Ben F. Johnson, who made the point with which a number of his listeners agreed, that the 1959 decisions were not particularly startling and had already been anticipated by at least six state supreme courts, as well as members of the ABA subcommittee.

The third presentation by John Dane, Jr. suggested the need for bringing the greatest measure of certainty at once, and doing this through Federal legislation. Mr. Dane was later associated with the effort of the United States Chamber of Commerce in the adoption of P.L. 86-272.

IS THERE A REAL DESIRE FOR CONGRESSIONAL ACTION?

In 1962, I gave an overall comment on the situation to a group of tax administrators (copy enclosed), entitled "Federal Control Over State Taxation of Interstate Commerce. Who Needs It? Who Wants It?" My conclusion was that practically everybody needs it and practically nobody wants it. The prediction was: "It would seem that congressional legislation, if it eventually comes, will be limited to the spheres in which organized business interests have well-defined objectives. An exploration of the economics of free trade among the states of the union, by a Congress requesting the concurrence of state governments, might possibly bring results, but nothing of this sort now seems to be under contemplation."

In 1966, this question was presented to the fourth business session of the American Bar Association Tax Section. (I enclose a copy of my presentation as the lead speaker on the "Case for Congressional Intervention"). This activity touched off an attack by state tax administrators and a serious, if acrimonious, debate which has in some degree or other persisted up to the present time.

WILLIS COMMITTEE INVESTIGATION FALLS SHORT

The investigative work of the Willis subcommittee of the House Judiciary Committee is interesting reading, but hardly revelatory to tax administrators who continually are required to contend with various levels of comprehension and motivation amongst taxpayers for every conceivable type of levy. The various items of legislation which have been proposed as a result of those investigtions have been directed toward particular types of taxes and establishing rules by which those taxes may be applied by the states and to whom. If the pronouncements of the Court over the years regarding the need for congressional investigation into the economics of interstate commerce are to be given any meaning and, more to the point, if Congress is to exercise its power to regulate commerce among the states, it may be entirely futile to deal with selected specified taxes. State, city and county governments are capable of devising tax methods and applications as yet undreamed of. Furthermore, the current trends toward corporate conglomerates and multinational concerns and the dwindling importance of small business and individually-owned and operated concerns may both turn out to be reversible in the future. The attitude of the United States Supreme Court is subjected to change and decisions yet to come may present an entirely different problem for solution than those which now confront the states and the relatively small handful of vocal business interests engaged in the current debate.

CONTINUING JURISDICTION FOR CONGRESS?

The Constitution gives the Congress *continuing* jurisdiction over this subject. Might it not be appropriate for Congress to deal with this matter as one over which it retains jurisdiction? Might it not be more appropriate for the Congress to establish guidelines which must be followed by the states in applying their revenue measures to multistate concerns—to interstate business?

If Congress adopts statutes which designate the manner in which particular taxes may be applied to designated businesses, will it have assured that the revenue of the states is appropriately protected? That deference to local business will not disadvantage interstate business? That preferences are not granted to interstate firms? Would it not be preferable to establish principles of fairness which would be applied by the courts in an *orderly* development of a "Common Market-of-the-United States" philosophy?

UNIFORMITY?

Perhaps another reason why Congress should retain and maintain continuing jurisdiction of these matters centers on the freely used and rarely achieved goal, "uniformity". For example, there is only one Internal Revenue Code of the United States, yet it hardly deserves comment to note that administrative rulings and lower court decisions, some acquiesced in and others not, plus changes in administration have led to far from evenhanded, uniform, nationwide application.

Public Law 86-272 was devised by business interests to offer some relief from the harsh results of Northwest-Stockham. Twelve years later we find California's Franchise Tax Board publishing its guide to interpretation of the statute. (CCH Cal. Tax Rep. § 205, 9-11-73). If California can make such a rule, what assurance is there that other states will follow it? Or that the states will avoid conflict with each other in their "interpretions"? [For a classic example of confusion achieved by a statute designed for relief of interstate carriers from nonessential compliance problems, reference should be make to Public Law 89-170, and the manner in which it has been received by the states.]

The true goal of Congress, if it acts, should be to accommodate the diversity which necessarily must exist among 50 sovereign states—sovereign in all save those areas specifically delegated to the National Federation—while at the same time providing safeguards to the nation's commerce.

STARE DECISIS

An essential element of good business administration—public or private—is a reasonably accurate knowledge of the ground rules, especially the rules of law which must be observed and the proscriptions entailed if they are not. The principal basis for the rule of stare decisis is to give those subject to "the rules" a reasonable degree of predictability as to how they will apply to transactions about to be undertaken. Inasmuch as the Court has apparently abandoned its role in this process insofar as state taxation of interstate commerce is concerned, it seems incumbent upon Congress to take up the task under the power conferred by the Constitution. In the long run the substance of Congressional rules would seem to be less important than the fact of their existence and availability to all concerned—to states, municipalities, and to taxpayers.

A CONTINUING DILEMMA

An exemplification of the dilemma which is possible in the absence of clearly enunciated rules may be found in the majority and dissenting views in General Motors v. Washington (June 1964). The State of Washington was permitted to apply an unapportioned gross receipts tax for the privilege of making wholesale sales in interstate commerce to customers in that state by divisions of General Motors Corporation whose activity in the State amounted to product through, in some instances, resident representatives. Presumably, the result was reached because of the existence of a single corporate ownership with other taxable activities in the state and because of "local incidents" extracted by the Court from a very complicated factual situation. The significance of the decision to this discussion is that the Court seems to have reverted, implicitly, to the sentiments of Mr. Justice Frankfurter, previously cited.

For the majority, Mr. Justice Clark said:

> "The validity of the tax rests upon whether the State is exacting a *constitutionally fair* demand for that aspect of interstate commerce to which it

bears a special relation. In other words, the question is whether the State has exerted its power in proper proportion to appellant's activities within the state and to appellant's consequent enjoyment of the opportunities and protections which the State has afforded." (Emphasis supplied.)

The dissenting opinion by Mr. Justice Goldberg points out the inadequacies of the majority statement as a rule for future use:

"Constitutional adjudication under the Commerce Clause would find little guidance in a concept of state interstate sales taxation tested and limited by the tax's 'fair' proportion or degree. To attempt to determine the 'fairness' of an interstate sales tax of a given percentage imposed on given activities in one State would be almost as unseemly as an attempt to determine whether that same tax was 'fairly' apportioned in light of taxes levied on the same transaction by other States. The infinite variety of factual configurations would readily frustrate the usual process of clarification through judicial inclusion and exclusion. The only coherent pattern that could develop would, in reality be based on a *wholly permissive attitude toward state taxation of interstate commerce.*" (Emphasis supplied.)

A "PERMISSIVE ATTITUDE"

In addition to the "permissive attitude" noted in the dissent above, another problem may confront the interstate taxpayer. The Court has indicated that, in the absence of active discrimination against interstate commerce by a state tax plan, it would prefer an active role by Congress in making the rules governing state taxation of interstate commerce. Congress has "investigated" and has actually legislated in at least one particular instance. May the Court not continue its "permissive attitude" in those instances where Congress, having the superior power, has failed to act and may therefore be presumed to have given tacit approval?

We have purposely refrained from commenting on various pieces of legislation before the Congress. Neither the organization I head, nor I, espouse any particular cause other than the need for well-defined standards available to all on a similar basis.

Sincerely,

JESS N. ROSENBERG, *Executive Director.*

* Enclosures:
(1) Background of Jess N. Rosenberg, Executive Director of Western Highway Institute
(2) "Interstate Commerce: To What Extent May Congress Define the Areas of State and Local Taxation?"—By Jess N. Rosenberg, August 1956
(3) Federal Control Over State Taxation of Interstate Commerce. Who Needs It? Who Wants It?—By Jess N. Rosenberg, June 1962
(4) The Case for Congressional Action—By Jess N. Rosenberg, August 1966

GULF OIL CO.-U.S.,
Houston, Tex., September 26, 1973.

CHIEF COUNSEL,
Committee on Finance, U.S. Senate,
Dirksen Office Building, Washington, D.C.

FINANCE SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE
STATEMENT OF GULF OIL COMPANY-U.S.

GENTLEMEN: Pursuant to invitation for written comments on proposals before the Subcommittee regarding state taxation of interstate commerce, Gulf Oil Company-U.S., the domestic operating division of Gulf Oil Corporation, respectfully submits its views in support of federal legislation.

Gulf Oil Company-U.S. (hereinafter Gulf) operates in all 50 states and the District of Columbia. As a multi-state taxpayer, Gulf has been affected by the multiple burdens resulting from the diverse, inconsistent impositions of various states. Instances in which Gulf is taxed or exposed to tax on more than 100% of income are as follows:

(1) Pennsylvania, Gulf's legal and commercial domicile, has the authority to tax 100% of Gulf's dividend income. Presently Idaho, Michigan, and New Mexico are attempting to tax a portion of Gulf's dividends, alleging that they constitute business income. If they are successful, Gulf will be exposed to tax on more than

*The material provided has been made a part of the official files of the Committee.

100% of its dividend income. That Pennsylvania has not chosen to tax 100% of the intangible income of corporations domiciled there is not relevant. Each state should have the right to tax in the manner it elects. The critical point is that no taxpayer should be subjected to possible taxation on more than 100% of its income. (Some states presently tax all dividends received by taxpayers whose commercial domicile is in the state. Such taxpayers are now in fact paying tax on more than 100% of their dividend income.)

(2) Mississippi taxes 100% of Gulf's income from the production of crude oil in that state. Most other states require that a portion of that same income be apportioned to them. Thus, Gulf is taxed on more than 100% of its Mississippi income.

(3) California, through its so-called "unitary concept", taxes not only Gulf's income from doing business in California and other states but is also attempting to tax income of affiliated corporations which operate exclusively in foreign countries. Thus, California levies its tax on income upon which foreign income taxes have already been paid.

The above instances are merely common examples of the overlapping multiple tax burdens imposed on multi-state business. More extreme instances have been experienced by other taxpayers.

Gulf has worked within industry groups and in cooperation with the states in an attempt to arrive at some mutually acceptable solution to the problems of regulating taxation of interstate commerce. The Multi-State Tax Compact and the Multi-State Tax Commission have not and, in our opinion, will not produce a uniform, certain and equitable method of taxation of multi-state business.

We belive the only remedy is federal legislation.

Federal legislation can, however, represent the consensus views of the states and the business community. The best chance for solution, we believe, lies in the potential accord that can be reached with respect to federal legislation as a result of the numerous meetings that have been held between the business community, viz., the Committee on State Taxation of the Council of State Chambers of Commerce (C.O.S.T.) and the National Association of Tax Administrators (N.A.T.A.), which represents the 50 states and the District of Columbia tax administrators. Both the President of the N.A.T.A., Honorable Kenneth Back, and members of C.O.S.T. as well as other witnesses testified before the Subcommittee on September 18-19, 1973, that it was their confident belief a consensus could be reached between the states and business to a compromise bill and that this could be done soon. Gulf believes this can be accomplished. It must be recognized that not every state nor every taxpayer may be satisfied, but that most will find it acceptable.

We feel that such a compromise federal bill should contain the following:

(1) Jurisdictional standards for sales-use tax and other taxes that are set out in either S. 2092 or S. 1245 and which represent reasonable solutions. The major controversy arises with respect to the sales or use tax collection on interstate sales of tangible personal property. We are amenable to new concepts being proposed as to advance collection of the sales taxes such as has been proposed by the Collector of Revenue of the State of Louisiana or any other similar proposals.

(2) A basic uniform formula (property, payroll, sales) should be prescribed in order to establish the maximum income or capital attributed to the various states in which a corporation is subject to taxation.

(3) The controversial distinction between business and non-business income should be eliminated. With the exception of dividends and foreign source income, all of the income of a corporation should be apportioned among the taxing states in accordance with the three-factor apportionment formula. Dividends received from affiliates should not be taxed and dividends from less than 50% owned corporations should be allocated to the receiving corporation's commercial domicile.

(4) Foreign source income should not be subjected to state taxation in and of itself or through the mechanics of a consolidated report.

(5) A consolidated return of affiliated corporations (as defined in the Internal Revenue Code for federal income tax consolidation) may be required by states or permitted to a taxpayer provided that it only includes income sources in the United States. It is in keeping with the basic structure of our federal-state system that international tax policy be reserved to the Federal Government and individual states should have no authority to inject themselves into the domain of international law.

We urge the Congress to establish uniform standards to regulate the taxation of interstate commerce. We believe that the multiple state tax burdens can be eliminated and, at the same time, that the states' sovereignty in administering their own tax laws can and should be preserved.

Respectfully submitted.

J. J. Ross, *Manager-Taxes.*

Statement of the Division of Federal Taxation, American Institute of Certified Public Accountants

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SUMMARY

It is our view that S. 1245 should be considered favorably by the Senate Subcommittee with a strong recommendation for enactment by Congress as early as possible. It may not be possible to fully satisfy all parties having an interest in interstate taxation. To some extent, this proposal represents a compromise. However, it would resolve a number of presently troublesome tax issues on a reasonable and supportable basis. We have experienced too many years of controversy and uncertainty in taxation of interstate commerce. Now is the time for constructive action in this area.

While we support the proposed legislation, we urge your consideration of the specific recommendations contained in this statement.

Statement

The American Institute of Certified Public Accountants is the sole national organization of professional CPAs. It was established in 1887 and currently has more than 91,000 members.

Our statement focuses primarily on the Mathias Bill (S. 1245) and consists of two parts: Our general comments which favor federal legislation in this area along the approach taken in S. 1245; and specific comments which are directed to the jurisdiction to tax, the obligation to collect sales or use taxes, the optional 3-factor formula to apportion income or capital among the states, the determination of income, and the use of consolidated apportionable income.

GENERAL COMMENTS

Members of the American Institute of Certified Public Accountants have been concerned for a number of years over the serious inequities in state and local tax treatment of businesses engaged in interstate commerce and the uncertainties in establishing whether there is tax liability and the amount thereof where a business makes sales to customers located outside the state in which the business is established. In 1966 an Ad Hoc Committee on State Taxation of Interstate Commerce of the Institute submitted to the Special Committee on State Taxation of Interstate Commerce of the House Committee on the Judiciary (the Willis Committee) its comments on H.R. 11798, entitled the Interstate Taxation Act. The Committee summarized its position as follows:

> "We favor the position of the bill which would establish the jurisdictional standards of taxing income, capital stock or sales. However, the provisions governing the method of approtionment and the determination of income to be apportioned are inadequate to promote an equitable division of multistate corporation's income and/or taxable capital among the states in which it conducts business."

In 1968, a Subcommittee of the Institute's Federal Tax Division updated its studies of the problems of taxing interstate commerce with particular attention being given to the provisions of H.R. 2158, successor to H.R. 11798, and to efforts by the Multistate Tax Commission to devise a Multistate Tax Compact as a solution to the problems involved in taxing multistate businesses. It was the conclusion of the Subcommittee that legislation similar to H.R. 2158 was needed to establish jurisdictional standards which were not adequately provided by the Multistate Tax Compact. Furthermore, a uniform method for establishing a maximum tax such as provided in H.R. 2158 was deemed necessary, although it was felt that the proposed optional 2-factor formula for apportionment required modification to give consideration to the businesses' sales activities by use of a sales or gross receipts factor.

In the years since 1968, additional state and local taxing jurisdictions have enacted taxes on income. With increased government needs for revenue, tax rates have increased and administrative policies and practices have tended to place heavier burdens on businesses which are engaged in interstate commerce. Over this period, it has become more apparent that the Multistate Tax Compact has made little progress toward general acceptance and offers no real hope for establishing uniform and equitable treatment of interstate businesses. Many states have not adopted the Compact—and judging from current administrative practices in a number of them, it is extremely unlikely that the states can reach a voluntary agreement on a uniform approach to interstate taxation.

In view of this history, it seems clear that federal legislation is the only means by which fair and orderly treatment can be obtained in the face of the multiplicity of state and local tax provisions which presently burden businesses engaged in interstate commerce. The increasing number of disputes between business and taxing jurisdictions make it essential that the Congress give priority to this serious burden on the business community and enact legislation which will provide certainty for business entities and for the states. The extended hearings in 1966 and the number of bills introduced since that time which have received broad public exposure have pointed out alternative solutions to the problem and those which offer the best possibility of acceptance by the parties involved.

The Tax Division urges your Subcommittee to promote legislation which will eliminate much of the controversy that unduly burdens the business community. We believe that enactment of the Mathias Bill (S. 1245) will provide equitable treatment for both businesses and taxing jurisdictions. Several features which we have found objectionable in bills introduced in prior years have been corrected. Therefore, we support this legislation and offer the following comments for your consideration.

SPECIFIC COMMENTS

Jurisdiction to Tax

The Willis Committee explored at length the efforts of various states to impose tax on persons that have no business location therein and found that voluntary compliance was inadequate, either by failure to file returns or by failure to comply accurately with the specific requirements of the different taxing jurisdictions. It is obvious that the Multistate Tax Compact would not correct this situation and provides no solution to the basic problem which has an impact on smaller and medium-sized businesses selling products across state lines. This basic problem involves what activities of a foreign business entity within a state are sufficient jurisdictional contact or nexus to give the state power to levy state income taxes or require the business to collect and remit use taxes upon goods which it sells to residents of that state.

A jurisdictional test which requires a business location within the state as a basis for taxing net income and capital stock will provide clear and unmistakable guidance to business in establishing whether it is subject to tax. *Section 513* of the Mathias Bill establishes an appropriate definition that a business location will exist if it:

1. Owns or leases real property within the state,
2. Has one or more employees located in the state,
3. Regularly maintains a stock of tangible personal property in the state for sale in the ordinary course of business, or
4. Regularly leases tangible personal property to others for use in the state.

The Institute has consistently favored the establishment of uniform jurisdictional standards to be applied on a national basis. It has maintained that the adoption of such uniform standards for determining the extent of business ac-

tivities which must be present before the state would be entitled to levy a tax would eliminate a substantial amount of doubt presently existing in the compliance areas and would reduce the cost of compliance and enforcement. In summary, this legislation would meet the test suggested by Congressman Willis that the proposal "respond to a universal plea for national guidelines which allow interstate business to pay its share of state and local taxes with assurance as to what its obligations are, and with confidence that it will not be subjected to multiple and unfair taxation or intolerable bookkeeping and other compliance burdens."

Sales and use taxes

Section 101 of the bill also provides for a business location requirement or other regular activity within a state in order for a business to be obligated to collect sales or use taxes from its customers. In the case of sales to business customers who hold valid registration numbers, collection of sales or use tax may be omitted where the seller does not have a business location in such state. These provisions should materially assist the small and medium-sized sellers to meet the reasonable requirements of the state sales and use tax laws. These businesses particularly need legislation which will eliminate the uncertainty about liability for collecting sales and use taxes, a liability which is often much less than the cost to comply with the tax provision. Over the years, more and more states and subdivisions have enacted sales and use tax laws which have substantially increased the exposures to business tax, penalties and other costs of compliance.

A number of states presently recognize the use of direct pay permits under appropriate safeguards, and we believe that this is a feasible solution to insure collection of tax in cases where an out-of-state business makes sales to customers doing business in the taxing state. It is recognized that more state registrations for use tax may be involved and put a new burden on the taxing jurisdiction. However, it appears that this procedure would encourage compliance and, therefore, should lessen rather than increase enforcement activity. Accordingly, we recommend that a provision of this type be incorporated in any bill which is proposed for enactment.

The related sales and use tax sections (*Sections 301–306*) which provide certain exclusions and exemptions should also be adopted. It is particularly necessary to have a provision such as that set forth in *Section 306* to deal with the lafge number of local jurisdictions which have adopted sales and use tax laws. The potential compliance problem can be limitless if all such taxing jurisdictions can expect out-of-state sellers to comply with each local requirement based on the geographical area in which the customer is located. The bill provides that if local taxes are imposed in all geographical areas of a state, upon like transactions at the same combined state and local rate, and are applied uniformly so that a seller would not be required to classify interstate sales by geographic areas in the state, then the tax shall be treated as a state tax and the jurisdictional standards for state tax purposes will apply. This provision should remove one of the major complexities which presently burden businesses making interstate sales and hopefully would lead to greater uniformity in application of local sales taxes throughout states where they are currently widely applicable.

Optional 3-factor formula

Sections 201–204 of the bill provide for a maximum amount of income tax or capital stock tax which may be imposed by any taxing jurisdiction computed by using an optional 3-factor formula to apportion income or capital among the states. There is general agreement that such a maximum tax determination is necessary in order to give business some protection from the variety of apportionment methods currently in use by the states. For each taxable entity, this formula includes as factors the value of property, payroll and sales within the states to the total amount of such factors in the United States. The Institute favors this formula because it has been in use for many years in a large number of states and is readily determinable. We are particularly gratified to see that the sales factor has been included, whereas a 2-factor formula was proposed in certain earlier bills for controlling taxation of interstate commerce. The sales factor included on a destination basis gives appropriate weight to the market where the goods are delivered and should provide a reasonable balance in distributing tax payments of an interstate business between the areas where goods are consumed and the areas where production takes place. In this regard, the formula therefore would provide equitable treatment as between taxpayers and the states and as between largely manufacturing states and those where manufacturing activities are not so substantial.

The sales factor would also not include the "throwback" or "recapture" provision which has been proposed by the Multistate Tax Compact and which produces an unfair distribution of tax among the states. Such a rule has little justification, particularly where some 46 states have now adopted an income tax on business.

It is also worthy of note that the sales taken into account are limited to sales for delivery within the United States. There is no justification for taking into account, either in the numerator or denominator, any portion of the sales made to customers in foreign countries where other taxes may be imposed on the goods by the time they reach the customer. It has been national policy to encourage exports, and this legislation should be consistent with such policy by not including as factors amounts which relate to export sales.

In determining the property factor, *Section 202* of the bill provides for computing the ratio of the corporation's real and tangible personal property owned and used or rented and used in the state, to the average value of all the corporation's real and tangible personal property owned and used or rented and used during the taxable year within the United States. In determining the value of such property, property owned by the corporation shall be valued at its original cost, according to the provisions of the bill. We do not favor use of original cost in determining the value of tangible property. We believe it would be preferable to use the adjusted basis of such property as determined for federal income tax purposes. Differences in accounting practices and dates of retirement or acquisition could result in substantial distortions. The abandonment or retirement of substantially depreciated property, either just before or just after the close of a taxable year, could cause material shifts in a taxpayer's tangible property factor if it is based upon original cost. Taxpayers have been accustomed to maintaining records of the depreciated federal tax basis of their properties, and therefore, such information is readily accessible. The use of adjusted tax basis would provide a more reasonable basis for attributing income among the states where such property is a significant factor.

Determination of income

Recent developments in many states have expanded the income base for imposing tax to include ever-increasing amounts of "business income". Among the items which are significant are the various types of income received from foreign sources and dividends received from other corporations. Therefore, we endorse the provisions of the Mathias Bill, *Section 207*, which would exclude from apportionable income, income which is received from other sources without the United States. It is appropriate that the provision be consistent with the amounts determined under the Internal Revenue Code for income derived from sources without the United States and that such income should not be subjected to tax by the states. The states have no provision for granting credit for foreign taxes paid and, therefore, an outright exemption of such income by the states is the only feasible method to assure avoidance of double taxation. There are also situations where divident income, including "gross-up" for foreign taxes paid, have been included in the base for state taxation. This produces a gross inequity for which clearly there in no justification when tax is imposed on amounts which exceed net income. The provisons of the Mathias Bill should be enacted to correct this situation.

Dividends are to be excluded from the apportionable income except in the case where the taxpayer's principal business activity is dealing in securities. The grounds for this exclusion are the need to eliminate double taxation. This treatment is consistent with the provision of the Internal Revenue Code which grants deductions for 100% or 85% of dividends from other domestic companies, depending on the percentage of ownership. Inasmuch as each domestic company will pay its own appropriate share of state and local taxes on income and on capital, this provision is needed to avoid double taxation presently occurring under the tax laws of certain states.

Consideration should also be given to a specific definition of "business income" which would exclude such passive income as dividends, interest, rent and royalties, and subject such items to special allocation rules.

Consolidated apportionable income

In recent years there has been a growing trend toward taxing on a unitary basis the income of a group of corporations rather than restricting state taxation to the income of each separate entity and the apportionment factors of each such separate entity. While the professed justification for such treatment has

been that relationships between the related companies have been other than at arm's length, the state rules for making such a determination are arbitrary and unpredictable. Taxpayers may not know until years after the returns are filed what the position of state auditors will be and what ultimate tax liability may be faced. Considerable litigation has resulted from imposing state income taxes under this procedure.

The assertion of tax on a combined basis has not been restricted to U.S companies alone, but has called for inclusion of foreign subsidiaries manufacturing and selling in foreign countries where the factors of property, wages and sales, arise under quite different conditions than in the United States and where national and local taxes are quite different from those imposed in the United States. Accordingly, there is no justification for inclusion of these entities for combined reporting purposes to any of the states.

Section 209 of the Mathias Bill would properly limit the taxation of consolidated apportionable income to those cases where it can be established that a taxpayer has engaged in non-arm's-length transactions. In each case, it would seem appropriate that the burden of proof rest on the party which asserts that a consolidated report is necessary. Under these conditions, we feel that the proposal is both desirable and necessary to eliminate another of the present inequities in the taxing systems of several states which are increasingly burdening members of an affiliated group of corporations.

MANUFACTURING CHEMISTS ASSOCIATION,
Washington, D.C., September 17, 1973.

Hon. WALTER F. MONDALE,
Chairman, Subcommittee on State Taxation of Interstate Commerce, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On August 3, 1973, you announced that your Subcommittee would conduct hearings on proposals bearing on the State taxation of interstate commerce. You indicated that interested parties could request to testify or, alternatively, submit written statements for inclusion in the record. You urged, however, that all witnesses having a common position or the same general interest consolidate their testimony and designate a single spokesman to present their common viewpoint to the Subcommittee.

The Manufacturing Chemists Association is a nonprofit trade association of 170 United States company members representing more than 90% of the production capacity of basic industrial chemicals within this country. This Association wishes to cooperate with your Subcommittee and, in lieu of testifying separately, desires to endorse the Joint Industry statement which is being presented to your Subcommitte at these hearings.

In addition, we would like to take this opportunity to express our views on certain aspects of State taxation of interstate commerce that are of particular concern to our members.

Our association believes that it is most important to enact reasonable Federal jurisdictional standards for the collection of net income, capital stock, gross receipts, and sales and use taxes in order to remove existing confusion and uncertainty in these areas. S. 1245, the Interstate Taxation Act of 1973, co-sponsored by Senators Charles McC. Mathias (R–Md.) and Abraham D. Ribicoff (D–Conn.), contains jurisdictional standards which appear to offer a reasonable solution to this problem. We recommend enactment of jurisdictional standards similar to those contained in S. 1245.

At the present time there is a divergence between the Internal Revenue Code and the various State codes as to the source of income, although many States rely on Federal net income as the starting point for their income tax calculation. Because of the difference between State and Federal tax rules, business often finds that its foreign source income is taxed by States that have no basis for doing so. We support the provisions of S. 1245 that would correct this inequitable situation.

There are a small number of States that impose the "Unitary Concept" of taxation upon business. Under this theory, a taxpayer with a business location in a State that follows this concept may find that the income of its foreign or domestic subsidiaries is included in its income base to be apportioned to such State even though the subsidiaries have no connection whatsoever with the State. In our opinion there is no justification for States to extend their taxing powers beyond their borders and we wholeheartedly support the provisions of S. 1245 which would preclude such action.

In closing, we wish to express our appreciation for being given an opportunity to submit our views on this subject to your Subcommittee, and respectfully request that this letter be included in the record of the hearings on interstate taxation.

Sincerely,

W. J. DRIVER, *President.*

AMERICAN AUTOMOTIVE LEASING ASSOCIATION,
Baltimore, Md., September 19, 1973.

Mr. TOM VAIL,
Chief Counsel, Committee on Finance, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. VAIL: I am President of the American Automotive Leasing Association, and I am writing in connection with the hearing regarding state taxation of interstate commerce being held by the Finance Subcommittee on State Taxation of Interstate Commerce.

First, a brief statement about the Association and its members and their operations may be appropriate. The American Automotive Leasing Association is a trade association composed of companies engaged substantially in the long-term leasing, in interstate commerce, of motor vehicles to commercial and industrial lessees many of whom themselves are companies engaged in multistate or nationwide operations. The leases generally run for periods of one year or more. The interstate operation of these leasing companies is different from the operation of the well-known rent-a-car companies which rent vehicles from local bases of operation, for short periods of time, primarily for individual use, and from the local leasing of a motor vehicle by a local automobile dealer.

These interstate automotive leasing companies do not maintain an inventory of vehicles for leasing. Instead, after a leasing arrangement is made with a lessee, they purchase their vehicles from retail automobile dealers in such volume as they may require to meet the specific requirements of that lease arrangement. These vehicles are then delivered in volume to the lessee, and, at the expiration of the lease, the vehicles are disposed of at wholesale, usually to used car dealers.

A fairly typical interstate leasing situation may be described as follows: A leasing company, organized in State A, has its offices and personnel in State A. It has no salesmen or employees in any other state, nor does it own or rent from others any property in any other state. It negotiates with a company, having its main office in State B, for the lease of 100 vehicles to the latter company. The negotiations may be conducted by mail or by telephone; sometimes a representative of the lessee company may come to the office of the lessor in State A, or a representative of the lessor company may visit the lessee's office in State B. Some negotiations may involve any combination of these methods. When a lease arrangement is concluded, it usually is entered into in State A, and thereafter all invoices are paid in State A.

The lessor company, thereafter, in order to satisfy the lease requirements, will purchase the 100 vehicles from a retail automobile dealer or from several automobile dealers. They may be ordered from a dealer in the home city or the lessor in State A who, under arrangements with the automobile manufacturers, will have the vehicles drop-shipped to the lessee's designated places of delivery in various parts of the country. Or, the lessor may order the vehicles from a retail dealer located in the home city of the lessee in State B. Or, the lessor may order the vehicles from several retail dealers located in the various places where the vehicles are to be based, in accordance with the needs of the lessee.

The lessee, of course, requires that the vehicles be distributed to its personnel in accordance with its own internal plans and requirements, and the lessee will either distribute those vehicles itself to its personnel from some central point of delivery, or, as above noted, the lessor may arrange to have the vehicles delivered to the lessee's personnel in accordance with lessee's instructions.

As already pointed out, many lessee companies are frequently engaged in multistate or nationwide operations. In many cases, the lessee might have three salesmen working and residing in State C and, indeed, in other states. Accordingly, three of the vehicles will be delivered to State C to be turned over to the lessee's salesmen there. Under the usual lease agreement, title and tags for the vehicles are registered in the name of the lessor in the state where the vehicles are based, and, in the example set forth, three vehicles leased by a lessor in State A to a lessee in State B, find their way into State C, with title and tags registered in the lessor's name. As already noted, the leasing company has no representative in State C,

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has no office or stand or any other property in State C, apart from the vehicles, and the cars are operated in ~~State C~~ under the direction and control of the lessee and in pursuit of the lessee's business. As a matter of fact, the vehicles, although registered in State C, may actually be operated there only to a limited extent and may be used by the lessee's personnel to a much greater extent in neighboring states. And, unlike the railroads, no record is or can be readily kept of the extent of operation in any given state. In the usual lease agreement, there is no limitation on the right of the lessee to operate the vehicles anywhere he wishes within the continental United States and Canada.

When the lease expires and the vehicles are to be returned to the lessor for disposal, the vehicles may in some cases be returned to the lessor's place of business in State A for disposal there. Or, the vehicles may be sold locally, where they were operated, to used car dealers or to the retail dealers from whom they were purchased. Sometimes, the vehicles are delivered to markets in other sections of the country where the used car situation may be more favorable at the particular time and there disposed of at wholesale. In general, the negotiations for both purchase and disposal of the vehicles are handled by telephone from the lessor's office in State A.

The particular problem which concerns us at this time is whether an out-of-state lessor should be subjected to a state income tax solely because the lessor owns personal property or equipment which is used by the lessee in the state in the pursuit of the lessee's business. As is evident from the above example, one lease transaction with one large lessee may often result in motor vehicles of a lessor being titled in the name of the lessor in many states, and could result in demands being made by many states for the lessor to file income tax returns, to have its books and records audited, and to pay whatever taxes the states claim may be due. And in many instances, demands could be made for lessors to prepare and file complicated income tax returns with states where the lessors would only have a few vehicles on lease and no income tax at all, or only a nominal tax, would be claimed by the states.

It should be noted that the problem is not limited to the interstate leasing of automotive equipment, but is equally present in the case of the interstate leasing of other personal property—for example, a lease of 100 typewriters or other office equipment to a lessee for distribution and use at its offices in many states.

The burdens and expense of complying with the complicated and varying income tax requirements of many jurisdictions are well-known to your Subcommittee. It is our position that state income taxation of out-of-state lessors in the circumstances described would be unfair, and would unduly burden the free flow of goods in interstate commerce. The lessor's contacts with the state clearly are not sufficient to justify subjecting the lessor to the state's burdensome income tax requirements.

The claim for income tax liability would seem to be based primarily on the fact that motor vehicles are owned by and titled in the particular state in the lessor's name, and it seems clear that this is the only contact that the lessor company may have with any given state. In the example set forth above, the only contact of State A leasing company with State C is the ownership of three vehicles titled in State C in its name, but under the circumstances this is not a significant contact. In this connection, it should be noted that the title and registration fees for ownership of the vehicles are paid for, and it cannot be suggested that the State A leasing company is receiving services and protection, etc., from Stte C for which it has not paid.

Moreover, the contact that an interstate leasing company has with the several states where the lessee operates the leasing company's vehicle is much less direct and much less significant than that of the interstate seller whose sales, actually solicited by his representative within a state, would not subject him to the state income taxes under the provisions of any of the bills now pending in the Congress. Whether a particular motor vehicle of a leasing company in Texas will wind up in Alabama, or in North Carolina or in any other state is not based on the decision of the lessor. It is the lessee who makes that decision, and the lessor keeps title in its name because it owns the vehicle and because the retention of title is an obviously necessary security measure. The lease agreements do not restrict the lessee from transferring a vehicle from one state to another, and although the lessee may have to bear the burden of the expense of the second titling and registration, it is the lessee's decision and not the lessor's. It would be possible, therefore, for a lessee to subject a lessor to the income tax claims of two states for the same year for the same vehicle. More than that, the actual operation of

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the vehicle in any state is for the benefit of the lessee; it is the lessee's business and not that of the lessor, which is being pursued.

It cannot properly be urged that an interstate lessor should be subject to state income taxation in the state where he has property on lease on the theory that the theory that the lessor is deriving income from property located there. For the interstate lessor receives income by virtue of the contract of lease which is entered into in a state other than the state where the property is located, and not because of any operation of the vehicles in any given state. Moreover, the lessee's three salesmen in State C may, by using the lessor's three vehicles, derive $300,000 worth of business in State C for the State B lessee, and still the lessee would not be subject to State C income taxes if it met the requirements of P.L. 86-272. In addition, an interstate seller who sells on an installment or conditional sales basis is also deriving income from property in a state; yet such a seller would not be subject to the state income tax under any of the pending bills or under P.L. 86-272. The liability for tax on income should not depend on the highly technical and largely irrelevant issue of where title may rest.

In the case of the interstate seller who is exempted from state income taxes by virtue of the pending bills and P.L. 86-272, that seller deliberately chooses to exploit a particular local market for his own business purposes and actually has agents or representatives within the state to solicit sales on his behalf. This is not so with respect to the interstate lessor who, as already noted, plays little or no role in determining where the vehicles are used or based. The only contact of the out-of-state lessor with the taxing state is the presence of motor vehicles titled in its name and, insofar as the lessor is concerned, it makes no difference where the vehicles are based or operated. We think that the position of the lessor in the circumstances outlined is certainly as appropriate, compelling and proper, for exemption from state income taxes as is the position of the interstate seller, if not more so.

Accordingly, we strongly urge that, in your deliberations, attention be given to the problem of interstate leasing companies which provide leasing services to national business enterprises, and that appropriate recommendations be made expressly to exempt lessors from the extremely burdensome requirements of the income tax laws of the many states with which the leasing companies have no meaningful or significant contacts. Such a result could be accomplished, for example, by deleting subparagraph (4) from the definition of "Business Location" which appears at Section 513 of S. 1245. Subparagraph (4) of Section 513 would provide that a person shall be considered to have a business location in a state if that person "(4) regularly leases to others tangible personal property for use in the State". The Interstate Taxation bills which have been approved by the House of Representatives in prior sessions of the Congress would have exempted an interstate lessor from state income taxation in the circumstances described in this letter, and present H.R. 977 also would not permit a state to impose income taxes on such a lessor.

It is noted that H.R. 977 would permit a state to tax an out-of-state corporation which has an average annual income in excess of $1,000,000 even though such a corporation may not have a business location in the state. The mere size of a corporation should not determine whether the corporation should be subjected to state taxation, and we recommend that your Committee should not approve any provision of this nature.

The opportunity of making this statement for your consideration and for the record is very much appreciated.

Very truly yours,

LOUIS ROSENSTEIN, *President.*

STATEMENT OF R. WALTER SHIPMAN, CORPORATE TAX MANAGER, CFS CONTINENTAL

Mr. Chairman, please permit me to introduce myself. My name is R. Walter Shipman, representing CFS Continental, Inc. (formerly Continental Coffee Company). I am the Corporate Tax Manager of this Chicago based comapny which manufactures and distributes food and related food products to the fast food service industry. The company has many subsidiaries and branches which collectively operate in every state of the Union. Because of the many instances of double taxation management is quite understandably supporting the passage of the various bills now pending before this Committee.

To not support these bills would be tantamount to stifling the very life blood of this industrial nation. Today industry cannot exercise its freedom to do business in and among the various states without awakening the sleeping giant, state and local taxation, be it in the form of income, sales, use, franchise, excise or whatever. The fast food industry with its rapidly expanding franchise chains presents a tax disadvantage to companys who supply their needs as this relatively new phase of business encompasses areas not anticipated in prior legislation, P.L. 86-272 and thereby making it (P.L. 86-272) ineffective in its operation. The suppliers of this rapidly growing segment of business seek tax relief through the passage of the aforementioned bills.

The nation as a whole, and the fast food industry in particular are desperately in need of a uniform system to regulate the taxation of interstate commerce.

My company is not without precedence when supporting such legislation for the uniform treatment of interstate taxation as we have in the past supported Senators Mathias and Ribicoff's previous bills. It is with this continued interest that we lend our name and support to the, hopefully, expeditious passage of the subject bills.

To exclude the sales factor on the one hand, (H.R. 977) would be equitable because sales made on a destination basis are not necessarily indicative of where the income producing property and persons who generated the income would be. On the other hand, the provision of S. 1245 to include the sales made strictly on a destination basis in the sales factor, but without the restrictions of the "throwback rule", would also appear reasonable. It is discriminatory to cause multi state corporations to include as a sale, in its domiciled state, sales made to the state of the purchaser when the subject corporation is not subject to tax in the purchasers state. Such discriminatory state laws tend to curb industry's efforts to foster business and effectively restrict the corporations right to transact interstate commerce free of any tax encumbrance.

Additionally, H.R. 977 compensates somewhat for the elimination of the sales factor by including gross rents, (Sec. 202(d)(2)) whereas S. 1245 would prefer to use net rentals of leased property. The apportionment formula of either bill would appear to be an improvement over that which is now in use by many of the states.

The effect of the business location tests, of the proposed bills, will be to tax only where there is sufficient nexus to do so. These business location tests will require more substance to subject a company to taxation as opposed to, in one extreme instance, the mere listing of a telephone number in a local directory. The aforementioned tests will also serve to more equitably assess the general sales and use tax. Additionally, in the area of sales and use tax, I would wholeheartedly support any legislation which would remove, from a seller, the liability of collecting a tax whereby the seller has obtained, and accepted, in good faith, the buyers written evidence of exemption from being charged a tax. Some states have circumvented this area to say that the seller is ultimately responsible for the collection of the tax if the use of the product to which the buyer intends is obvious. However, that which is obvious to one may not be obvious to another, less experienced, person making a states interpretation of whether or not the seller accepted written evidence of exemption in good faith subjective in nature. The proposed bills would eliminate this area of conflict.

Today, the various states are not exercising the business location test with any degree of understanding when dealing with the suppliers of the fast food industry, who, as previously stated, are in a somewhat unique position when it comes to defining property which is at a business location. The present bills now pending before this Committee will eliminate future arguments on this point.

In conclusion, and to reiterate very briefly, please let me assure this Committee that the companys of the fast food service industry are watching the progress of these bills with keen awareness and anticipation that the passing of the bills will, in fact, provide a fair and uniform system of taxation of interstate commerce as well as relief from the now ever increasing, business restricting, method of taxation.

Statement of Tax Executives Institute, Inc.

Tax Executives Institute is pleased that the Finance Subcommittee on State Taxation of Interstate Commerce has conducted public hearings with a view toward legislation for regulating the taxation of interstate business. Tax Executives Institute is a professional organization of some 2800 business executives who are responsible for tax matters of the major companies in the United States and Canada.

Members of the Institute represent companies whose business operations are multistate in scope and are therefore vitally concerned with the taxation of interstate business by state and local governments. Our members have become increasingly concerned with the present status of intestate taxation which is characterized by a lack of uniformity, burdensome and costly compliance requirements and, in many cases, double taxation.

Our members have served over the years on various study groups which have attempted to resolve conflicting philosophies among the states as well as between the states and the business community. Unfortunately, these efforts have been unsuccessful and the only practicable solution now appears to be the establishment by Congress of certain guidelines and limitations upon the states' power to tax interstate business, leaving to the states some discretion within these limitations. Recognizing the demands on government for more and more services requiring added revenue, the leadership of TEI has been reluctant in the past to call for help from Congress. Even now, it is done because it appears to be the only alternative. Considering the diversity of businesses represented in Tax Executives Institute, it is understandable that a few of our members prefer to let the states work out the problems without assistance from the Congress. Nonetheless, based on a survey of the membership, we find the overwhelming majority of our members agrees that federal legislation is not only desirable but necessary to resolve problems in four major areas.

We did not ask to present testimony on behlaf of TEI at the hearings held on September 18 and 19 but wish to submit our views in favor of federal legislation on the following points:

1. ESTABLISHMENT OF JURISDICTIONAL STANDARDS

Under present practices, the requirements for filing returns and paying taxes vary widely among state and local taxing jurisdictions. This results in uncertainty and burdensome compliance obligations, particularly for small business. It is urged that no taxpayer be subjected to the taxing jurisdiction of a state unless it has within the state a business location as specifically defined by federal law. This would clarify for all taxpayers their legal responsibilities for filing returns and paying taxes.

2. PROVIDE UNIFORMITY AMONG STATES IN REQUIRING OR PERMITTING THE FILING OF COMBINED OR CONSOLIDATED RETURNS

There appears to be a feeling among many state tax officials that a business which operates through subsidiary companies is *per se* "bad" and is so organized for the purpose of avoiding state income taxes. Thus, some states insist on combining or consolidating all companies in an affiliated group to determine the amount of income to be subjected to tax in that specified state. Where there is a clear showing of non-arm's-length dealing between affiliated companies to the detriment of a state, an argument can be made for this procedure. However, to insist on consolidation merely because of common ownership—which goes beyond the current requirements of any state law—can and often would subject a business to double taxation, and would create a serious question of whether there were a denial of constitutional due process. (Even more complications exist if foreign affiliates are included in the consolidation, as explained uner point 3 below.) For example, one state may insist on a consolidated filing where it produces more revenue whereas another state may refuse to permit the filing of a consolidated return where it is to the advantage of the taxpayer. It is suggested that this inequity could be corrected by:

(*a*) Prohibiting consolidation, and leaving it to the states to otherwise correct any diversion of income arising from non-arm's-length dealings with affiliates, or

(*b*) Giving to the taxpayer the sole election of filing consolidated returns as provided in the Internal Revenue Code, or

(*c*) Providing for an election by either the state or the taxapyer as to the filing of a consolidated return, but only where there exists a significant operational interdependence among the affiliated corporations which is specifically defined by federal law.

3. EXEMPT FOREIGN SOURCE INCOME FROM STATE TAXATION

The authority to establish and administer international tax policy should be reserved to the Federal Government and the individual states should not be permitted to inject themselves into this area. Since the avoidance of double taxa-

tion is inherent in tax treaties between the United States and foreign nations, a prohibition against the states taxing foreign source income would protect the spirit of those treaties.

There are a few States which include such income in the tax base and apportion a part of the total income by formula. It is widely recognized that the use of a formula (normally based on ratios of sales, property and payroll) is at best an approximation, but when applied to U.S. income generally constitutes a fair procedure. However, such a formula can produce serious inequities and distortions when foreign source income is included in the tax base since no State has an apportionment formula applicable to foreign source income which produces an equitable result and, indeed, the construction of a fair formula would be extremely difficult if not impossible. For example, if dividends from foreign subsidiaries are included in the tax base, the use of only U.S. sales, property, and payroll ratios ignores the business activity abroad which generated the income. On the other hand, if foreign source income is included in the tax base, through the device of consolidating domestic and foreign affiliates, severe distortions usually occur. This results from the widely differing national economies which exist throughout the world, particularly the economy of the United States as compared with those of most foreign countries. Unpredicatble currency fluctuations are a further complicating factor. This distortion can be avoided if all foreign source income as defined in the Federal Internal Revenue Code is exempt from State taxation.

4. CLEARLY DEFINE "BUSINESS" AND "NON-BUSINESS" INCOME FOR APPORTIONMENT PURPOSES

For many years, there was gen ral agreement amont States that certain types of "passive" income should be treated differently from "operating" income. Dividends, interest, rents, royalti s, and capital gains, for example, were allocated entirely to the taxpayer's commercial domicile or to the State where the property generating rents, royalties or capital gain was located. Other income from business operations was apportioned to all States where the taxpayer conducted business. Currently there is a growing trend among States to lump all income, including dividends and other passive income, and apportion this ratably among States where the taxpayer does business. Because many States continue to tax dividends on the long-established basis of commercial domicile, notwithstanding the trend toward apportionment, double taxation is assured in many situations. It is suggested that this double taxation can be alleviated if items of "business" and non-business" income are clearly defined and guidelines established which specify how each type of income may be taxed by a State.

Tax Executives Institute strongly urges the Subcommittee on State Taxation of Interstate Commerce to give consideration to these specific areas of interstate taxation and thereby alleviate the problems now faced by interstate business.

Respectfully submitted,

PAUL L. DILLINGHAM,
President.

Hon. WALTER F. MONDALE,
Chairman, Sub-Committee on State Taxation of Interstate Commerce, Senate Finance Committee, Washington, D.C.

DEAR SENATOR MONDALE: The question of taxation of interstate commerce by the various states is of vital importance to the business community and requires the urgent attention of all parties concerned.

Present methods used by the various states to tax the income of businesses operating on a multi-state basis without uniformity in approach have created a burdensome and chaotic compliance problem for the taxpayer.

Our company is presently qualified to do business in 37 states. We recognize our responsibility and that of each member of the business community to assume the fair and equitable share of burdens of services rendered within each tax jurisdiction.

In meeting our corporate responsibility in this area, we are required to prepare over 69 separate income tax returns coupled with an additional 272 separate sales and use tax returns, and an unimaginable number of license, gross receipts, excise, franchise, personal property and annual reports; many of which are uniquely distinct in their request for information and method of determining tax liability. With over 80 separate operating units, it is necessary to request, receive, process, audit, compile and utilize over 6,750 *separate* and *distinct* reports in the preparation of returns. These are aside from the many internal documents available

without request. An additional 1,223 reports are requested from various units and utilized for preparation of the sales and use tax returns. In 1972, 56 separate taxing authorities conducted audits of returns filed, further complicating the administrative problems with requests for support.

Over the past years, there has been little relief from the burdens of tax compliance and, in many respects, compliance requirements have been greatly expanded at additional cost to the taxpayer.

Uniformity is an absolute necessity for small business and multi-state corporations alike to reduce the burgeoning costs of compliance and provide a stabilizing factor to the current revenue producing activities of the various states.

We strongly support the passage of S. 1245 Interstate Taxation Act of 1973 as a realistic approach to establishing equity and uniformity in the various states among corporate taxpayers. We particularly support the provisions in S. 1245, establishing a uniform minimal jurisdiction test, the non-taxation of foreign source income and dividends, and the use of a *pure* destination sales factor and the elimination of any throwback rule.

However, we believe that your committee should carefully consider the inclusion of a provision establishing the proper method for allocating royalties. This seems to us a natural adjunct to the provisions in the bill dealing with dividends. To the extent that royalties are in the tax base, they should be allocated to commercial domicile. Our company has had numerous instances of what we feel to be unfair attempts by the states to tax royalty income in no way related to operations or sales in that state. We therefore, feel that it is important to properly cover the royalty question in S. 1245.

In consideration of the multitude of problems which the taxing authorities have, we certainly agree with *Ralph D. Turlington,* chairman of the Committee on Finance and Taxation of the Florida House of Representatives, who summarized the matter which is before you when he said:

"I believe that federal legislation setting jurisdictional guidelines and methods for the apportionment of taxable income, with proper safeguards to *protect the states right to tax,* are desirable in order to achieve *uniformity* for state taxations. Furthermore, the federal legislation should *protect the multistate business from having more than 100 percent of its taxable income being subjected to taxation* in the various states in which it does business. In order to support federal legislation in this area, however, the states must be assured that all corporations will actually report all of their taxable income to the states. The states need a mechanism to insure that all taxable income is subject to taxation, while at the same time, corporations need assurance that not more than 100% of their income will be subject to a state taxation." (Emphasis added)

Reasonable men on both sides are seeking an equitable solution to the present chaos in interstate taxation. If there is to be any renovating of the current structure, we must step forward to assume our responsibilities to initiate and motivate the changes which are necessary. Accordingly, we will be happy to supply any additional data we have available which you feel would be helpful in your support of S-1245.

Very truly yours,

R. J. JORANKO,
Director of Tax Administration.

Hon. WALTER F. MONDALE,
Chairman, Subcommittee on State Taxation of Interstate Commerce, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: Following up on the recent hearings of your Subcommittee, I would like to emphasize two major points that perhaps were not brought out in sufficient clarity at the time.

I. ACCOUNTABILITY FOR SALES AND USE TAX LIABILITY

During the hearings, the sales and use tax registration procedure provided for in Sec. 304 of S. 1245 was opposed by a number of the state tax administrators.

The states' concern seems to arise from three major questions:

(*a*) How to define a "business;"

(*b*) Whether more or less revenue would accrue to the states than in the present situation; and

(*c*) The added administrative burden that would allegedly accrue to the states under the registration procedure.

In response to these concerns, it is generally agreed that the definition of a "business" should exclude the professionally self-employed. This is the actual practice in most states now and excluding them would minimize the administrative burdens.

Ultimately in our view, substantially more revenue would accrue to states because of more widespread compliance under Sec. 304. In the interim, while the registration procedure was being phased in, the tax burden would be more fairly spread among all business liable for sales and use taxes instead of following the present avowed practice of singling out likely "target" firms.

The states claim that they want "total accountability" instead of the present hit-and-run system of enforcement. What simpler way than the registration procedure? Many states presently collect state unemployment taxes from all firms employing one or more people. In the same way, registering businesses (excluding the self-employed) would be a relatively simple procedure. Certainly not all firms in a state make interstate purchases from vendors with no business location in the state.

In fact, this procedure would undoubtedly be less expensive than sending auditors hit-or-miss around the country after "target" firms. To help the states and to reassure them that their interest in revenue is being protected, I am certain that the business community would be amenable to suggestions for sample reporting or a centralized collection of information on interstate sales. Such an approach would be a further help to states with respect to enforcement but would ease the present intolerable load of paper work on Interstate vendors.

INCOME TAX ASPECTS OF S. 1245 APPLYING TO SMALL AND MIDDLE-SIZED BUSINESSES

It is believed that during the hearings, the case was well made for the need of income tax provisions in a federal law on interstate taxation. However, it is possible that the Subcommittee might have been left with the impression that most income tax questions were mainly the concern of large multinational corporations. This is definitely not the case.

Although questions concerning the taxation of intercorporate dividends in foreign source income are of particular interest to multicorporate taxpayers engaged in international business, there are several provisions of S. 1245 which are more important to small and medium-sized taxpayers than they are to the large international corporations.

The jurisdictional rules enunciated in S. 1245 are mainly for the benefit of those interstate taxpayers who engage in business in relatively few states. To those businesses, adquate jurisdictional rules are necessary to preclude the enlargement of their tax base by requiring the apportionment of their income to states in which their activities are nebulous.

The enactment of a destination test in the sales factor of the apportionment formula will also protect the smaller companies from the assignment of income to states which would not be entitled to tax such income under ordinary apportionment rules.

Further, the provisions of S. 1245 which permit early access to the federal courts, will enable many small taxpayers to seek judicial relief from onerous tax burdens which at the present time may be imposed by default, because a smaller company simply cannot afford the legal expense of pursuing its case through several levels of state courts, and eventually to the U.S. Supreme Court.

I would appreciate it if this communication is included in the official record of the hearings.

Very truly yours,

ROLAND M. BIXLER,
Chairman, State Taxation of Interstate Commerce Subcommittee.

STATEMENT OF GENERAL MILLS, INC., SUBMITTED BY HENRY DUITSMAN, ASSOCIATE TAX MANAGER

My name is Henry Duitsman, Associate Tax Manager of General Mills, Inc., Minneapolis, Minnesota. We thank you for the opportunity to submit the following views regarding interstate taxation:

We believe that action by Congress is both desirable and necessary, to protect the free flow of goods in interstate commerce and to define the administrative burden and tax liability to be imposed on interstate business. The Constitution has

given Congress the power to regulate interstate commerce and to promote an open economy while still preserving the power of the states to tax interstate business.

There are a number of reasons for Congress to act now in order to help both state tax administrators and business by setting a uniform, fair and equitable ceiling for state taxation. More and more state tax laws are being passed, and similar laws are being interpreted differently in different states. The taxation of Kennecott Copper Corporation by California and Utah clearly points out how differing doctrines can result in double taxation. The fact that the U.S. Supreme Court has decided not to arbitrate these matters makes congressional action imperative.

In the past twenty years there has been a great deal of activity in the area of interstate taxes and much more uniformity of opinion between business and the states on theories of taxation. At the same time there has been more uncertainty in the actual operation of state taxation. We have reviewed this activity and the proposals before Congress, and we strongly support S 1245 as a fair and equitable solution to interstate taxation. Business has made numerous concessions in S 1245 in an effort to promote uniform and equitable taxation, and the advantages of having uniform laws and interpretation far outweigh the few problems the states may have.

We firmly oppose the unitary doctrine advocated by California and others as taxation without economic benefit. The measure of the tax is computed on income from operations which are not connected with the state. We agree that if a taxpayer is wrongly manipulating its income to avoid state taxes, then the states must have the ability to determine the proper income and tax it. We believe that S 1245 accomplishes this through allocation of non-arm's length transactions. This obtains the desired results and yet preserves the legal jurisdiction standards which have been developed under the Constitution and other laws of the country. We also believe that manipulation of income to avoid state taxation is not a common business practice, and that a proposed correction in the form of unrealistic combination of income brings about more evils than it cures.

Each state should have the power to determine the amount of income that is subject to its taxation based on the activities of the taxpayer in that state. Such a determination should not be dependent on whether or not other states can impose taxes on the taxpayer. For this reason, we oppose proposals that "throw back" sales in other states to the state of origin.

The income of a taxpayer should not be subject to double taxation. Therefore, we agree with the provisions of S. 1245 that only income earned in the United States should be apportioned to the states. This exclusion should be handled in a simple manner rather than through a complex apportionment formula. In most cases this income has already been subject to foreign taxation.

There is no justification for taxation of dividends from affiliated corporations. This has already been recognized in Federal income tax law. Furthermore, we believe that the taxation of intercorporate dividends of affiliated corporations is double taxation which should not be allowed.

We believe very strongly that the Multistate Tax Compact constitutes an additional layer of government with no political accountability which has been adopting and enforcing tax regulations without legislative process and has extended the powers of the states in combination without constitutional authority. Certainly this organization has operated against the interests of the business community and is not a workable organization for administering a Federal interstate tax law. The business community has unsuccessfully tried to work with this organization in an attempt to solve our problems. We strongly believe that an agency of government which lacks accountability to the normal political process is bad government.

We believe a more equitable treatment would be the settlement of disagreements by the U.S. Court of Claims. If there has to be an administrative agency, it should be a Federal agency. We believe that PL 86–272 has been a workable law without an administrative agency. Since S 1245 would only impose a ceiling on state income taxation, such a determination can be made by the courts.

We are not opposed to nexus requirements presently determined by the courts for sales and use taxes on our own activities (Scripto and National Bellas Hess, Inc.). But we believe that these requirements often unduly penalize smaller businesses. These small taxpayers find it an expensive administrative burden to comply with local use tax laws. They also are often faced with penalties for non-compliance with laws of which they have no knowledge. Maybe size should be

a criterion for limiting the liability of small businesses for the burden of multiple local use taxes in states where they have no business location.

At the same time that Congress is considering this interstate taxation question, we believe that a limitation should be enacted on gross receipts taxes, so that the state of origin and the state of destination cannot both tax the same gross receipts. We believe that gross receipts taxes should be levied only by the state of destination. Businesses usually keep sales statistics on a destination basis.

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