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UNIFORMITY OR PREFERENTIAL IMMUNITY FOR MULTI-STATE FIRMS—TAX EQUITY AND FEDERAL-STATE RELATIONS

By LOUIS F. DEL DUCA* and RICHARD H. WAGNER**

The recent introduction in Congress of H.R. 11798,[1] a bill which would regulate state taxation of multi-state firms, has produced considerable discussion and raised far reaching policy and constitutional issues. Much concern has been expressed by the business community as well as the state and local governments over H.R. 11798. The many strong statements which already have been made suggest a need for a careful evaluation of H.R. 11798 and should dispel any illusions that the business community as a whole would benefit from this type of legislation. As part of an evaluation of some of the basic issues involved, relevant current developments in federal-state fiscal relations will be briefly outlined.

P.L. 86-272,[2] hurriedly enacted by Congress in 1959 after the Supreme Court decision in *Northwestern States Portland Cement Co. v. Minnesota*,[3] directed congressional committees to study the whole field of state taxation of multi-state businesses. The activities of the House Special Subcommittee on State Taxation of Interstate Commerce, which was appointed pursuant to P.L. 86-272, have extended from the period 1959 to 1966. In September 1965, the Subcommittee issued Volume IV of its report.[4] This report included the recommendations of the Subcommittee which subsequently were endorsed by the full House Judiciary Committee. H.R. 11798, which carried out these recommendations, was introduced on the last day of the congressional session on October 22, 1965.

Title 1 of this bill contains "business location standards" which are a prerequisite to exercise of tax jurisdiction by a state. Title 2 would require the states to adopt a federal definition of net income and a two factor property and payroll apportionment formula.

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The views herein expressed are those of the authors and do not necessarily represent those of the Commonwealth.

1. H.R. 11798, 89th Cong., 1st Sess. (1965).
2. 73 Stat. 555-56 (1959) 15 U.S.C. 381-84 (1964).
3. 358 U.S. 450 (1959).
4. H.R. Rep. No. 952, 89th Cong., 1st Sess. (1965).

Title 3 would require states to adopt a federal sales and use tax law as a prerequisite to assertion of effective tax jurisdiction over multi-state firms. Title 4 would permit the state to impose gross receipt taxes only where sales have their "origin" in the state. Title 5 would set up a procedure for federal administration of state taxation including issuance of rules, regulations and forms, auditing of firms engaged in multi-state activities, and the litigation of tax disputes of multi-state firms before federal rather than state agencies and courts.

APPORTIONMENT OF INCOME — FORMULAE FOR DIVIDING

The most wide-spread objections to H.R. 11798 have been leveled at the two factor formula—property and payroll only—which it would impose on the states for dividing the income of multi-state corporations for tax purposes.

When a firm engages in production and sales activities in various states, obviously its income is derived from many areas including the states where it makes or assembles its products and the market states in which it sells them. This has been recognized in principle by the Uniform Division of Income for Tax Purposes Act recommended for enactment by the states by the National Conference of Commissioners on Uniform State Laws.[5] Each state is entitled to tax, but to tax only a representative fraction of the firm's total income. Any fair, practical and logical apportionment of such income for tax purposes should, therefore, consider each state in which any of these activities are conducted.

If Congress were to impose upon the states a formula which did not allow full consideration of the sales made in a taxing state, this would be the equivalent of a denial of tax jurisdiction with respect to the multi-state firm's sales activities in the taxing state. This would be just as objectionable, and for precisely the same policy and constitutional reasons, as tax prohibiting type legislation.[6] The only difference between the two is the legislative form or technique by which jurisdictional curtailment is accomplished. The ideal solution, of course, would be for the states themselves to enact fair, uniform apportionment formulae along the lines recommended by the Commissioners on Uniform State Laws and thereby avoid constitutional complications and federal involvement in their internal affairs. Since twenty-seven of the thirty-eight state income tax jurisdictions already have allocation formulae based on

5. See Conlon, *The Apportionment of Multi-State Business Income*, THE TAX EXECUTIVE 220 (1960); Cox, *The NCCUSL Uniform Apportionment Formula*, 42 TAXES 530 (1964); Lynn, *Uniform Division of Income for Tax Purposes Act*, 46 VA. L. REV. 1257 (1960); Pierce, *Uniform Division of Income for State Tax Purposes*, 35 TAXES 747 (1957); Remarks on state experience under the Uniform Act were made at the Annual Conference of the National Association of Tax Administrators (June 1965), by Dean Burkhead (Kansas) and W. H. White (Virginia).

6. See *infra* notes 31-64 and accompanying text.

property, payroll and sales,[7] it is quite likely that this goal could be readily achieved if there were widespread understanding of the issues involved. Not one of the thirty-eight corporate income tax states utilizes the two factor formula proposed in H.R. 11798. To the contrary, all thirty-eight income tax states utilize formulae which expressly recognize the right of the market state to a fair portion of the income of multi-state firms. Certainly a state which protects and promotes the markets and purchasing power which a corporation utilizes in selling its merchandise and from which the corporation extracts its income and profits can justly claim that the corporation should contribute to the cost of the services and benefits which it confers.

It is helpful in evaluating any apportionment formula to specifically consider what we expect a formula to accomplish. If a manufacturing or mercantile establishment conducts its activities exclusively in a single state, attribution of its income to that state is obviously equitable. If the activities are conducted in more than one state, however, difficulties arise in determining how the income should be equitably assigned to the various states in which the activities take place. For example, if a manufacturer extracts raw materials in state A, processes the materials in state B, fabricates products in state C, and conducts wholesale operations in state D, the question of deciding what amount of the total income of the manufacturer is attributable to each of the four states must be resolved. It might be theoretically possible to engage in a comprehensive economic study which would allocate with scientific precision the loss or profits resulting from the manufacturer's activities in states A, B, C, and D. The tools for such precise scientific analysis, however, normally are not readily available and, in addition, the costs of such analysis would be prohibitive. The solution, therefore, is one of utilizing a formula which is equitable in its general application and does not result in unjustifiable attribution of income.

The Supreme Court of the United States also, from a very early period in the history of state income taxation, has recognized the need for application of equitable standards to state allocation and apportionment formulae. For example, as early as 1931 in *Hans Rees' Sons, Inc. v. North Carolina*,[8] in striking down the state's one factor apportionment formula, the Supreme Court stated:

> When . . . there are different taxing jurisdictions each competent to lay a tax with respect to what lies within and is done within its borders and the question is necessarily one of apportionment, evidence may always be received which tends to show that a State has applied a method, which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions with-

7. P-H STATE AND LOCAL TAXES, ALL STATES ¶ 1046.
8. 283 U.S. 123 (1931).

> in its jurisdiction. . . . It is sufficient to say . . . 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.[9]

The Special Subcommittee on State Taxation of Interstate Commerce has apparently erred in its assumption that the Supreme Court is not concerned with the fairness of state apportionment formulae and that congressional action is necessary.[10] Furthermore, the two factor apportionment formula of H.R. 11798 will itself undoubtedly require close scrutiny to determine whether it conforms with the commerce clause and the due process clause of the fifth amendment which would invalidate any federal enactment which produced arbitrary and unreasonable results. The rumblings of constitutional challenge by business and state officials to the federal two factor formula are clearly discernable even at this early stage.

Apportionment rules should have as their objectives: (1) A result which is equitable among the businesses conducting similar operations regardless of the legal form of business and regardless of whether it is purely intrastate in nature or interstate; (2) a result which is equitable among the states and local governments; (3) a result which will not impede the development and utilization of the income tax as a revenue source by state and local governments; (4) the avoidance of a method which can easily be manipulated for tax purposes; and (5) administrative simplicity to the extent possible to reduce taxpayer compliance costs and reduce enforcement costs.

Any apportionment formula must balance these competing objectives since the conflict among them is patent. We could achieve simplicity by apportioning all income to the state of incorporation. Such a solution, however, would hardly be equitable to the states or taxpayers.

The two factor apportionment formula contained in H.R. 11798 does not meet the above desirable objectives of apportionment rules. H.R. 11798 would require states to utilize a formula which considers the firm's property and payroll within the state but which ignores gross receipts. This is contrary to the procedure followed in the thirteen states and the District of Columbia, which have adopted the Uniform Division of Income for Tax Purposes Act and the remaining twenty-five income tax states which include sales factors in their formulae. The Subcommittee's bill in requiring the two factor property and payroll formula ignores the well-estab-

9. *Id.* at 134-35.

10. See also Northwestern Portland Cement Co. v. Minnesota, 358 U.S. 450, 462 (1959); General Motors Corp. v. Washington, 377 U.S. 436 (1964).

lished equitable and legal principle that a state which provides a market for the sale of goods has a just claim to apportionment of a part of the income derived from sales made in its market. The conclusions reached by the Subcommittee have been analyzed by impartial experts who have questioned the accuracy and validity of its revenue loss projections resulting from elimination of the sales factor. They have considered that the revenue loss figures were understated and distorted in the House Subcommittee Report. They have also concluded that the administrative and compliance difficulties attributed by the Subcommittee's report to the employment of a sales factor were exaggerated. The emphasis in the Subcommittee's report on the complications and costs to business of maintaining records of sales destinations is considerably weakened by its own recommendation as to sales and use taxes. These authorities quite accurately point out that if the provisions of H.R. 11798 dealing with sales and use taxes were to be adopted, the sales destination records which the Subcommittee assumed were too onerous for income tax purposes, would have to be kept by all businesses making sales of goods under the federally proposed uniform sales and use tax acts with the exception of certain mail order house type selling operations.[11]

There are other consequences of a two factor formula which are not adequately considered, if they are considered at all, by the report of the Subcommittee. The two factor property and payroll formula would immediately increase the tax burden of firms with heavy plant or property commitments in a state.

The Subcommittee's report brushes aside much too lightly the tremendous shift in the burdens of individual taxpayers. Michigan reports that it:

> . . . recently analyzed the impact of a formula on receipts of the Michigan Business Activities tax. We took as our sample our twenty-six largest taxpayers doing business on an interstate basis and whose payments comprise 37% of our total revenue from this source. We now use the traditional three-factor formula with sales on a destination basis. Substituting the two-factor formula of property and payroll, we found in 1963 that ten of the twenty-six would have paid $10,487,000 more or for them an increase of 40% while the other sixteen would have paid $708,000 less, or a reduction of 32%. It is doubtful that the ten companies paying 40% more would be easily convinced that the change would have the minimal effect suggested by the report.[12]

Oregon reports that:

> . . . while the elimination of the sales factor did not reduce

11. See, *e.g.*, HELLERSTEIN, *Allocation and Nexus in State Taxation of Interstate Business*, in STATE AND LOCAL TAXES ON BUSINESS 67, 78-84 (1965).

12. Lock, *A Moderate's Viewpoint on State Taxation of Interstate Commerce*, 19th Annual Conference, Tax Executives Institute (1964).

> the amount of revenue collected, an immediate result was a substantial shift in the burden of the tax from out-of-state corporations to domestic and other corporations having substantial business interests in Oregon. [F]or example, in the lumber industry (28 corporations) there was a 40 per cent increase in tax; in the pulp and paper industry (14 corporations) there was a 26 per cent tax increase; and in the electronic machinery and equipment industry (12 corporations) there was a 58 per cent increase.
>
> With respect to non-Oregon industries who are primarily selling their products here, . . . [there is a] tax decrease . . . . Examples [include] tobacco companies (7 corporations) with a decrease of 84 per cent; petroleum companies (15 corporations) with a decrease of 39 per cent; and transportation equipment (11 corporations) with a decrease of 67 per cent.[13]

Pennsylvania reports on the basis of its statistical study that:

> The magnitude of the percentage change for the manufacturing firms was a positive 20.7% Again those firms in "Heavy" industry tend to show a larger percentage increase. Without doubt significant changes in the tax payments of individual companies will occur and the magnitudes and direction of these changes will vary significantly from company to company. It seems certain that for most of the interstate industrial companies the net effect will be significant tax increases.[14]

The shifting of tax burdens is also aggravated by the possible

13. Analysis and Recommendations on Interstate Taxation Act by the Oregon State Tax Comm'n. Other problems arise in connection with the provisions of the bill pertaining to consolidated returns and foreign service income. H.R. 11798, 89th Cong., 1st Sess. § 205 (1965). See also papers presented by Cahoon at the Tax Forum of the Practicing Law Institute, *The Unitary Business Concept as it Relates to State Franchise and Income Taxation* and *An Evaluation of the Willis Subcommittee Recommendations as They Relate to the Unitary Business Concept* (1965). The bill recognizes that its formula is inadequate for dividing income of transportation, electric power, gas, telephone and water service, insurance and banking businesses, investment and personal holding companies and therefore excludes such companies from its provisions, directing the Secretary to make further studies on the matter. H.R. 11798, *supra* at §§ 531, 607. The bill does not adequately recognize that a division of income formula applicable to manufacturers and vendors may be completely inadequate for other businesses such as radio and television, magazines and newspapers, book publishers, telegraph services, stock and commodity brokerage, building construction and other businesses and industries. See Hellerstein, *1966 Hearings on H.R. 11798*. The bill also ignores the constitutional requirements and custom followed by the states of specifically allocating rather than apportioning items such as dividends, interest, capital gains, rents, royalties, patent income and other items. *Ibid.*; Sabine, *Constitutional Limits on the Power to Tax*, 12 HASTINGS L. REV. 23 (1960).

14. Smith, *Hearings Before the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary*, 89th Cong., 2d Sess. (1966) [hereinafter cited as *1966 Hearings on H.R. 11798*]. (To be published.)

industrial relocation of plants which has been recently described as follows:

> What a tool the suggested 2 factor formula gives to a state not imposing a state income tax or a special levy such as Michigan's activities tax but which is surrounded by states which do! Such a state can say to industry "Locate your plant here. Flood our neighboring states with salesmen but be careful not to have your employees spend their entire time in any one of the states."
>
> Under the 2 factor formula and the jurisdictional standard proposed by the bill, a company operating in this manner would owe no income tax to any states. With 39 states levying business income taxes of some form at rates up to 8%, they would be at a severe competitive disadvantage with devastating results.[15]

While such relocation may not be economically desirable for firms with heavy plant and machinery investments already committed, such would not be the situation of firms seeking new plant locations or expansion of existing capacities.

In addition, to the extent that the jurisdictional curtailment provisions of Title 1 and 4 and the definitional provisions of Title 6 of H.R. 11798 would decrease state revenues, the likelihood of local based firms and non-exempt multi-state firms incurring higher rates of taxes is further increased.[16] Utilities, which are necessarily local based by virtue of the nature of their operations, as well as non-exempt multi-state firms and all local based firms will face the inequity of higher tax rates and, in many cases, the unfair competition of those who manage to arrange their operations so as to qualify for the preferential immunity granted. These effects of the two factor formula would aggravate the competitive inequality produced by the jurisdictional curtailment provisions of the bill between those firms which qualify for the preferential immunity granted and those which would not so qualify.

These are only some of the considerations involved in an appraisal of the two factor formula provisions of H.R. 11798. Other areas of concern exist. These include the provision excluding inventory from the property factor,[17] the exclusion of wages in excess of $40,000 paid to an employee during the taxable year[18] and the restrictions imposed on the use of separate accounting.[19] The need for separate accounting would be particularly felt in a situa-

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15. Lock, *Federal Control of State Taxation of Interstate Commerce—Good or Bad?, Proceedings of National Tax Association* (1965) (To be published by N.T.A., Payne-Shoemaker Bldg., Harrisburg, Pa.)

16. For an example of the adverse impact which H.R. 11798 would have on industrial development programs, see Taborg, *1966 Hearings on H.R. 11798.*

17. H.R. 11798, 89th Cong., 1st Sess. § 202(b)(1) (1965).

18. *Id.* at § 203(b).

19. *Id.* at § 205.

tion where the sales factor is eliminated and the formula is limited to property and payroll factors. Distortions in the application of a formula are increased when the number of factors is reduced. In addition, manipulation of activities to avoid tax consequences can be more readily achieved.

The two factor formula proposed does not achieve the objectives of a sound apportionment system. This formula along with the other provisions of H.R. 11798 creates inequities among businesses conducting similar operations. The bill increases the burden of non-exempt multi-state firms and local based businesses. It creates inequities among state governments. It creates inequities among local governments. It increases pressure on a large portion of the business community to distort methods of operation for tax purposes rather than for sound economic reasons.

TAX BASE AND ADMINISTRATION

Twenty-two of the thirty-eight income tax states are, of their own volition, presently using the federal income tax base, with stated variations, as the basis for state tax purposes.[20] Certainly it would be desirable for all income tax states to enact such a provision. The difference, however, between a voluntary choice of such a provision and a federal requirement that it be done is a significant one. The portion of H.R. 11798 which imposes the federal standard[21] is another indication of the economic strait jacket within which the states would be confined under such legislation.

Section 212 of the bill would prohibit a state from allowing an adjustment to the federal taxable income measured by an increase in the allowable deduction "for depreciation or amortization with respect to any property which is subject to depreciation or amortization under both state or federal law." This provision would eliminate the practice in some states of allowing accelerated depreciation on new investment in manufacturing, processing, research and development. The effect of section 212 would be to increase the tax burden on corporations now receiving this investment-stimulating tax deduction. In effect, the subcommittee proposal would deny to state legislatures the right to determine their own tax policies irrespective of the impact which the federal income tax law would have on the economy of the state.

In the sales and use tax field H.R. 11798 ostensibly grants to the states the option to retain their own sales and use tax law or adopt a "model law."[22] It would require the states, however, to adopt the model congressional law if the state is to retain power to require collection by a multi-state firm not having a "business location" in the state or not regularly making household deliveries

20. P-H STATE TAX GUIDE ¶ 221.
21. H.R. 11798, 89th Cong., 1st Sess. § 211 (1965).
22. *Id.* at § 321.

into the state. The household delivery basis for exercising jurisdiction does not significantly expand the state's tax jurisdiction or produce equity as between multi-state and local-based firms. It is a method which, as a commercial matter, is probably not very extensively utilized by firms selling goods in one state and delivering them in another. In addition, it is a standard of jurisdiction which for all practical purposes is meaningless, since like the other jurisdictional provisions of H.R. 11798 it can be readily avoided by firms which are large enough and flexible enough to make the appropriate adjustment. In the case of the household delivery basis for jurisdiction, a firm could easily avoid the jurisdiction of a state merely by turning over the delivery portion of its business to a public carrier. Ultimately, it could create a subsidiary to accomplish the same result.

It is well established that the successful administration of any sales and use tax depends on vendor collection.[23] If a state did not accept the congressional "model law," it would have to revert to the collection of use tax from purchasers on sales made to them by out-of-state vendors. Experience has proven this to be a very inadequate procedure. It is obvious, therefore, that if the model law were not accepted, there would be discrimination against instate vendors who would be burdened with the collection of the bulk of sales tax revenue. H.R. 11798 would require as a precondition to efficient collection of sales and use tax by the states a shift to the federal government of all of the state's sales and use tax law making and administrative and adjudicatory functions. This shift would make it impossible for the states to adjust their tax policy to their own economic conditions.

The "model law" would require sales of all consumer goods, including clothing, to be taxed except for permissible exclusion of food, prescription drugs, and prosthetic and orthopedic devices as defined by the Secretary of Treasury and would permit even these exemptions to be eliminated.[24] The dimension of the denial of the clothing and food exemption is suggested by the fact that it is estimated that the clothing exemption in Pennsylvania involves 90.2 million dollars per year in taxes and that the food exemption would involve 175 million dollars per year. The proposed "model law" would also virtully eliminate sales and use tax exemptions for manufacturing and related businesses such as farming, dairying, public utilities, mining and printing. Apart from the limited exemptions expressly granted by this "model law" no further exemptions other than a resale exemption, an isolated sale exemption and a limited exemption to farmers on feed, seed and fertilizers would be permitted. Manufacturing and other business exemptions would

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23. See Due, *State Tax of Interstate Commerce*, 13 CANADIAN TAX J. 519 (1965).

24. H.R. 11798, 89th Cong., 1st Sess. §§ 321, 322 2-3 (1965).

also be eliminated in capital stock type taxes.[25]

Within the framework of our national economy and our federal system, state governments have been able to develop tax systems encouraging industrial development of their own local and human resources and geographic advantages. This is as it should be. Development of lumber, fishing, industrial, and farm resources through wise and fair use of tax policy is desirable. These industrial development efforts of the states have fostered the growth of our national economy, created more jobs and benefited business and consumers alike. H.R. 11798 would make it impossible for the states to formulate tax policies responsive to their economic development needs. This would have adverse effect on the national economy, business, labor and consumers. Adaptation of government to local needs is the virtue of a federal system of government. H.R. 11798 would impose a nationalized fiscal strait jacket on the states and discourage development of local government initiative responsive to the people at the grass roots level.

Under the "model law" the United States Treasury would register and license vendors, prescribe tax return forms, conduct audits and fix reporting periods. The administration of state tax laws is therefore placed in the hands of an agency of the central government which has no responsibility for the fiscal policies of the states and which derives no authority from and is completely unaccountable to the state legislatures for any of its acts. It is questionable that this type of centralization will facilitate tax compliance procedures for multi-state vendors.

H.R. 11798 calls for federal administration by the Internal Revenue Service and the Secretary of the Treasury who would issue rules and regulations not only in the sales and use tax area,[26] but also the income tax, capital stock and franchise tax areas.[27] The Internal Revenue Service would also have general responsibility for auditing the interstate sales pertaining to these taxes.[28] The bill would also substantially replace the adjudication of state tax questions by state tribunals with adjudication of such matters by federal administrative bodies and courts.[29] The virtual elimination of jurisdiction over these state tax issues from state tribunals raises serious constitutional questions of jurisdiction under Article III and the eleventh amendment.[30] The overburdened Tax Court, which already has a backlog of nearly 7,000 cases—twice as many as disposed of within the last fiscal year—would be burdened with a

25. See *id.* at §§ 202, 203.

26. *Id.* at §§ 322 1-15, 2-3(3), 3-1, 4-2, 4-5(1). See also *id.* at §§ 308-10.

27. *Id.* at § 511.

28. H.R. 11798, 89th Cong., 1st Sess. §§ 308-10, 511 (1965).

29. *Id.* at § 522.

30. Section 626 of H.R. 11798, which would invalidate liability for state taxes incurred prior to its enactment, is also of questionable constitutional validity.

type of litigation in which it has not developed expertise and which is presently being handled in state tribunals throughout the country. This volume of litigation would be inflicted on the Tax Court at a time when its backlog is increasing at the rate of 600 cases per year.

It is fair to say that H.R. 11798 would curtail state taxing jurisdiction—to a substantial extent eliminate it all together—and secondly, it would substitute federal administrative organizational and enforcement procedures and decision making for state administration over what remains in the broad field called interstate commerce.

Jurisdictional Standards

In 1959 and 1960 the Supreme Court of the United States decided the *Northwestern* and *Scripto Inc. v. Carson*[31] cases, sustaining the right of states to tax multi-state firms regularly and systematically soliciting and taking orders for merchandise through their salesmen within the state. These cases restated principles which had long been established by Court decisions.[32] They unequivocally ruled, however, for the first time that creation of artificial independent contractor relationships would no longer provide a basis for avoiding state taxation.[33] Prior to that time, many firms engaged only in selling activities in a state avoided tax liability to such states by selling through so-called "independent contractor" representatives. *Scripto* also made it clear that a firm conducting sales activities in a state through its salesmen could not disclaim that it was doing business in the state through the ruse of having the salesmen send the orders they take to some point outside the state for formal approval and "acceptance."[34]

The *Northwestern* case led to hurried congressional enactment in 1959 of P.L. 86-272[35] which overruled the Supreme Court's affirmation of state tax jurisdiction by establishing a contrary standard of business activity within the state as a prerequisite to imposition of an income tax by the states. This was the first time in the history of our nation that Congress attempted to impose limitations upon state tax jurisdiction beyond those imposed by the federal constitution.

It is difficult to grasp fully how all of these questions should have come to a head without some understanding of the background of state taxation and its role in our governmental system. Slightly more than a decade ago, state expenditures, state taxation, and programs of state tax enforcement were far different than the

31. 362 U.S. 207 (1960).
32. See, *e.g.*, West Publishing Co. v. McColgan, 328 U.S. 823 (1946); General Trading Co. v. State Tax Comm'n, 322 U.S. 335 (1944).
33. *E.g.*, 362 U.S. at 211.
34. *E.g.*, *id.* at 211-12.
35. 73 Stat. 555-56, 15 U.S.C. §§ 381-84 (1964).

scene today. Before the advent of Sputnick, the reappraisal of our educational system, the population explosion and the revitalization of state and local government to meet the growing problems of an expanding society, state government had not developed in any respect comparable to the evolution of government at the national level in the preceding years since the depression of the thirties. Revenue raising at the state level was in proportion to the comparative lethargy of state and local government in those years, and the enforcement of state tax laws was relatively "free and easy" because there was little pressure for it to be otherwise. But suddenly this picture changed. During the ten year period 1954-1963, state and local expenditures doubled from $36.6 billion to $74.9 billion. During the same period, state and local debt rose from $38.9 billion to $86.4 billion—more than five times what it was ($15.9 billion) as recently as 1946. Today, state and local government expenditures are twice the federal outlay for domestic programs, and they have been rising at about 8 per cent a year. In the last dozen years, the number of persons employed by state and local governments has doubled from 4 million to 8 million, as compared to about 2.5 million federal civilian employees. To meet the growing demand for essential government services, states were compelled to add debt on debt and tax on tax for, although grants-in-aid from the federal government also increased, they were nowhere near society's demands on government at the state and local levels. Reviewing these facts one journalist recently said: "It's fashionable to accuse state and local governments of either being blind or indifferent to social needs; it's largely on this basis that the centralists insist on Federally-directed programs in practically every field. But this view finds little support in the statistics of state and local expenditures."[36]

> Pressures producing higher and higher levels of spending at the State and local levels are not likely to abate in the foreseeable future but are almost certain to increase. . . . And it is doubtful that the States and localities can continue to raise consumption, payroll, and service taxes anywhere near the rate they have been increasing them over the last decade. . . . The tightening fiscal squeeze on State and local governments has received a great deal of attention recently . . . grants-in-aid tied to specific activities . . . [have] proven a mixed blessing . . . [since] these governments have little influence on which projects are considered critical and are often required to direct a portion of their own revenues toward federally chosen projects . . . . For example, about 45 per cent of the increase in Federal aid to the States over the last 10 years has been earmarked for highways and another 25 per cent restricted to public welfare. . . . The strengthening of State and local control over their own spending is essential in a federal system. . . .

36. Price, *Tax: A Slice for the States,* New York Herald Tribune, Aug. 31, 1965, p. 18, cl. 1.

> A level of government without effective control over its expenditures has essentially lost its identity. . . . Those levels of government closest to the people are most responsive to their wishes. . . . In order to strengthen these governments to meet their increasingly heavy responsibilities, the trend toward fiscal centralization must be restrained.[37]

With the rapid growth in need for revenues the states, of necessity, not only turned their attention to new tax programs but also commenced to review their enforcement of existing laws. With varying perception and dispatch they were to discover that substantial sources of revenue long due under existing laws had not been explored because of indifferent enforcement and poor compliance. This was particularly true with regard to many non-resident firms engaged in multi-state sales operations who maintained no sales offices or other realty in their own names in the states where they sold their articles, though using all other practical means at their disposal necessary to carry on their systematic sales activities there.

It was at this point that non-compliance and the use of legalistic techniques to avoid tax responsibility, such as the "independent contractor" device and the formal "acceptance" of orders at out-of-state points, commenced to become a major financial issue. When those who had been relying on these techniques for many years to insulate systematic sales activities from state taxation pondered the changing scene of governmental expenditures in the light of Supreme Court decisions sustaining state jurisdiction, it took no clairvoyance to see the end of their road in the judicial area. With no time to spare, the strategy shifted to the legislative arena and Congress was importuned to place its stamp of approval on the very avoidance techniques that were crumbling under judicial review—on the theory that state and local taxation were in a state of chaos and that federal intervention was necessary to curb drastic extensions of state jurisdiction. The implications of past due and unpaid state taxes[38] in addition to the prospects of future liability gave impetus to the drive for swift congressional action, and P.L. 86-272 resulted in a matter of months.

P.L. 86-272 is a startling new assumption of power by Congress which, while understood by the small fraternity of state and local tax specialists, still has yet been largely unnoticed. It prohibits any state from taxing the net income of non-residents and foreign corporations notwithstanding that they systematically engage in selling merchandise therein in competition with local-based businesses which remain liable for income taxes. Such grants of preferential immunity to select multi-state firms patently discrim-

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37. Joint Economic Comm., *Federal-State-Local Fiscal Relations*, H. R. Rep. No. 1334, 89th Cong., 2d Sess. 65 (1966).
38. See, *e.g.*, H.R. 11798, 89th Cong., 1st Sess. § 626 (1965).

inate against non-exempt multi-state and local-based businesses and thereby raise serious questions under the fifth amendment due process clause. At the same time, this legislation involves an unprecedented extension of congressional power under the commerce clause. Heretofore, the power of Congress under this clause, although vast, has nevertheless been deemed to be only what the Constitution provides, *i.e.*, the power to regulate commerce. It has operated as a restriction on state and local taxation only to the extent that such taxation, by discriminating against or imposing an undue burden on interstate commerce, actually constituted a regulation of interstate commerce. It is a radical theory of constitutional law which would equate congressional power to regulate businesses engaged in interstate commerce with the power to regulate fair and equal state taxation of such businesses. Proponents of such federal curtailment legislation, however, present the novel argument that Congress, and not the Supreme Court of the United States, has the power to so define state jurisdiction under the United States Constitution.

In addition, such legislation would grant vast areas of preferential immunity from state taxes to certain multi-state firms. For example, such firms are granted immunity under P.L. 86-272 type legislation even though:

1. They have any number of full-time employee salesmen or other representatives soliciting and taking orders for the sale of their merchandise, provided only that the orders obtained are sent to some point outside the state for formal acceptance. This leads to incongruous situations when, for example, $10,000 a year salesmen in State A are sending orders into State B to be stamped "Accepted" by a $3,000 a year file clerk. In addition, the applicable section of the act[39] is so worded that noncorporate proprietors or partners may obtain immunity even if they personally solicit the orders in the state and take them into another state for purposes of officially accepting them.

2. The non-resident multi-state firm has any number of fully authorized contracting agents acting within the state, provided only that these agents are engaged as "independent contractors" rather than "employees." This exemption is applicable even though such representatives are fully controlled as to the end results obtained on behalf of their principals. Under this exemption, they may maintain offices, warehouses and even enter into contracts and sell and deliver goods within the taxing state. The only thing such agents need to do to qualify as "independent contractors" is to carry one additional line of merchandise for a second firm (possibly an affiliate?) and hold themselves out as being willing to do so.[40]

39. 73 Stat. 555, 15 U.S.C. § 381(a)(1) (1964).
40. 73 Stat. 555, 15 U.S.C. § 381(c) & (d)(1) (1964).

The combination of these two exemptions (which might be described as the solication exemption and the independent contractor exemption) makes it possible for the multi-state firm to have operating within the taxing state virtually all of the work force needed to compete effectively with local-based firms in the local market. These exemptions by themselves make it possible for such multi-state firms to solicit business and service accounts on the same personal basis as local-based firms required to pay state and local taxes.

3. The non-resident has its regular full time employee salesmen obtain orders and submit them to independent dealers within the state who stock and sell the non-resident's product. The multi-state firm is immunized from state taxes if the "independent" dealers forward their inventory replacement orders to the multi-state firm at an address outside the state for formal acceptance and filling.[41] From every practical commercial viewpoint, such orders for stock replenishment obviously originate from sales made by the multi-state firm through its solicitation activities in the taxing state. Moreover, the solicitation efforts are obviously aided by the advertising and other merchandising activities of the "independent" dealers and in particular their availability for servicing accounts from a fixed place of business within the taxing state. The preferential immunity from state taxes is, nevertheless, granted.

These exemptions would extend preferential treatment to multi-state operators selling vast amounts and varieties of merchandise including virtually anything purchased for use in household, industrial and commercial activities.

In his dissenting opinion in *Northwestern*, Mr. Justice Frankfurter was induced to sympathize "with the thousands of relatively small or moderate size corporations" which would be required to "keep books, make returns, store records . . . which would involve large increases in bookkeeping, accounting and legal paraphernalia."[42] This quotation, somewhat out of context, has become the rallying cry of those seeking tax immunity through curtailment of state tax jurisdiction, although Mr. Justice Frankfurter in the same dissenting opinion also clearly said:

> These considerations do not at all lead to the conclusion that the vast amount of business carried on throughout all the States as part of what is exclusively interstate commerce should not be made to contribute to the cost of maintaining state governments which, as a practical matter, necessarily contribute to the conduct of that commerce by the mere fact of their existence as governments.[43]

The claims of excessive compliance costs which were made

41. 73 Stat. 555, 15 U.S.C. § 381(a)(2) (1964).
42. Northwestern States Portland Co. v. Minnesota, 358 U.S. at 474.
43. *Id.* at 475.

following the decisions in *Northwestern* and *Scripto,* as well as the patent inequities of P.L. 86-272, have led to a multiplicity of jurisdictional proposals on the subject of state taxation of multi-state firms. It is convenient for purposes of analysis to divide these diversified proposals into three major groups.

One group of distinguished authorities suggests that tax equity and simplicity would best be achieved by a congressional grant to the states of "unrestricted jurisdiction to tax property, activities, transactions, or the receipt therefrom or the income from a source within the state,"[44] coupled with measures designed to achieve ease of compliance particularly for small taxpayers. If sales of less than one hundred thousand dollars constitute the taxpayer's only source of income in the state during the taxable year, some supporters of this view would permit the taxpayer firm to approximate its tax liability by paying a lower rate of tax on the total sales in the state in lieu of computing a detailed tax return.[45] Others would exempt the taxpayer in such cases. In the case of sales and use tax no return would be required until the amount of tax due is one hundred dollars or the last filing period of the year, whichever comes first.[46]

Another group, including the proponents of P.L. 86-272 and H.R. 11798 type legislation, takes the opposite approach. They would drastically curtail state tax jurisdiction over multi-state firms instead of extending it. The proponents of P.L. 86-272 type legislation have already formulated several such plans. Notwithstanding the far-reaching preferential immunity and discrimination produced by P.L. 86-272, additional proposals have been made which would prevent states from imposing any tax, including but not limited to franchise, excise, sales and use, personal and real property, unemployment compensation, and a host of other taxes. Beyond the three types of exemptions granted by P.L. 86-272, they vigorously continue to campaign for additional congressional enactments prohibiting all state taxes unless multi-state firms have a so-called "permanent establishment" in the taxing jurisdiction. For example, one of these proposals[47] would make available to multi-state corporations all three types of P.L. 86-272 exempt

44. Interim Report of Comm. on Interstate Allocation of Business Taxes, 58th Annual Conference on Taxation, PROCEEDINGS OF THE NATIONAL TAX ASS'N (1965). See Cox, *1966 Hearings on H.R. 11798;* Hellerstein, *1966 Hearings on H.R. 11798;* Address by Hellerstein, *Resolving the Interstate Income Tax Problem,* Conference of Nat'l Ass'n of Tax Administrators (June 1965); see also Hartman, *State Taxation of Interstate Commerce: A Survey and an Appraisal,* 46 VA. L. REV. 1051, 1101-02 (1960); Hartman, *State Taxation of Corporate Income from a Multistate Business,* 13 VAND. L. REV. 21, 43 (1959).

45. Cox, *1966 Hearings on H.R. 11798.*

46. Hellerstein, *1966 Hearings on H.R. 11798.*

47. Shannon, *Hearings Before the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary,* 87th Cong., 1st Sess. 76 (1961) [hereinafter cited as *1961 Hearings*].

methods of operation. In addition, such corporations would be permitted to (1) maintain inventories of goods or merchandise on consignment or in a public warehouse located within the state; (2) systematically solicit orders for and deliver machinery and equipment which employees erect, install and service within the taxing state; (3) maintain offices or agencies within the state for the purchases of goods or merchandise; (4) create evidence of debt, mortgages or liens on real estate or personal property; and (5) secure or collect debts or enforce any rights in property securing said debts. This proposal further provides that multi-state operators shall be tax exempt even if they also have "an affiliated corporation engaged in trade or business within the state, whether through a permanent establishment or otherwise."[48] As the coup de grace, this proposal would also grant a blanket exemption to all multi-state operators "transacting business in or incident to interstate commerce."[49]

Another version of this proposed curtailment legislation would invert the traditional principle for the division of power under our federal constitution by a blanket elimination of state taxing powers, except in those instances in which Congress delegates such power with reference to specifically enumerated activities. Under the provisions of a "First Incomplete Outline of A Possible Federal Statute to Regulate State and Local Taxation of Interstate Commerce, Matters Affecting Interstate Commerce and Multi-State Businesses,"[50] the states would be required to obtain the express consent of Congress every time it became necessary for them to exercise taxing powers not specifically delegated to them by previous congressional enactment.[51]

H.R. 11798 would limit the right of a state to impose an income, capital stock, franchise or sales and use tax on a multi-state firm to situations in which the firm has a "business location" in the state.[52] This basically requires: (1) the ownership or leasing of

48. Shannon, *1961 Hearings* at 76, § 2(e).

49. Shannon, *1961 Hearings* at 77, § 2(j).

50. This proposal was presented as the views of private individuals and discussed at a Technical Session, sponsored by the Comm. on State and Local Taxation, American Bar Ass'n, August 8, 1965.

51. See section 101 of the proposal.

52. H.R. 11798, 89th Cong., 1st Sess. § 101 (1965). Section 612 defines "business location" as:

> (a) GENERAL RULE.—A person shall be considered to have a business location within a State only if that person—
>
> (1) owns or leases real property within the State or
>
> (2) has one or more employees located in the State.
>
> (b) BUSINESS LOCATION IN SPECIAL CASES.—If a person does not own or lease real property within any State or have an employee located in any State (or in a case described in the last sentence of section 204), that person shall be considered to have a business location—
>
> (1) in the State in which the principal place from which its trade or business is conducted is located, or
>
> (2) if the principal place from which its trade or busi-

real property by the firm in its own name, or (2) the maintenance of an "employee" virtually working full time in the tax state, or (3) the presence of an "employee" in a state where the employer has a "tax base" in the state.[53] The bill further provides that a multi-state firm which regularly makes household deliveries into a state may be required to collect a sales and use tax on such deliveries.[54] It also ostensibly grants to the states the option to retain their own sales and use tax law or adopt a model congressional sales and use tax law.[55] In essence, however, it would require the states to adopt the federally prescribed sales and use tax law if the state is to have the power to require collection by a multi-state firm not having a "business location" in the state (as restrictively defined by the bill) or not regularly making household deliveries into the state.[56]

As under P.L. 86-272, the proposed jurisdictional rules of H.R. 11798 invite a multi-state firm to avoid tax jurisdiction, even though an unlimited number of its employees regularly and substantially solicit an unlimited amount of money and compete with local-based business and non-exempt multi-state firms. Such a firm could avoid taxes merely by: (1) not owning or leasing real property in its own name in a state but storing all of its inventory in a public warehouse in the state; (2) having its salesmen operate out of their own homes or offices rather than from a "tax base" maintained by the firm in the state, but nevertheless utilizing

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ness is conducted is not located in any State, in the State of its legal domicile.

"Location of employee" is defined in section 614 of H.R. 11798:

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

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

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

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

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

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

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

53. See H.R. 11798, 89th Cong., 1st Sess. § 614(c).

54. H.R. 11798, 89th Cong., 1st Sess. § 101(2) (1965). Section 615 provides:

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

55. H.R. 11798, 89th Cong., 1st Sess. §§ 101(2), 321, 322 (1965).

56. H.R. 11798, 89th Cong., 1st Sess. §§ 101(2), 322 1-18 (1965).

business listings in the firm name in the state; and, (3) requiring each of its salesmen, service, or collection employees to cover two or more states or by hiring personnel under contracts in which they are labeled "independent contractors" rather than "employees."

The area of preferential immunity granted by the "household delivery" test of jurisdiction is also broad. The number of multi-state firms which regularly make deliveries across state lines to private residences in a state is relatively small. The bulk of such multi-state merchandising is done through the mail or common carriers. More significantly, to the extent that multi-state firms would not already qualify for the exemption under the "household delivery" test, they obviously could readily convert their delivery system so as to qualify for the proposed immunity.

The predilection of the bill to immunize multi-state firms from state tax liability rather than achieve procedural uniformity is further illustrated by the provisions pertaining to gross receipts taxes which would permit such taxes to be imposed only by the state in which the sale has its origin and by no other state or political subdivision.[57]

The origin of a sale is:

> (1) In the state or political subdivision in which the seller owns or leases premises at which the property was last located prior to delivery or shipment of the property by the seller to the purchaser or to a designee of the purchaser, or
>
> (2) if the property was never located at premises owned or leased by the seller, in the state or political subdivision in which a business location of the seller is located and in or from which the sale was chiefly negotiated.[58]

The ease with which gross receipts taxes could be avoided under these superficial tests merely by appropriate location of warehouses in tax haven states is patent.

The Council of State Governments has recently stated that H.R. 11798

> . . . can only be helpful to those businesses whose operations are of such magnitude and flexibility that they can arbitrarily adjust without undue cost as compared to the taxes avoided, their methods of operations to qualify for the immunity and preferential treatment granted. It is respectfully submitted for the benefit of those few businesses, that the greater part of the business tax paying community is being asked to suffer.[59]

Statements issued by the Michigan, Maine, and Pennsylvania retail trade associations express the concern which many business-

57. H.R. 11798, 89th Cong., 1st Sess. §§ 101(3), 401 (1965).

58. H.R. 11798, 89th Cong., 1st Sess. § 610 (1965).

59. Statement by Council of State Gov't, 1755 Massachusetts Ave., Washington, D.C.

men throughout the country have regarding the proposed bill, particularly with its grants of preferential immunity to certain types of merchandising activity.[60] This concern is best illustrated by the letter recently forwarded by the Executive Vice-President of the Pennsylvania Retailers Association to the Governor of the Commonwealth of Pennsylvania, reaffirming its opposition to H.R. 11798 type legislation. It said in part:

> H.R. 11798, introduced on October 22, (the very last day of the first session of the present Congress) by Congressman Edwin E. Willis of Louisiana, will provide an unjustifiable tax haven for many companies that distribute consumer goods on a multi-state basis.
>
> If this Bill becomes a federal law, it will give out of state vendors tremendous advantage over retailers in Pennsylvania, since these out of state firms for the most part will be relieved of any obligation to collect the 5 per cent sales and use tax on sales to Pennsylvania residents.
>
> Not only will the instate retailer lose by this, the Commonwealth of Pennsylvania will likewise suffer from this loss of revenue, since it is already quite obvious that few Pennsylvania residents voluntarily pay the 5 per cent use tax on purchases mailed from outside Pennsylvania.[61]

Distinguished authorities have been particularly critical of the preferential immunity inherent in the jurisdictional curtailment provisions of this type of legislation.[62] One authority said:

> However, the report and recommendations of the Subcommittee are open to very serious criticism. In the first place there runs throughout the Report the acceptance of the philosophy that the states act improperly and unfairly when they extend their taxing jurisdiction to out of state vendors selling in the state. This philosophy is a very questionable one. The sales tax is widely accepted, especially by business groups, as the most satisfactory primary source of state revenue. Equity, revenue, and economic considerations require the tax to apply to purchases from

60. See, *e.g.*, Bailey, *Hearings Before the Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary*, 87th Cong., 2d Sess., 455 (1962) [hereinafter cited as *1962 Hearings*]; Fissell, *1962 Hearings* at 456; Means, *1962 Hearings* at 587; Meek, *1962 Hearings* at 242; Tate, *1962 Hearings* at 456; Tisdale, *1962 Hearings* at 781; Hollander, *1961 Hearings* at 351; Means, *1961 Hearings* at 349; Stone, *1961 Hearings* at 351. The economic realities of granting preferential immunity to multi-state operations has also been recognized by scholars such as Paul J. Hartman who, in one of his learned studies has stated: "An interstate business ought not to be given a tax preference over local business." Hartman, *Sales Taxation in Interstate Commerce*, 9 VAND. L. REV. 138, 203 (1956).

61. Letter from John E. Means to Governor William W. Scranton, Dec. 24, 1965, presented by Sec'y Smith in *Hearings on H.R. 11798* (1966).

62. See, *e.g.*, Gronouski, *1962 Hearings* at 570; Address by Jerome Hellerstein, *supra* note 44; Koch, *A Business Viewpoint*, in PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION 541 (1964).

> outside the state as well as to those within the state. Since collection from the customer is usually not feasible, the states must, if they are to make the taxes effective, collect from out of state vendors. Thus it can be argued that any firm which undertakes interstate selling must also accept the responsibility of collecting sales taxes for states into which they sell. The sales taxes of the various states constitute a part of the environmental framework in which business firms operate. Firms should be aware of this, and take the taxes into consideration when they undertake interstate selling.
>
> The Subcommittee conclusion that firms selling only by mail order should not be subject to the collection requirement is particularly difficult to accept. There has been a great increase in recent years in the number of firms selling giftware, clothes, foods and many other items through catalogues which are mailed throughout the country. Some catalogues contain statements that the customers can escape tax by purchasing from the firms. The firms are in direct competition with local merchants, and to some extent are thriving simply because of escape from sales tax. Obviously such firms will experience some nuisance and expense if they must collect sales tax—but the tax should be regarded as one of the requirements of conducting this form of business. It is incredible that a Subcommittee of Congress would propose a measure which would free these firms of tax requirements, even under a proposed cooperative system.[63]

Such provisions discriminating against local-based and non-exempt multi-state firms and curtailing state tax jurisdiction are of questionable constitutional validity. The preferential immunity granted under this jurisdictional limitation is one of several provisions in the bill which shift tax burdens increasingly to non-exempt multi-state and local based firms. The justification economically, equitably, legally or constitutionally of excluding from a state's tax jurisdiction taxpayers who compete with local business by maintaining an inventory of merchandise in a public warehouse, and independent sales representatives who while not technically "employees" nevertheless regularly and systematically solicit sales in two or more states rather than in a single state is extremely questionable. Such artificial distinctions have long been disregarded by the United States Supreme Court in setting reasonable standards of tax jurisdiction.[64] These artificial distinctions only lead to manipulation of contractual arrangements for tax avoidance purposes and distort the process of making economic decisions by requiring emphasis on tax considerations in lieu of the basic economic factors involved.

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63. Due, *State Taxation of Interstate Commerce—Sales and Use Taxes,* 13 CANADIAN TAX J. 519, 523 (1965).

64. See Scripto, Inc. v. Carson, 362 U.S. 207 (1960); General Trading Co. v. State Tax Comm'n, 322 N.S. 335 (1944).

COMMERCE CLAUSE AND FOURTEENTH AMENDMENT DUE PROCESS CONSIDERATIONS

Congress is delegated plenary power "to regulate commerce . . . among the states."[65] However, the question as to whether H.R. 11798 type legislation is a valid exercise of the powers delegated by the commerce clause is not whether Congress has "plenary power" under this clause to regulate interstate commerce.[66] Under many Court decisions sustaining or disapproving federal action, as the case may be, this power of Congress has been described as plenary - always subject, of course, to recognized limitations of state integrity and other constitutional principles, particularly the pervasive requirements of the due process clause and the fundamental requirements of the separation of powers doctrine. Congressional legislation must meet the fair play requirements of due process and may not usurp the powers of the judicial branch of the government. Plenary does not mean pre-emption of all powers of government. The "plenary powers" of Congress under the commerce clause are not in issue.

Nor is the issue whether these powers permit Congress to regulate portions or aspects of a person's interstate transactions which, if standing alone, would appear to be intrastate. The local preparation of goods destined for interstate movement, the local receipt and handling of articles within a state upon the completion of such movement, and the many component and related details of an interstate business which are, "local somewhere," are all necessarily touched and affected in the exercise of regulatory power over the series of activities which comprise any interstate business. No one would challenge these realities of our modern social-economic system and jurisprudence. These, however, are not the great fundamental issues raised by H.R. 11798 type legislation.

Nor is it in issue that federal regulatory power under the commerce clause necessarily includes the power to invalidate or interdict state action which, under the guise of or in the exercise of state taxing power, has the effect of *regulating* interstate commerce. State taxes which discriminate against interstate commerce, which are levied on property in transit in interstate commerce, which are aimed at the privilege of engaging in interstate commerce, which are so levied as to probably work an unreasonable burden on the bare exercise of such privileges—as distinguished from fair, impartial and reasonable taxation requiring only that interstate commerce "pay its way"—have been considered regulatory and, therefore, within the realm of reasonable federal control under the commerce clause. This is not the issue raised by H.R. 11798 type legislation. The powers claimed by the advocates of these measures go far beyond this.

65. U.S. CONST. art. I, § 8, cl. 3.
66. See cases cited note 73 *infra*.

Nor is the question here whether Congress can regulate all businesses "affecting" or "affected by" interstate commerce. And what businesses today are not engaged in interstate commerce under these tests? Twenty-four years have passed since the Court in *Wickard v. Filburn*[67] sustained congressional regulation of the amount of wheat a farmer could raise to feed his own cattle. Since the farmer probably would have bought the wheat on the open market if he had not grown it himself, "interstate commerce" was held to be involved. The scope and depth of congressional power to act affirmatively, by way of regulation, in what is conceived to be the public interest is far reaching and now firmly established. But this is not the basic issue raised by the enactment of H.R. 11798 type legislation.

The great fundamental issue which H.R. 11798 type legislation raises is: *Does the national government possess the same power to prohibit all state taxation of businesses engaged in interstate commerce which it has to regulate all businesses engaged in interstate commerce?* It is clear that the postulate upon which the proponents of H.R. 11798 and similar federal restrictive legislation proceed is that these powers of Congress are, both in scope and depth, identical. The United States Supreme Court decisions, however, are not in accord with this postulate. The Court has ruled that the power of Congress to forbid state taxation of interstate commerce is not as broad as the power of Congress to regulate such commerce.[68] Congress has exercised this power in adopting the Agricultural Adjustment Act[69] and the Civil Rights Act.[70] This distinction was most recently set forth as follows by the Supreme Court in its decision in *Katzenbach v. McClung*,[71] upholding the public accommodations provision of the Civil Rights Act of 1964:

> Nor are the cases holding that interstate commerce ends when goods come to rest in the state of destination apposite here. That line of cases has been applied with reference to state taxation or regulation but not in the field of federal regulation.[72]

It is one thing to expand judicially the concept of interstate commerce to permit federal uniform regulation in areas like farming, labor-management relations, and civil rights.[73] It is quite an-

67. 317 U.S. 111 (1942).
68. Gibbons v. Ogden, 9 Wheat. 1, 10 (1824).
69. 52 Stat. 31 (1938), 7 U.S.C. § 1281 (1964) (regulation of farming).
70. 78 Stat. 243, 42 U.S.C. § 2000a (1964) (regulation of obligation to serve by any business open to the public).
71. 379 U.S. 294 (1964).
72. *Id.* at 302.
73. In Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 254 (1964), sustaining the constitutionality of the Civil Rights Act of 1964, Mr. Justice Clark enumerated the following cases affirming the plenary power of Congress to regulate interstate commerce: Hudson Distribs., Inc. v. Eli Lilly & Co., 377 U.S. 386 (1964); Boynton v. Commonwealth of Virginia, 364 U.S. 454 (1960); Federal Trade Comm'n v. Mandel Bros., Inc., 359 U.S.

other to assert the application constitutionally of the same expanded concept of interstate commerce to deprive states of traditional taxing powers, essential if their existence as separate and pre-existing governments is to be maintained. The judicial expansion of the concept of interstate commerce in the first case is required to meet changing economic and social conditions in the United States. The same expansion is not needed to protect interstate commerce, as thus defined, from long established state taxing jurisdiction. The Court has recognized the power of the states to tax "when goods come to rest in the state of destination," but the power of Congress to regulate for purposes of civil rights, farming, etc., continues thereafter.

In holding in *Union Pacific R.R. v. Peniston*[74] that the doctrine of federal immunity from state taxation did not extend to a railroad company merely because it was operating under a federal charter, the Court said:

> That the taxing power of a State is one of its attributes of sovereignty; that it exists independently of the Constitution of the United States, and underived from that instrument; and that it may be exercised to an unlimited extent upon all property, trades, business and avocations existing or carried on within the territorial boundaries of the state, except so far as it has been surrendered to the Federal Government, either expressly or by necessary implication, are propositions that have often been asserted by this Court. And in thus acknowledging the extent of the power to tax belonging to the States, we have declared that it is indispensable to their continued existence. . . . The Constitution contains no express restriction of this power other than a prohibition to lay any duty of tonnage, or any import, or duty on imports or exports, except what may be absolutely necessary for executing the State's inspection laws.[75]

Acceptance of the point of view of proponents of H.R. 11798 type legislation would portend a new and unpromising era in Federal-State relations in the field of taxation. Heretofore, a State has had the power to tax firms engaged in multi-state operations unless the application of the tax to a firm imposed an undue burden on or discriminated against interstate commerce. For example, in the

385 (1959); Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954); Securities & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119 (1953); United States v. Baltimore & Ohio R.R., 333 U.S. 169 (1948); Morgan v. Commonwealth of Virginia, 328 U.S. 373 (1946); Wickard v. Filburn, 317 U.S. 111 (1942); United States v. Darby, 312 U.S. 100 (1941); National Labor Relations Bd. v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937); Brooks v. United States, 267 U.S. 432 (1925); Weeks v. United States, 245 U.S. 618 (1918); Caminetti v. United States, 242 U.S. 470 (1917). However, in the companion *McClung* case, Mr. Justice Clark carefully distinguished federal regulation of commerce from state taxation of commerce.

74. 85 U.S. 5 (1873).

75. *Id.* at 29.

case of *International Shoe Co. v. Washington*,[76] the Court held that a company whose salesmen regularly and systematically solicited sales in the State of Washington was subject to its tax and civil enforcement jurisdiction. It is noteworthy that in this case, more than two decades ago, all of the company's sales transactions were across state lines—that is, exclusively in interstate commerce—and yet the Court sustained the state tax jurisdiction. The Court rejected the argument that the due process clause or the commerce clause prohibited exercise of this jurisdiction. In so ruling, Mr. Justice Black, in his separate opinion, said:

> [I]t is unthinkable that the vague due process clause was ever intended to prohibit a state from regulating or taxing a business carried on within its boundaries simply because this is done by agents of a corporation organized and having its headquarters elsewhere. To read this into the due process clause would in fact result in depriving a state's citizens of due process by taking from the state the power to protect them in their business dealings within its boundaries with representatives of a foreign corporation. Nothing could be more irrational or more designed to defeat the function of our federative system of government. Certainly a State at the very least, has power to tax and sue those dealing with its citizens within its boundaries, as we have held before. . . . I believe that the Federal Constitution leaves to each State, without any "ifs' or 'buts,' a power to tax and to open the doors of its courts for its citizens to sue corporations whose agents do business in those states.[77]

More recently in *Northwestern* the Court again ruled that regular and substantial solicitation of sales in a state would subject the firm to its tax jurisdiction and make it liable—in this case for a fairly apportioned net income tax—notwithstanding that the orders were being stamped "accepted" and filled by shipment from some point outside the state and, therefore, characterized as being in interstate commerce.[78] The Court reiterated its earlier holdings to the effect that the apportioned non-discriminatory net income tax on profits derived from interstate commerce was not an undue burden on interstate commerce and did not offend the requirements of the due process clause of the fourteenth Amendment. In so ruling, the Court stated:

> We believe the rationale of these cases involving income levies by states control the issues here. *The taxes are not regulations in any sense of that term.* Admittedly, they do not discriminate against nor subject either corporation to an undue burden. While it is true that a state may not erect a wall around its borders, preventing Commerce an

76. 326 U.S. 310 (1945).
77. *Id.* at 323.
78. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. at 460.

> entry, it is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefit it derives from within the state. . . . [I]t is too late in the day to find offense to that [commerce] Clause because a state tax is imposed on corporate net income of an interstate enterprise which is attributable to earnings within the taxing state.[79]

Jurisdiction of the states to tax based upon solicitation activities or activities of "independent contractors," has been clearly sustained by the Court when such taxes are fairly apportioned and do not discriminate against multi-state business.[80] In *Northwestern* the Court made clear its lack of reliance upon the presence of sales offices as a basis for state tax jurisdiction when it remarked about its decision in *West Publishing Co. v. McColgan:*[81]

> The opinion was not grounded on the triviality that office space was given West's solicitors by attorneys in exchange for the chanceful use of what books they might have had on hand for their sales activities. Rather, it recognized that the income tax arose from a purely interstate operation.[82]

From these cases it would appear that Congress has exceeded its delegated powers in attempting to immunize from state taxation situations which the Court has held not to constitute a "regulation of commerce."

In *Scripto* the Court ruled that regular and systematic solicitation of orders by salesmen labeled "independent contractors" in the employment contract subjected the firm to the state's jurisdiction and made it liable for collecting the state's sales and use tax on such sales.[83] In emphasizing the substance of the company's profit-making activities and lack of relevance of superficial technicalities such as the place where the company arranged to have the orders formally "accepted," or the nomenclature used to describe sales personnel, the court said:

> The *only* incidence of this sales transaction that is *non-local* is the acceptance of the order. True, the 'salesmen' are not regular employees of the appellant [the Georgia Company] devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The *formal shift* in the *contractual tagging* of the salesman as 'independent' neither results in

79. *Id.* at 461-62.

80. The Court's traditional protection of multi-state business against *discriminatory taxation* was reaffirmed in Halliburton Oil Co. v. Reilly, 373 U.S. 64 (1963), when it ruled that a state compensatory use tax, on the use within the state of goods purchased from outside sources, *cannot constitutionally exceed* the sales tax which would have been collected in an identical situation on a purchase from a local-based seller.

81. 328 U.S. 823 (1946), *affirming* 27 Cal.2d 705, 166 P.2d 861 (1946).

82. 358 U.S. at 461.

83. Scripto, Inc. v. Carson, 362 U.S. at 211.

> changing his local function of solicitation nor bears upon its *effectiveness in securing a substantial flow of goods* into Florida. This is evidenced by the amount assessed against appellant on the statute's 3% basis over a period of but four years. To permit such formal 'contractual shifts' to make a constitutional difference would *open the gates to a stampede of tax avoidance*. . . . Moreover, we cannot see, from a constitutional standpoint, 'that it was important that the agent works for several other principals.' . . . *The test is simply the nature of the activities of the appellant* in Florida. . . . 'All these differences are without constitutional significance.'[84]

In *International Shoe, Northwestern* and *Scripto* the Court has held that regular and systematic solicitation by salesmen constitutes a valid basis for exercise of state tax jurisdiction and that the exercise of such jurisdiction does not constitute a regulation of commerce or a violation of the due process requirements.[85] The import of congressional action in the form of P.L. 86-272[86] or H.R. 11798 is that even though the Supreme Court has held that such a levy does not constitute a regulation of commerce or violate due process requirements, Congress can nevertheless, arbitrarily rule that such action constitutes an unfair regulation of interstate commerce. This argument suffers from the defect that on this theory of its power, Congress could then extend the scope of its power, to the diminution of state jurisdiction in a virtually unlimited manner merely by taking action.

The cases of *Pennsylvania v. Wheeling & Belmont Bridge Co.*[87] and the *Prudential Ins. Co. v. Benjamin*,[88] do not empower Con-

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84. *Id.* at 211-12. (Emphasis added.) See Powell, *Sales and Use Taxes: Collection from Absentee Vendors*, 57 HARV. L. REV. 1086, 1090 (1944).

85. On the other hand, the Court has insisted that a state cannot impose tax liability on a non-resident firm in the absence of regular and systematic activities within the state. Thus, in Miller Bros. v. Maryland, 347 U.S. 340 (1954), the Court held that a department store may deliver merchandise to the homes of customers in another state who come to the store to make purchases without incurring a duty to collect the purchaser's sales and use tax if these are the only activities in customer's state.

The question of whether regular and systematic solicitation of orders by mail and other forms of advertising within a customer's state constitutes a basis for exercise of tax jurisdiction is pending before the Court. National Bellas-Hess Co. v. Korshak, P-H STATE AND LOCAL TAX SERV. *Ill.* 23,045 (jurisdiction aff'd by state supreme court). See also Alabama v. Bryant, Inc., 171 So.2d 91 (Ala. 1965) (jurisdiction denied by state supreme court, no appeal pending).

86. As of this writing, P.L. 86-272 has been upheld in International Shoe v. Cocereham, 246 La. 244, 164 So.2d 314 (1964), *cert. denied*, 379 U.S. 902 (1964); C.I.B.A. Pharmaceutical Prod., Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964); Smith, Kline & French v. State Tax Comm'n, 403 P.2d 275 (Ore. 1965). The question has yet to be considered on the merits by the Supreme Court of the United States.

87. 59 U.S. 421 (1856).

88. 328 U.S. 408 (1946).

gress to overrule constitutional limitations on its power merely through the device of legislating in the prohibited areas. Both *Belmont Bridge* and *Prudential* involved situations in which the Court had initially held that a *particular state action was prohibited because it constituted a regulation of commerce, and therefore was within the power delegated to the Congress.* In both situations, Congress subsequently relinquished its admitted power to regulate the activities in question under the interstate commerce clause and specifically empowered the states to legislate in those areas.[89]

Proponents of federal curtailment legislation would extract from these cases a distorted principle of law which would empower the Congress to redefine constitutional limits on its own authority, through the device of enacting legislation which would in effect repeal Supreme Court decisions on the subject. No case upholding the constitutionality of such a device has been found. In no situation has the United States Congress been empowered to act subsequent to a Supreme Court decision, as yet not overruled, which expressly states that the state action involved did not constitute a "regulation" of commerce.

The distinction between the power of Congress to regulate interstate commerce on the one hand and its lack of power to deprive states of tax jurisdiction on the other is so fundamental that it has been recognized since the earliest days of the Supreme Court. For example, the leading case of *Gibbons v. Ogden*,[90] establishing the power of Congress to regulate interstate commerce, also includes a clear statement by the leading exponent of federal power, Mr. Chief Justice Marshall, who said:

> Although many of the powers formerly exercised by the states are transferred to the government of the Union, yet the state governments remain, and constitute a most important part of our system. The power of taxation is indispensable to their existence, and is a power which, in its own nature, is capable of residing in, and being exercised by different authorities at the same time.[91]

In the same case, Mr. Chief Justice Marshall also said that "there is no analogy . . . between the power of taxation and the power of regulating commerce."[92]

The Court has also stated that:

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89. This right of Congress in the insurance area to relinquish its admitted power to regulate was recognized recently in State Bd. of Ins. v. Todd Shipyards Corp., 370 U.S. 451 (1962), where the Court ruled that in the statute under review Congress did not intend to grant jurisdiction to the states over foreign insurance firms engaged in interstate commerce in the absence of any nexus, activity, or act whatsoever on the part of the insurer within the state.

90. 22 U.S. (9 Wheat.) 1 (1824).

91. *Id.* at 198.

92. *Id.* at 200.

> Authority is also conferred upon Congress to lay and collect taxes but this grant does not supersede the powers of the states to tax for the support of their own government, nor is the exercise of that power by the states, unless it extends to objects prohibited by the Constitution, an exercise of any portion of the power that is granted to the United States.[93]

Alexander Hamilton stated the matter as follows:

> Although I am of the opinion that there would be no real danger of the consequences which seem to be apprehended to the State Governments from a power in the Union to control them in the levy of money, because I am persuaded that the sense of the people, the extreme hazard of provoking the resentments of the state governments, and a conviction of the utility and necessity of local administrations for local purposes, would be a complete barrier against the oppressive use of such a power; yet I am willing here to allow in its full extent, the justness of the reasoning which requires that *the individual states should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants. And making this concession, I affirm that with the sole exception of duties on imports and exports, they would under the plan of the convention, retain that authority in the most absolute and unqualified sense; and that an attempt on the part of the national government to abridge them in the exercise of it would be a violent assumption of power unwarranted by any article or clause of its constitution.*[94]

Hamilton also said:

> Though a law, therefore, for laying a tax for the use of the United States would be supreme in its nature and could not legally be opposed or controlled, *yet a law for abrogating or preventing the collection of a tax laid by the authority of a State (unless upon imports and exports) would not be the supreme law of the land but, a usurpation of the power not granted by the Constitution.*[95]

H.R. 11798, P.L. 86-272 and similar proposed legislation in the income, capital stock, sales and use, gross receipts, personal and real property areas involve radical new claims against state jurisdiction never previously asserted by Congress. If "interstate commerce" in the field of Federal regulation is to be the standard by which congressional power to control and curtail state taxing jurisdiction is to be measured, what is left of the taxing power of state governments in light of the current concepts of what constitutes "interstate commerce?" What is not interstate commerce after *Wickard v. Filburn*? If this premise were accepted our constitu-

93. Cox v. Lott, 79 U.S. 204, 214 (1870).

94. THE FEDERALIST No. 32, at 193 (Modern Library ed. 1937). (Hamilton). (Emphasis added.)

95. THE FEDERALIST No. 33, at 202 (Modern Library ed. 1937). (Hamilton. (Emphasis added.)

tional system of government would be converted to one in which states, deprived of most of their taxing power, would become mere administrative arms of an all powerful central government and be forced to rely on federal grants-in-aid as a source of revenue. In essence, our system of government, without constitutional amendment, would be converted from a federal to a unitary form of government.

To read into the decisions of the Supreme Court and the invitations to congressional action expressed by members of the Court the idea that whenever and wherever Congress can regulate any business or aspect thereof Congress may also act negatively to prohibit non-discriminatory and reasonable state taxation of such businesses, is a gross misinterpretation of the cases.

FIFTH AMENDMENT DUE PROCESS CONSIDERATIONS

By curtailing state taxing jurisdiction H.R. 11798 and P.L. 86-272 type legislation would grant preferential immunity from state taxes to certain multi-state businesses and thereby simultaneously discriminate against hundreds of thousands of local based and non-exempt multi-state firms selling identical types of merchandise in the identical markets.

As a nation we have long prided ourselves on our free competitive enterprise system and our restraints against unfair competition. It is therefore startling to consider the enactment of laws fostering situations in which multi-state sellers of merchandise may operate with unfair advantages in local markets to the detriment of hundreds of thousands of resident competitors throughout the United States, and at public expense through tax exemption. It is all the more startling when one realizes that the Congress is asked to prohibit or regulate the whole gamut of state taxes (*i.e.*, income, capital stock, gross receipts and sales and use) with regard to certain multi-state firms in such a manner as to give them substantial competitive advantages. Such legislation instead of encouraging development of small businesses as its advocates frequently suggest, would to the contrary advance the development of industrial and commercial giants, which, limited only by anti-trust considerations and fortified by such tax subsidies, would be encouraged to set up networks of wholesale and retail merchandising operations. Those operations would soon be in a position to replace smaller resident businesses operating at competitive tax disadvantages.

P.L. 86-272 would exempt all selling transactions of multi-state organizations from state taxes regardless of the regularity and volume of business done, so long as orders obtained by agents in the taxing jurisdiction are technically accepted and shipped from outside the taxing jurisdiction. H.R. 11798 would exempt such transactions even though the orders are accepted in the state and the goods are delivered from public warehouses in the state. Under

this type of legislation unlimited numbers of salesmen in the state could sell unlimited amounts of merchandise without subjecting their firms to any tax liability. Fair competition in a free economy is one of the requirements of a free enterprise system. Such legislation is not in accord with this principle. The severe impact of this type of legislation on local businesses selling identical merchandise in identical markets would probably be sufficient to drive many such local based businesses into bankruptcy and out of existence. Statistical data compiled by Dunn and Bradstreet on profit margins of various types of businesses eloquently establish this potentially disastrous effect.

The effect of the unfair competition resulting from the cumulative grants of preferential immunity from sales and use tax, income, capital stock and gross receipts tax is apparent from a consideration of the latest available five year average ratio of net profits to net sales for the period 1957 to 1961 covering 70 lines of the major types of business activities. This Dunn and Bradstreet report shows the following: (a) the data covering forty-two manufacturing groups establishes a low of .46 per cent (applicable to the dress industry) and a high of 8.44 per cent (applicable to the drug industry); (b) the data covering 21 wholesaler groups establishes a low of .42 per cent (cigarette industry) and a high of 2.25 per cent (baked goods industry); and (c) the data covering retailer groups establishes a low of 1.14 per cent (independent vendors of groceries and meats) and a high of 2.06 per cent (clothing, men's and boys').[96]

At the very outset when this type of legislation was first enacted in the form of P.L. 86-272, it was recognized that the arbitrary classifications involved would unreasonably deprive local based and non-exempt multi-state firms of their property rights. The Commerce Clearing House State Tax Review reported in September 1959 that:

> Fully aware of the temporary nature of the legislation, Congress provided for a thorough study . . . to be followed by proposals for permanent legislation . . . The new law is in the nature of an armistice, some of the terms of which will be subject to judicial interpretation. . . . It is to be expected that some corporations will close offices in as many states as possible and will concentrate stocks of goods in states that have no income taxes. Modes of rapid transportation make it possible to concentrate sales headquarters in states where there are no income taxes. Perhaps local businesses will find spokesmen to advocate taxation of net income of interstate business. They will find help among tax administrators who have been studying this question thoroughly. Combined action may influence Congress to repeal the new law. There is a widespread feeling that Congress has already encroached too far upon the state

96. Dunn & Bradstreet, Inc., 99 Church St., New York, N.Y.

tax domain.[97]

The unfair discriminatory impact which this type of legislation has on local based and non-exempt multi-state firms is indicated by the statements made by various trade associations.[98]

P.L. 86-272 and H.R. 11798 type federal curtailment legislation is properly described as:

> . . . inappropriate and unnecessary and . . . its only practical effect is to create state taxing immunity for those multi-state businesses that wish to technically qualify for this immunity; . . . [and] standards employed in this legislation involve distinctions without substance. . . .
>
> P.L. 86-272 employes distinctions without substance as follows:
>
> 1. The requirement that an order be subject to acceptance or rejection outside the taxing jurisdiction and the difference between a corporation conducting activity within the state through 'employees' or 'independent contractors' are empty legal formalisms under present business practices.
> 2. Any corporation that does not manufacture a product in the taxing jurisdiction can, without changing the substance of any in-state relationship, bring itself within the immunity of P.L. 86-272. There is not much substantive difference between an independent employee and a dependent independent contractor.
> 3. Distinctions of this sort have been abandoned by the Supreme Court of the United States because in determining state tax jurisdiction such distinctions are meaningless. I am confident that *Scripto* and *Northwestern-Stockham* decisions so indicate.[99]

Under H.R. 11798 a multi-state firm may have millions of dollars of inventory in a public or a private warehouse and make deliveries from such warehouses, have any number of salesmen and other employees soliciting millions of dollars worth of sales and installing and servicing its products and accounts, have its name and place of business listed in the telephone book or other advertising, all without incurring any state tax liability so long as technical formalities for avoiding jurisdiction are fulfilled. It is not surprising to find many of the proponents of such legislation also in the vanguard of attempts to immunize such firms from civil jurisdiction in warranty liability as well as other cases, and also to have such firms exempt from state corporate registration requirements. If these efforts were successful, such privileged multi-state firms would not only be immunized from state taxes but also from all

97. CCH STATE TAX REVIEW, Vol. 20, No. 35, 13-21 (Sept. 3, 1959).

98. See *supra* note 60.

99. Dexter, *1961 Hearings* at 367, 369-71. For cases in support of this proposition see Eli Lilly v. Sav-On-Drugs, Inc., 366 U.S. 276 (1961); Miller Bros. Co. v. Maryland, 347 U.S. 340 (1954); General Trading Co. v. Tax Comm'n, 322 U.S. 335 (1944); McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940).

products liability to the consumer citizens of the states where their merchandise is sold.

Actions of the Federal Government are circumscribed and limited by the rquirements of the due process clause of the fifth amendment. The Supreme Court has ruled for example that restrictive covenants in the District of Columbia are unenforceable,[100] exclusion of day laborers from jury panels is unconstitutional.[101] Likewise, in *Steele v. Louisville & Nashville R.R.*,[102] the Railway Labor Act was construed to require a collective bargaining representative to act for all members of the craft without discrimination on account of race. Chief Justice Stone noted the constitutional questions raised, and in a concurring opinion Justice Murphy unequivocally stated that the act would be inconsistent with the due process clause of the fifth amendment if the bargaining agent, acting under cover of federal authority, would permit it to discriminate against any of the persons he was authorized to represent.[103] Mr. Justice Jackson similarly stated in *Railway Express Agency v. New York*.[104] "I regard it as a salutary doctrine, that cities, states, *and the Federal Government* must exercise their powers so as not to discriminate between their inhabitants except upon some reasonable differentiation fairly related to the object of regulation."[105]

The United States Supreme Court more recently has restated this fundamental limitation imposed on the federal government by the due process clause of the fifth amendment. In a decision handed down in 1963, Mr. Justice Black unequivocally stated that under the Court's decision in *Bolling v. Sharpe*,[106] any federal law "requiring applicants for any job to be turned away because of their color would be invalid under the Due Process Clause of the Fifth Amendment. . . ."[107]

In *Lappin v. District of Columbia*,[108] it was held that Congress could not arbitrarily classify persons or property for taxation purposes within the District of Columbia. In so ruling the court quoted the earlier language of the United States Supreme Court in *Munn v. Illinois*,[109] noting that the principle that no person shall be deprived of life, liberty or property without due process of law is found

> . . . in Magna Charta, and, in substance, if not in form, in

100. Hurd v. Hodge, 334 U.S. 24 (1948).
101. Thiel v. Southern Pac. Co., 328 U.S. 217 (1946).
102. 323 U.S. 192 (1944).
103. *Id.* at 208.
104. 336 U.S. 106 (1949).
105. *Id.* at 122. (Emphasis added.)
106. 347 U.S. 497 (1954).
107. Colorado Anti-Discrimination Comm'n v. Continental Airlines, Inc., 372 U.S. 714, 721 (1963).
108. 22 App. D.C. 68 (1903).
109. 94 U.S. 113 (1877).

> nearly or quite all the constitutions that have been from time to time adopted by the States of the Union. By the Fifth Amendment it was introduced into the Constitution of the United States as a limitation upon the powers of the national government, and by the Fourteenth as a guarantee against any encroachment upon an acknowledged right of citizenship by the legislatures of the States.[110]

In *Lappin* the court held unconstitutional as a violation of the fifth amendment due process clause a brokerage license tax that imposed a higher tax on resident brokers than on non-resident brokers for business done in Washington, D.C. The court in invalidating this act of Congress stated:

> But why should membership on exchanges organized in other states entitle one to a discrimination in his favor in the imposition of taxes for the pursuit of a calling of a general broker in the District of Columbia? . . . The statute, . . . by imposing an unreasonable burden upon the right of a citizen to pursue a lawful occupation open to his competitors upon less onerous terms—which right of occupation is, as we have seen, of the nature of property—operates substantially as the taking of property without due process of law, and is therefore within the prohibition of the 5th Amendment of the Constitution.[111]

The grant of preferential immunity to selected multi-state firms from state taxes under H.R. 11798 and P.L. 86-272 legislation is equally inconsistent with the requirements of the fifth amendment due process clause of the United States Constitution.

JURISDICTIONAL STANDARDS DEVELOPED BY THE SUPREME COURT

The Supreme Court has, therefore, supplied us with a body of sound principles and practical guide lines for the development of adequate, fair and workable programs of state taxation within the framework of our traditional federal-state system of government, designed to preserve and foster our competitive free enterprise system.

The role of government and the significance of economic power in the future of our society are matters of concern to all Americans. The concentration of over-riding political power in a central government is neither desirable nor necessary. Our historical structure of government in the United States is sound; it deliberately calls for the sharing of jurisdiction by the local, state and national levels. The keystone of this structure has been the belief that the various levels of government serve different purposes and that each has certain functions which it can better perform than any other. This is particularly relevant in the area of tax jurisdiction because taxing power is fundamental to the existence of true political power

110. *Id.* at 123-24.
111. 22 App. D.C. at 76.

at any level of government. The decisions of the Court have recognized these realities of political life and have furnished essential jurisdictional rules of taxation under our Constitution appropriate to the integrity and evolution of government at state and local levels to meet the needs of our society. At the same time, the Court has recognized the realities of our more complex and mobile economy and the need to protect our competitive free enterprise system from a concentration of over-riding economic power in the hands of multi-state firms which compete with smaller enterprises in state and local markets. The commerce clause was never intended as an instrument for the concentration of political or economic power at the national level to the diminution and disadvantage of either state and local government or small enterprise. The Court has stated this proposition very clearly:

> But it was not the purpose of the commerce clause to relieve those engaged in interstate commerce of their just share of State tax burdens, merely because an incidental or consequential effect of the tax is an increase in the cost of doing the business . . . . Not all State taxation is to be condemned because, in some manner, it has an effect upon commerce between the States, and there are many forms of tax whose burdens, when distributed through the play of economic forces, affect interstate commerce, which nevertheless fall short of the regulation of the commerce clause which the Constitution leaves to Congress.[112]

The Court has been just as realistic in its appraisal of the facts of cases brought before it to determine whether claims for immunity from state and local taxes have any support in the commerce clause. It has declined to underwrite artificial devices and technical legalisms by which certain multi-state firms have endeavored to obscure the substance of their merchandising activities and to achieve the result of preferential immunity from state and local taxes which their competitors pay to support and foster the markets which both enjoy. Under the Court's decisions, mere nomenclature in an employment contract describing sales personnel as "independent contractors," and mere technical stamping of an order as "accepted" in an out-of-state office after the order has already, for all practical purposes, been obtained in the taxing jurisdiction, cannot replace substantive considerations as the basis for determining tax liability. These and other technical devices have been held irrelevant to the basic, fundamental test of tax jurisdiction which the Supreme Court has laid down: Is the firm regularly, substantially and systematically engaged in sales activities within the state? If the answer is in the affirmative, in the view of the Supreme Court it is reasonable that the firm should bear its fair share of the costs of government where it is conducting its activities, and the tax is valid.

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112. McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 46-47 (1940).

STATE ACTION FOR UNIFORMITY

The conclusion reached by the Special Subcommittee Report and other proponents of federal intervention is that our system of state and local taxation in this country is hopelessly chaotic and has allegedly inhibited the growth of our national economy. They assert that our state and local governments have been and continue to be unable to work out a fair, practical and efficiently administered tax program for themselves and that only congressional nationalization of the system can bring order out of this alleged chaos.[113] However, this argument that our state and local tax systems have seriously inhibited the growth of our national economy lacks persuasiveness when applied to an economy which has in recent years experienced record profits, wages, and growth—an economy which the Census Bureau recently reported increased its Gross National Product 7.5 per cent to a record $675 billion in 1965.

Although the Special Subcommittee should be commended for producing the most exhaustive study of this subject which has thus far been undertaken, the soundness of its conclusions has been

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113. The Wall Street Journal, in a recent article regarding the third volume of the report of the Special Subcommittee, reported that the Subcommittee

> . . . already has concluded that the thicket of state tax rules is a burden on interstate commerce, that the courts can't furnish a remedy and that the situation can best be cleared up through Federal legislation. . . .
> As did last year's report on state income taxes, the Willis Subcommittee's new study of state sales-type taxes paints a picture of confused tax accountants trying to figure out how much their companies owe to a pack of revenue hungry states.

The Wall Street Journal, June 28, 1965, p. 22.

In June of 1964 the Subcommittee released the first 2 volumes of its report. The tenor of the report is indicated by the following statement relating to state income taxes:

> For 50 years, State tax administrators have been discussing ways of achieving simplicity and uniformity. One proposal after another has been formulated, discussed, revised, and in spite of the expenditure of economic efforts, discarded. And, today, the States appear to be as far from a solution as they have ever been.

H.R. Rep. 1480, 88th Cong., 2d Sess. 599 (1964). In his letter transmitting this Report to the Chairman of the Committee on the Judiciary, the Chairman of the Special Subcommittee, the Hon. Edwin E. Willis, similarly said:

> I think it will suffice for me to say that the information contained in this Report 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.

Id. at vii. See DRABKIN, *The Role of Myth in State Taxation of Interstate Business*, in STATE AND LOCAL TAXES ON BUSINESS 55, 65 (1965), wherein it is said:

> Let us therefore put to rest, once and for all, the tired old myth that each of the states will suddenly give up its own peculiar views and enter into a uniform system. Let us make no mistake about it. The choice is not between federal action or state action; the choice is between federal action or no action.

questioned by many reputable authorities. A substantial body of responsible opinion has developed which in varying degrees criticizes the conclusions, objectivity, methods and in particular the "paper thin" statistical procedures of the Subcommittee Report. Most of the sources cited also question the advisability of the Subcommittee's recommendations for further concentrating powers in the national government through enactment of additional federal curtailment legislation.[114] Nevertheless the study has pointed up the need for continuing analysis of the state and local tax systems from a composite perspective which will properly balance local and national needs. In addition, to the extent that inequities may exist because of diversification, it is imperative that a positive program of workable alternatives to this proposed federal takeover of state and local tax powers be implemented.

The need of firms operating across state lines in our national economy for uniform legislation is not new and in the past has

114. See Chemical and Engineering News, July 13, 1964, p. 48; Koch, *A Business Viewpoint* in ANNUAL PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION (1964); Clark, *Appraisal of Current Trends in Business and Finance,* Wall Street Journal, Aug. 31, 1964, p. 1; Brieske, in ANNUAL PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION (1963); Conlon, *Report of the Special Subcommittee* in ANNUAL PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION 529 (1964). Mr. Fred Cox questioned the "razor thin margin of experience" on which the subcommittee bases its conclusions regarding high cost of compliance with state tax laws in a paper submitted to the Western States Association of Tax Administrators, Sept. 1964. See also, Dexter, *The Case Against Federal Intervention,* in STATE AND LOCAL TAXES ON BUSINESS 98 (1965). The constitutional questions raised by federal curtailment legislation were reviewed in a paper presented by T. Carl Holbrook, *Status of P.L. 86-272 Litigation,* Annual Meeting of the National Association of Tax Administrators (1964). At that same meeting, Harry L. Hulman expressed his opposition to federal interference in the matter of state tax jurisdiction in a paper titled *Some Second Thoughts on the Tax Administrator's Job.* See also Lock, *Federal Control of State Taxation of Interstate Commerce—Good or Bad?,* in ANNUAL PROCEEDINGS OF THE NATIONAL TAX ASSOCIATION (1965); Del Duca, *Uniform State Legislation: An Alternative to Federal Legislation Curtailing State Tax Jurisdiction and Granting Preferential Immunity,* Annual Meeting of the National Legislative Conference, (1964); Hellerstein, *Allocation and Nexus in State Taxation of Interstate Business,* in STATE AND LOCAL TAXES ON BUSINESS 67 (1965); Hellerstein, *Resolving the Interstate Income Tax Problem,* 33rd Annual Meeting of the National Association of Tax Administrators (1965); Lock, *A Moderate's Viewpoint on State Taxation of Interstate Commerce,* 19th Annual Conference of the Tax Executives Institute (1964); Newman, *Hearings on H.R. 11798* (1966); Huff, *Is the Willis Bill Proposal to Nationalize State and Local Tax Systems the Answer,* Symposium, Tax Executives Institute (Dec. 1965); United States Chamber of Commerce statement reported in CCH STATE TAX REVIEW, March 14, 1966, Vol. 27, No. 11. See Brown, Executive Director, Pennsylvania Bureau of Employment Security, *Federal State Relations,* delivered at the 1965 Meeting of the Interstate Conference of Employment Security Agencies, published in Proceedings of the Conference for 1965. (At the time of this writing, the extensive hearings on H.R. 11798 are not yet concluded. The reader should consult the published hearings when available for further pertinent materials.)

been successfully accommodated by the states within our Federal system. For example, this has been accomplished in many areas, such as commercial law, by state adoption of uniform state laws prepared by the National Conference of Commissioners on Uniform State Laws, an organization created more than 70 years ago expressly for this purpose.

In the field of state and local taxation the need for uniformity was not strongly felt or extensively articulated until the post war era. Prior to that time the amount of taxes paid to state and local governments was not substantial enough to focus attention on the subject. Total state and local tax collections in 1913, 1932, 1946, 1955, 1962 and 1965 were as follows:

	1913	1932	1946	1955	1962	1965[115]
Local Government	$1,051	$4,468	$5,152	$11,879	$22,200	$27,500
State Government	979	1,600	6,000	12,900	22,000	26,400
Totals	$2,030	$6,068	$11,152	$24,779	$44,200	$53,900

In addition, the affirmation of state tax jurisdiction by the Supreme Court in the post war *Northwestern* and *Scripto* cases quickly developed intensive interest in this area. Precipitous federal intervention at this time would therefore appear to be undesirable and unnecessary.

The business community and the state and local governments need much more time to evaluate the effect of the H.R. 11798 type of proposal which was not introduced into Congress until October 22, 1965 and which resulted from several years of activity by the Subcommittee staff. Furthermore it does not appear prudent that such important changes in long standing state practices pertaining to complex technical matters should be forced on the business community and states without much more consideration, testing and public discussion than would be possible if such legislation is now precipitously pushed by its proponents through Congress. It would also appear to be the course of prudence and wisdom not to discard the considerable uniformity which the states have already achieved.

The states have recently, perhaps motivated by the threat of unwarranted federal intervention, shown an increased awareness and maturity in their enactment of desirable uniform tax procedures. Although prior to 1965 only five states had enacted the Uniform Division of Income for Tax Purposes[116] Act, nine jurisdictions have adopted it since then, and it is now law in one-third of the corporate income tax states. California, Idaho, Indiana, Kentucky, Michigan, New Mexico, North Dakota, Oregon and the Dis-

115. U.S. Bureau of the Census, Historical Review of State & Local Government Finance (1918); Compendium of State Government Finances (1959); Quarterly Tax Reports, U.S. Department of Commerce GT-No. 4, March 1966. (Figures are in millions of dollars.)

116. See authorities cited note 5 *supra*.

trict of Columbia have enacted this uniform act since January 1965. Prior thereto, Alaska, Arkansas, Kansas, South Carolina and Virginia had enacted it. Bills are currently pending in a number of other states for its enactment.

The Commissioners on Uniform State Laws have also undertaken a project to expand the Uniform Division of Income for Tax Purposes Act to include additional provisions which will equitably and fairly apportion the income of types of business for which its three factor formula is inappropriate. It is anticipated that this will reduce the need to utilize the equitable apportionment principles of Section 18 of the Act and therefore produce greater predictability and equity in apportionment of income for such businesses.

Substantial uniformity also results from the fact that twenty-two of the thirty-eight income tax states are presently using the federal income tax base with stated variations as the basis for state tax purposes. The laws of seven of the remaining sixteen have major portions of the state law modeled on the federal law[117]

In other fields pertaining to achievement of uniformity, it is interesting to note that, contrary to the generally inaccurate impression created by the Subcommittee literature, state and local governments have enacted similar constructive legislation. For example thirty-two of the forty-one sales and use tax states presently have a tax credit provision in their statutes.[118] Nine of

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117. P-H STATE TAX GUIDE *All States* 221.

118. They are:

States	Citations to State Code	Reported in Prentice-Hall State & Local Taxes at Par	Reported in CCH All-State Sales Tax Reporter at Par:
Alabama	Tit. 51-Chap. 20 Art. 11	22,920	20-158
Arizona	§ 42-1409	22,866.10	22-225
California	Enacted 4-4-66. Text not available at date of publication.		
Connecticut	§ 12-430(5)	22,340.30	27-084
Florida	§ 212.06(7)		30-084
Georgia	§ 10	22,190	31-065
Idaho	§ 21	22,600.60	33-171
Illinois	S.H.A. ch. 120, § 439.3 (c)	22,310.40	34-220
Iowa	§ 423.25	22,662	36-246
Kansas	§ 79-3704	22,403	37-216
Kentucky	139.510	22,662	38-069a
Louisiana	§ 305(6)	22,220.30	
Maine	Chapter 17, § 12	22,255	41-103
Maryland	Art. 81 § 375 (c)	22,410.25	42-240
Massachusetts	§ 5(c)	22,715.15	
Michigan	§ 7.555(4)(e)	22,525.25	44-218
Mississippi	10146-02	22,506.5	46-322
Missouri	§ 144.615	22,640.25	47-222
New Mexico	§ 72-17-4(c)	22,919	54-218
New York	Art. 28 § 1118	22,565.40	55-142
North Dakota	§ 57-40-10	22,850	59-235
Oklahoma	68 OKL. St. Ann. § 1404(c)	22,614	61-217
Pennsylvania	72 P.S. § 3403.205	22,751-V	63-059
Rhode Island	Chapter 170	22,155	66-066

these adoptions have occurred in the past two years and it is likely that the remaining nine states will also adopt such tax credits in the near future.

Contrary to the impression created by the Subcommittee release[119] that very little has been accomplished to simplify administration of local sales and use taxes, the opposite is true. Much has actually been accomplished without federal intervention.[120] The fact of the matter is that eleven of the fifteen states which permit local governments to impose sales and use taxes have made provision for centralized collection and administration of these taxes. Although, as indicated by the House Subcommittee on State Taxation of Interstate Commerce, approximately 2,300 local governments impose sales and use taxes, any inference that 2,300 separate returns are required is unfounded. A detailed study shows that approximately 2,140 of the 2,250 local sales and use tax jurisdictions in the country are operating under state enabling acts which centrally administer local sales taxes under a uniform statute requiring only a single return to be filed with the state which in turn remits taxes collected back to the local governments. Eleven states centrally administer and collect the sales and use taxes imposed by 2,145 local jurisdictions.[121] The remaining local sales tax jurisdictions

Tennessee	§ 67-3008	22,035	69-055
Texas	V.A.T.S. Tax.-Gen. Art. 20.04(i)	22.025.85	77-196
Wisconsin	§ 77.53(16)	22.025.85	77-196
District of Columbia	§ 47-2706(c)	22,590.15	29-235
Wyoming	Unavailable at date of publication.		

Three states have special tax credits: Arkansas, § 1, Act 270 of 1959, P-H ¶ 22,756, CCH ¶ 23-117; Indiana, § 45(b), P-H ¶ 22.150.5, CCH ¶ 35-189; South Dakota, Ch. 219, Laws of 1961, effective 7-1-65.

The following states have sales, use on gross receipts statutes which do not permit credit of sales tax paid in one jurisdiction against the use tax incurred when goods are subsequently brought into the destination state: Colorado, Hawaii, Nevada, North Carolina, Ohio, South Carolina, Utah, Washington, West Virginia.

119. See CCH STATE TAX REVIEW, Vol. 26, No. 34, 6-7 (Subcommittee news release reproduced).

120. See generally MOAK & COWAN, ADMINISTRATION OF LOCAL SALES AND USE TAXES (1961).

121. The jurisdictions involved follow:

STATES PERMITTING LOCAL SALES AND USE TAX *WITH* STATE ADMINISTRATION AND COLLECTION

State[a]	Enabling Act Adopted	State Sales Tax Rate	Local Sales Tax Rate	Type of Local Gov. and Number[a]
California[b] CCH 24-451 P-H 68,000	1955	3%	1%	Cities—351 Counties—57 CCH 60-27 P-H 68,000
Illinois[c] CCH* 34-703 P-H 68,150	1961	3½%	½%	Cities—1211 Counties—71 CCH 60-40 P-H 68,400

administer the tax locally.[122]

Maryland[d] CCH* 42-285 P-H 68,202	1965	3%	d	None
Mississippi[c] CCH 60-571 P-H 68-230	1950	3%	½% to 1%	Cities—181 CCH 60-571 P-H 68,150
New Mexico[c] CCH 60-677 P-H 68,602	1955	3%	1%	Cities—29 CCH 60-677 P-H 68,700 68,800
New York CCH 60-683 P-H 21,364.5	1965	2%	3%	Cities—8 Counties—8 CCH 60-684 P-H 68,000
Utah[b] CCH 60-875 P-H 68,200	1959	3%	½%	Cities—137 Counties—27 CCH 60-875 P-H 68,070
Wyoming[e] CCH 6999 P-H 68,500	1965	2½%	½%	None
Alabama[f] CCH 6991 P-H 69,000	1965	4%	½% to 2%	Cities—23[g] Counties—22[g] CCH 68-210 & 68-211 P-H 68,200 & 68,700
Colorado[f]	1963	2%	1% to 2%	Cities—1 CCH 60-285 P-H 68,000
Tennessee[f] CCH* 69,702 P-H 68,200	1963	3%	1%	Cities—4[h] Counties—15[h] CCH 60-8 & 60-841 P-H 68,210
Oklahoma[i] P-H 68,500	1963	2%	1%	None

[a] The following abbreviations are used as references:
CCH—Commerce Clearing House, State Tax Guide, 2d Edition, All-States
CCH*—Commerce Clearing House, All-States Sales Tax Reporter
P-H—Prentice Hall, State and Local Taxes

[b] Cities, but not counties, *may* levy a non-conforming tax which is locally administered. However, only two cities have done this and apparently this is only a temporary arrangement.

[c] In these states no local use tax is levied.

[d] Enabling Act addressed to Baltimore County, Baltimore City and Anne Arundel County became effective 6-1-65; none of these local units have at the moment taken advantage of the Act.

[e] Enabling Act became effective 7-1-65; apparently no localities have yet utilized the Act at the time of this writing.

[f] State administration and collection is optional with each locality; in Alabama 32 localities administer the tax; in Colorado 11 localities administer the tax; and in Tennessee no localities administer the tax.

[g] Figure up-dated per letter from Supervisor of Alabama Sales Tax Division, dated 7-19-65.

[h] Figure up-dated per letter from Director of Tennessee Sales and Use Tax Division, dated 7-19-65.

[i] State administration and collection is optional with each locality; at this date 5 localities have enacted local sales and use taxes with local collection and administration.

The program of state administration of local sales and use taxes has been eminently successful. Problems which have arisen have been minimal in number and scope. The California and Illinois experience will be considered in detail in this paper to illustrate some of the legal and administrative techniques which have been utilized.

In the case of Illinois the state enabling act makes it mandatory that local sales taxes be collected and redistributed to the municipalities by the state. This is possible under the type of provision contained in the Illinois Constitution which provides that "the General Assembly may vest" the local governments with tax power.[123]

"Home rule" provisions of the California Constitution apparently do not permit the California legislature to *require* local governments to utilize uniform sales and use taxes.[124] The California legislature therefore achieved substantial uniformity in local sales and use taxes by passing an enabling law which provides that the state will administer and collect local sales and use taxes if the uniform ordinance prescribed by the state is adopted by the local government. Under this enabling act all except one of California's fifty-eight counties and two sales tax municipalities have adopted the suggested uniform ordinance.[125] The limitations of the home rule provisions of the California Constitution have been fully complied with in this enabling act. The right of the local government to deviate from the proposed uniform ordinance is preserved. As a

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122. These jurisdictions follow:

STATES PERMITTING LOCAL SALES AND USE TAXES *WITHOUT* STATE ADMINISTRATION AND COLLECTION

State	Years First Adopted by A Municipality	State Sales Tax Rate	Local Sales	Type of Local Gov.
Arizona CCH 60-240 P-H 68,100 & 68,200	1949	3%	½% to 1%	Cities—11 CCH 60-240 P-H 68,050
Louisiana CCH 60-475 et seq. P-H 68,100 & 69,200	1936	2%	1%	Cities—31 Parishes—5 CCH 60-475 & 60-480 P-H 68,250 *et seq.*
Virginia CCH 60-900 P-H 68,100	1950	None	2% to 3%	Cities—12 CCH 60-900 P-H 68,150 *et seq.*
West Virginia P-H 21,112 & 68,000	1940	3%	up to 1%	Cities—9 P-H 68,000

Total Local Sales Tax Jurisdictions—2261
Total Subject to State Administration—2145

123. ILL. CONST. Art. 9, § 8.

124. CALIF. CONST. Art. 11, § 7½, 12, 13.

125. Tehama County, Cities of Corning and Red Bluff.

practical matter, however, the advantages to taxpayers and the local governments of centralized administration of the tax by the state have induced the local governments to utilize the uniform ordinance proposed by the state.

Illinois, which has no local use tax, distributes local sales taxes back to its local governments on the basis of the locality where the retailer collecting the tax engages in business. The regulations indicate that the place where the order is accepted will usually determine where the sale took place and where he engages in business.[126]

In California, the major part of the tax is distributed to the local governments on the basis of the place where the seller has his "permanent place of business." The California administrators indicate that $284 million of the $302 million of tax collected each year or approximately 94 per cent is directly allocated on this basis.[127]

The remaining $18 million collected (6 per cent) is obtained from: (a) sales made away from the permanent place of business of the vendors: (b) sales made by out-of-state vendors without a permanent place of business in the state; (c) sales made by itinerant vendors; (d) sales by construction contractors, vending machine operators, and auctioneers. Rather than have these groups file returns on the basis of the locality in which delivery occurs, California merely requires the total amount of sales made in the state by such vendors to be noted on the return. The state places these monies in a pool and remits it to the local government pursuant to the terms of the agreement between the state and its local governments.[128]

Under the recently enacted New York statute, the locality where delivery occurs (*i.e.*, where the goods are received) determines the locality to which the local tax will be remitted.[129]

The California and Illinois methods of dividing sales tax revenues between counties and municipalities are also worthy of comment. The California law permits a maximum rate of 1 per cent of combined city and county sales tax to be added to the 3 per cent state sales and use tax. The city and county governments by agreement then determine how this 1 per cent shall be divided among themselves. In California the cities and counties generally have agreed to an apportionment of .85 per cent to the city and .15 per cent to the county.[130] The Illinois enabling Act permits the counties and cities to impose a maximum tax of .5 per cent each.[131]

The matter of uniformity in the tax base also deserves com-

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126. P-H STATE AND LOCAL TAXES, *Illinois* 68,820.

127. Address by Denney, Annual Nat'l Ass'n of Tax Adm'rs, June 1964.

128. *Ibid.*

129. P-H STATE AND LOCAL TAXES, *New York*, 21,245, 69,866.

130. CCH STATE TAX REPORTER, *California*, Vol. 2 60-023.

131. P-H STATE AND LOCAL TAXES, *Illinois* 68,159, 68-165.

ment. The Illinois enabling law requires the local tax base to be identical to the sales tax imposed by the state.[132] This simplifies compliance and enforcement. The California enabling act permits local sales and use tax ordinances to grant certain exemptions not permitted under the state sales and use tax law.[133] To the extent that such deviations are permitted by state enabling laws, the advantages gained from uniformity are lost. Such deviations are, therefore, undesirable from a compliance and administrative point of view.

It might be suggested at this point that if centralized administration of such local taxes by the states is desirable, then a fortiori centralized administration of the entire state and local system by the federal government in Washington is also desirable. We suggest in response, however, that there are fundamental legal, economic and political differences involved. As a legal matter, state constitutions set up unitary systems of governments vis-a-vis their local governments. The local governments are creatures of the state government and apart from home rule limitations imposed on the state by the state constitution and certain federal constitutional provisions, state governments are sovereign over their local governments. On the other hand, the relationship of the federal government to the states is governed by our national constitution which creates a federal system reserving to the states power not delegated to the central government.

In addition, the economic and political implications of centralizing in one place control over all state and local revenues as well as the already enormous power represented by the existing federal control over the vast national revenue system should also be considered.

The Subcommittee's report creates the impression that a vendor almost has to make a personal investigation of the use to which the buyer will put the property before accepting a resale or other exemption certificate—at the risk of being personally liable if the purchaser uses the property otherwise than for the specified purpose.[134] Actually, a variety of procedures, including registration numbers, resale and other exemption certificates, exemption letters and rulings and direct payment procedures on which the vendor may rely in determining whether he should make a tax free sale, have been developed to permit vendors to accept such certifications and thereby avoid personal liability.[135] The principle of validating exemption certificates accepted in good faith has been reaffirmed in the recent statement of policy issued by the National Association of Tax Administrators.[136]

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132. Address by Hanselman, *Illinois Administration of Local State Tax,* See P-H STATE AND LOCAL TAXES, *Illinois,* ¶ 21,112.5.

133. Address by Denny, *supra* note 127.

134. See H.R. 565, 89th Cong., 1st Sess. 682-84, 705, 760-66 (1965).

135. Due, *supra* note 63, at 524.

136. Lynch, *Hearings on H.R. 11798* (1966).

Only five states (Kentucky,[137] Michigan,[138] Missouri,[139] Ohio[140] and Oregon),[141] permit their localities to impose a corporate income tax and apart from Ohio only fourteen local governments geographically distributed through Kentucky, Michigan, Missouri and Oregon impose a corporate income tax. In Ohio, eighty-one localities have a corporate income tax, but the state itself does not. Michigan requires its localities to utilize a uniform ordinance if they decide to impose a corporate income tax.

Although the mammoth federal superstructure created by H.R. 11798 is justified on grounds that excessive compliance burdens of multi-state firms and possibilities of multiple taxation require federal nationalization of state and local taxes, the report of the Subcommittee actually finds that there is no substantial compliance cost problem under the present system.[142] The report does find widespread non-compliance by taxpayers in meeting the assertions of jurisdiction by the various states, and then finds "ample reason to suspect" that full compliance would result in burdensome costs[143] although elsewhere the Report states that ". . . at least from a cost point of view, a much broader spread of registrations than is now the case may be implemented without harm to the interstate seller."[144] The mammoth superstructure, severe curtailment of state jurisdiction and the resultant unfair competition created by H.R. 11798 are unwarranted and unnecessary to resolve these problems. There are other more effective ways to resolve the compliance problems of small businesses expanding in the interstate economy.

Forward looking taxpayers and tax administrators and appropriate committees of the National Tax Association,[145] the National Association of Tax Administrators[146] and the Council of State Governments[147] are recommending that an optional provision be included in our state income tax statutes pursuant to which a tax-

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137. CCH STATE TAX GUIDE *All States* ¶ 10-463; P-H STATE AND LOCAL TAXES *Kentucky* ¶ 68,000.

138. CCH STATE TAX GUIDE All States ¶ 10-535; P-H STATE AND LOCAL TAXES *Michigan* ¶ 68,200.

139. CCH STATE TAX GUIDE All States ¶ 10,588-89; P-H STATE AND LOCAL TAXES *Missouri* ¶ 68,500.

140. CCH STATE TAX GUIDE All States ¶ 10-725; P-H STATE AND LOCAL TAXES *Ohio* ¶ 68,100.

141. P-H STATE AND LOCAL TAXES *Oregon* ¶ 69,950.

142. H.R. Rep. No. 565, 89th Cong., 1st Sess. 1102 (1965); H.R. Rep. No. 952, 89th Cong., 1st Sess. 1126-27 (1966).

143. *Id.* at 1127.

144. H.R. Rep. No. 565, 89th Cong., 1st Sess. 812 (1965).

145. *Interim Report of the committee on Interstate Allocation of Business Taxes,* ANNUAL PROCEEDINGS OR NATIONAL TAX ASSOCIATION (1965).

146. Statement of Policy of NATA, *H.R. 11798 and State and Local Taxation of multistate business,* by Lynch, *1966 Hearings on H.R. 11798.*

147. Special Committee on Interstate Taxation, Council of State Governments.

payer whose only activities within the state consist of sales might elect to pay a lower rate tax on gross sales in lieu of the tax on net income. This provision would be applied only in those cases in which the gross sales did not exceed a limit of one hundred thousand dollars or any other reasonable figure to be fixed by the states. The compliance problem with reference to sales and use tax in the case of small businesses could similarly be resolved by uniform provisions in the state sales and use tax statutes providing that when sales within a state were below one hundred thousand dollars or any other reasonable figure which might be agreed upon, the taxpayer would be granted permission to file a return once or twice a year in lieu of the usual reporting requirements. Such legislation, if adopted by the states in conjunction with a continuation of the substantial progress already achieved in these areas, would eliminate to a considerable extent the compliance difficulties upon which many of the recommendations of H.R. 11798 are said to be based. This would be done without any sacrifice of the traditional and constitutional rights of the states and without creating the widespread preferential immunity and unfair competition, which would result from the jurisdictional and other provisions of H.R. 11798 type legislation.

Other constructive efforts to supplement these accomplishments and achieve desirable uniformity through voluntary State action have already been initiated in the form of recommendations for an Interstate Compact. Such efforts have considerable potential and warrant serious considerations.

Leading authorities have discussed the increased use of Compacts by the states as follows:

> In recent decades the interstate compact has emerged as one of the better known and more widely employed mechanisms for intergovernmental cooperation. Today it is being used in an ever expanding number and variety of fields: conservation, development and use of natural resources; higher education; provision of welfare and correctional facilities; law enforcement; public works; and other applications.
>
> Between 1783 and 1920 states had entered into a total of thirty-six compacts. Between 1921 and 1955 they entered into sixty-five. Since 1955 more than a score have been added to the list, and it continues to grow. Prior to the 1920's, compacts were typically bi-state agreements. Since that time, many of them have been written for region-wide or even nation-wide adherence by states.[148]

The idea of a compact was endorsed by such an emminent authority as John Wigmore who forty years ago stated:

> Our forefathers devised a political expedient of profound significance when they inserted section 10 in Article 1 of

148. ZIMMERMAN & WENDELL, *The Law and Use of Interstate Compacts*, v (1961).

> the Constitution. One hundred years of natural growth have now shown us the utility of it. We ought to use it freely, and, thus, save ourselves from the dilemma of economic disorder on one hand and top heavy federal organization on the other.[149]

Justice Frankfurter, as early as 1925 in cooperation with James Landis endorsed the use of a Compact, particularly in the field of State taxation.[150]

A distinguished Committee[151] of Governors, Attorney Generals, State Legislators, and State Secretaries of Revenue, was recently appointed by the Council of State Governments to implement studies on state taxation of multi-state businesses and particularly to consider the use of an interstate compact to supplement measures which have already been taken in this field. It is premature to specifically enumerate the content of such a compact. It is likely, however, that the compact would consider the following: (1) utilization of an interstate agency for continuous promotion of increased statutory uniformity; (2) utilization of an interstate agency for continuous promotion of uniform regulations, rulings, and forms; (3) establishment of a mechanism for settlement of apportionment disputes and elimination of possibilities of multiple taxation; and (4) utilization of an interstate agency for purposes of cooperative state audits which would reduce the number of audits that would have to be made of a multi-state taxpayer and thereby simplify compliance and enforcement.

CONCLUSION

These achievements of state and local governments evidence their capacity and desire to move constructively in the direction of uniformity in state and local taxation. They demonstrate the desire to minimize compliance costs of taxpayers and enforcement costs of tax administrators, eliminate possibilities of double taxation, and define with precision the incidence of the tax so that taxpayers may predict with certainty the extent of their liability. These achievements also evidence a recognition by state and local governments of their responsibility to create a tax system which facilitates continuing expansion of our national economy. Contrary to the erroneous, but nevertheless carefully nurtured myths resulting from the activities of proponents of H.R. 11798 type legislation that the states are incapable of administering their own state and local tax programs, this progress is evidence of the capacity of the states to act constructively to meet the needs of an expanding national economy for a fair and efficient system of taxation which will develop employment opportunities and provide the revenues needed

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149. Note, 19 ILL. L. REV. 479-80 (1925).

150. Frankfurter & Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments*, 34 YALE L. J. 685 (1925).

151. O'Connell, *1966 Hearings on H.R. 11798.*

to meet state and local government responsibilities within the framework of our federal system of government.

The proponents of restrictive legislation frequently fly the banner of uniformity. Careful examination of their testimony before the congressional committees, however, shows that they are not particularly interested in legislation requiring uniformity but rather that their main objective is to immunize the multi-state seller from taxation by any state in which no factory, warehouse or other installation is maintained by the seller in its own name. One of their leading spokesmen declared that "the heart of our testimony is to support amendment of P.L. 86-272 to make the maintenance of a permanent establishment in the form of a fixed place of business the test for state taxation of out-of-state firms."[152]

Powerful efforts are under way to convince the general public and the Congress that the state and local governments are incapable of developing or administering their own tax systems. The current extensive use of communications media and tax forums to attempt to sell this idea is a prelude to anticipated enactment of additional federal legislation decreasing state tax jurisdiction and granting preferential immunity. The effect of congressional legislation in this area in the form of P.L. 86-272 has not been to achieve uniformity, but rather to curtail state tax jurisdiction and grant preferential immunity to selected multi-state firms.

To avoid further extension of this federal intervention, it is imperative that the state and local governments continue their efforts to achieve desirable uniformity in as many areas as possible. The substantial progress made by state and local governments in achieving uniformity in their tax programs is in accord with the pattern of experience of the National Conference of Commissioners on Uniform State Laws in achieving enactment of numerous uniform acts during its more than seventy years of existence.[153] The approval and subsequent enactment of uniform laws is a history of careful preparation and drafting, followed by enactment in a relatively few states serving as experimental proving grounds prior to widespread adoption of these acts throughout the nation. For example, work on the Uniform Commercial Code began in 1942. It was 1952 before the text and comments were officially approved by the Commissioners on Uniform State Laws. In 1953 it was passed in one state (Pennsylvania) to be effective in 1954. It became law in Massachusetts in 1958 and in Kentucky in 1960. The Commissioners made some changes in the Code in 1958 and 1962.

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152. *1961 Hearings* at 309; another spokesman told the Subcommittee that his organization had not even taken a position on uniform apportionment. *Id.* at 315. See also Newman, *1966 Hearings on H.R. 11798;* Statement of the United States Chamber of Commerce, CCH STATE TAX REVIEW, March 14, 1966, No. 27, No. 11.

153. Handbook on Nat'l Conference of Comm'rs on Uniform State Laws (1966).

During the state legislative sessions of 1961 and 1962 the total number of states enacting the Code was raised to fifteen. At the present time, forty-four states plus the District of Columbia and the Virgin Islands have enacted the Code and plans for its enactment in the remaining states are under way. One should note that widespread enactment of the Code occurred only after the seven year period of testing in Pennsylvania. In varying degrees, this has been typical of the experience of the Commissioners on Uniform State Laws in achieving enactment of uniform legislation with widespread and profound policy implications.

For those proponents of federal legislation seeking curtailment of state tax jurisdiction and preferential immunity for selected multi-state firms, it is advantageous to insist that the states are incapable of achieving uniformity in the tax field comparable to that achieved in the Commercial Law and other fields during the latter part of the nineteenth century and the present century. This point of view chooses to ignore the fact that state taxation of multi-state firms has been made a critical issue primarily since 1959 and 1960 following the United States Supreme Court decisions in *Northwestern* and *Scripto* which unequivocally reaffirmed and clarified the right of a state to impose income and sales taxes on firms regularly and systematically soliciting sales but not otherwise maintaining a place of business in a state. It also chooses to ignore the fact that state and local governments have achieved and are continuing to achieve considerable success in enacting uniform tax legislation. The accomplishment of the states in obtaining enactment in more than one-third of the income tax states of the Uniform Division of Income for Tax Purposes Act since 1957 when that act was promulgated by the Commissioners ranks very favorably with the six enactments of the Commercial Code obtained during the eight year period between 1952 and 1960. As in the case of the Commercial Code, the states at first cautiously experimented with the Uniform Act in a few jurisdictions. The adoption since January 1965 of this law by nine jurisdictions in addition to the five which previously had enacted it, suggests that this experimentation has established the fairness and practicality of the law.[154] It is therefore likely that many of the remaining income tax states will enact this law in the near future.

Mr. Justice Holmes once observed that the states in our federal system serve as chambers for experimentation in government.[155] The highly coordinated intensive campaign being waged by proponents of restrictive federal legislation is not calculated to preserve our national tradition of local self government nor the opportunities for experimentation by the states. Such legislation goes far beyond the call for procedural simplification of state taxation; it raises serious constitutional questions and it creates many new

154. See authorities cited note 5 *supra*.
155. Truax v. Corrigan, 257 U.S. 312, 344 (1921).

problems. From a Constitutional and policy point of view it is not likely that local self government in our traditional federal form of government and local-based business under our traditional free enterprise system can effectively survive widespread enactment of legislation by the national Congress assuming the power to regulate fiscal policies of the states and creation of areas of preferential immunity and resulting unfair competition for non-exempt firms. There is no surer and more direct road to creation of a monolithic central government.

Recent converts to the new school for "a constructive federalism" have long decried federal intervention in state and local affairs. Now they suddenly propose a handy solution to "the increasing demands of present-day life" through a program of national taxation with the federal government distributing the revenues under a system of "equalization grants . . . only to the states which themselves contribute a fair proportion of their per capita incomes to the costs of their own state and local services."[156] These converts might well ponder the practical implications of this scheme in terms of the centralization of power. Power resides where the money is distributed according to the judgment of the distributor—Congress in the proposed plan. With the shift of taxing power to Washington will come the twilight of state and local government in all except name.

Before Congress embarks on a massive program of intervention in state tax matters which will completely upset the traditional independence of the states which they have enjoyed for nearly two centuries, it would seem desirable to recognize the remarkable progress which the states have recently made in achieving uniformity. There is every reason to expect that this progress will be continued and accelerated in the near future and that this approach would cure most of the difficulties involved in this area. We can reduce compliance costs, eliminate possibilities of double taxation, achieve certainty of tax incidence and greater equity and uniformity without eliminating state governments in our federal system of government, or endangering the principles of fair competition which have been one of the hallmarks of our free enterprise system.

156. Lawrence, *Getting Your Money Back*, U.S. News & World Report, April 18, 1966, p. 124.